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Better to Give Than to Receive: Should Nonprofit Corporations and Charities Pay Punitive Damages?

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Notes

BETTER TO GIVE THAN TO RECEIVE: SHOULD NONPROFIT CORPORATIONS AND CHARITIES PAY PUNITIVE DAMAGES?

Charity suffereth long and is kind, but in the common law it cannot be careless. When it is, it ceases to be kindness and becomes actionable wrongdoing.[1]

I. INTRODUCTION

The doctrine of charitable immunity[2] originated in the dicta of two early English cases.[3] American courts adopted and expanded the English dicta,[4] and

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1. President & Directors of Georgetown College v. Hughes, 130 F.2d 810, 813 (D.C. Cir. 1942) (Rutledge, J.).

2. "[I]mmunity means exemption from the application of general tort rules which, but for the charitable character of the tortfeasor, would apply." E.H. Schopler, Annotation, *Immunity of Nongovernmental Charity from Liability for Damages in Tort*, 25 A.L.R. 2d. 29, 45 (1952). "An immunity avoids liability in tort . . . because of the status . . . of the favored defendant." *Introductory Note,* RESTATEMENT (SECOND) OF TORTS § 392 (1977). "The immunity was traditionally quite broad and protected the defendant even in cases that undoubtedly involved tortious behavior [on the part of the defendant]." W. PAGE KEETON ET AL., PROSSER & KEETON ON THE LAW OF TORTS, *Immunities* § 131, at 1032 (5th ed. 1984). "The idea was that, even though the defendant might be a wrongdoer, social values of great importance required that the defendant escape liability." *Id. See also* 15 AM. JUR. 2D *Charities* § 189 (1976); BLACK'S LAW DICTIONARY 234 (6th ed. 1991).

For an organization to receive the benefit of charitable immunity, the organization had to be adjudicated "charitable." *See* 15 AM. JUR. 2D *Charities* § 211 (1976). "Charitable," however, is a difficult term to define and has both a lay meaning and a legal meaning. *Id.* at §§ 2, 3. Charity, in its legal sense, is not aid to the needy alone, but encompasses all which seeks to improve the human condition. *Id.* Under the common law, diffusion of knowledge, acquiring knowledge of the arts and sciences, and the advancement of learning without any reference to serving the poor were considered charitable objects. *See, e.g.*, Waddell v. Young Women's Christian Assoc., 15 N.E.2d 140, 142 (Ohio 1938). Charity was defined as any gift made for a general public use for the benefit of an indefinite number of persons, designed to benefit them in educational, religious, moral, physical, or social ways. *See In re* Funk's Estate, 45 A.2d 67, 69 (Pa. 1946). *See also* Trustees of New Castle Common v. Megginson, 77 A. 565, 570 (Del. 1910) ("It is obvious that the word 'charitable' implies primarily a donation to the poor, the sick, or the needy. But, it has undoubtedly has been given a much broader definition . . . . "). *See also* 15 AM. JUR. 2D *Charities* § 3 (1976). Therefore, charity and benevolence are not synonymous. *Id.* at §§ 3, 4.

3. Feoffees of Heriot's Hosp. v. Ross, 8 Eng. Rep. 1508 (1846); Holliday v. The Vestry of the Parish of St. Leonard, 142 Eng. Rep. 769 (1861).

In *Feoffees of Heriot's Hospital*, Lord Cottenham, relying on Duncan v. Findlater, 7 Eng.

by 1938, forty states held that charities were immune from paying damages in tort actions.[5] Throughout the history of the doctrine of charitable immunity, courts enunciated various theories to explain why charities should be immune from paying damages in tort.[6]

Rep. 934 (1839), stated that "[t]o give damages out of a trust fund would not be to apply it to those objects whom the author of the fund had in view, but would be to divert it to a completely different purpose." 8 Eng. Rep. at 1510. Although this dicta was later relied on by some American courts in crafting the doctrine of charitable immunity, it is interesting to note that none of these cases involved tortious conduct on the part of a charity. *See* Schopler, *supra* note 2, at 38-40; Note, *Developments in the Law – Nonprofit Corporations*, 105 HARV. L. REV. 1578, 1679-80 (1992) [hereinafter *Developments in the Law*]; Note, *The Quality of Mercy: "Charitable Torts" and Their Continuing Immunity*, 100 HARV. L. REV. 1382, 1383-84 (1987) [hereinafter *The Quality of Mercy*]; John R. Feather, Comment, *The Immunity of Charitable Institutions from Tort Liability*, 11 BAYLOR L. REV. 86, 86-89 (1959). In addition, 10 years before the American courts adopted these cases, these cases were overruled by Mersey Docks v. Gibbs, 11 Eng. Rep. 1500 (1866). In fact, in England, charities remained liable for their torts. *See, e.g.*, Marshall v. Lindsey County Council, 340 K.B. 516 (1935), *aff'd*, 483 App. Case 97 (1937).

4. Massachusetts was the first state to announce the doctrine of charitable immunity in this country in McDonald v. Massachusetts Gen. Hosp., 120 Mass. 432 (1876). In *McDonald*, the plaintiff fell from a building while he was at work and was taken to Massachusetts General Hospital. *Id.* at 432. The hospital was in the business of providing medical care to indigents at little or no cost and based the cost of treatment on the patients' ability to pay for services rendered. *Id.* at 433. While at the hospital, the plaintiff received "nurses, bed, food, warmth . . . other comforts . . . ," and medical care free of charge. *Id.* When the plaintiff's leg failed to heal properly, he sued the hospital for malpractice. *Id.* at 432. Relying on the "trust fund theory," purportedly established in Feoffees of Heriot's Hosp. v. Ross, 8 Eng. Rep. 1508 (1846), and its progeny, Judge Devens held that the hospital was immune from damages in tort. *Id.* at 435. Because the hospital received its funding from donations and provided medical care to indigent persons without any expectation of compensation, the hospital was a charity under the common law of Massachusetts. *Id.* at 434-35. Judge Devens reasoned that "[where] there has been no neglect on the part of those who administer [a] trust . . . and if due care has been used . . . in selection of [the trustees'] . . . agents, . . . [the trust] cannot be made [liable]." *Id.* at 436.

Thus, the doctrine of charitable immunity was born. Maryland was the second state to adopt the doctrine in Perry v. House of Refuge, 63 Md. 20 (1885). *See also* Schopler, *supra* note 2, at 39-40; *Developments in the Law*, *supra* note 3, at 1680; *The Quality of Mercy*, *supra* note 3, at 1383.

5. For a summary of modern case law and statutes concerning charitable immunity, see Janet Fairchild, Annotation, *Tort Immunity of Nongovernmental Charities – Modern Status*, 25 A.L.R. 4th 517 (1983). *See also* Bradley C. Canon & Dean Jaros, *The Impact of Changes in Judicial Doctrine: The Abrogation of Charitable Immunity*, 13 LAW & SOC'Y REV. 969, 971 (1979); Ronald M. Lipson, *Charitable Immunity: The Plague of Modern Tort Concepts*, 7 CLEV. MARSHALL L. REV. 483, 484 (1958).

6. One reason enunciated for the doctrine is the "trust fund" theory. Under this theory, courts argued that charities should be immune from paying damages in tort because charitable donations were said to be held in trust for the beneficiaries of the charity, and paying tort judgments from those funds would frustrate the intent of the donor. *See, e.g.*, Parks v. Northwestern Univ., 75 N.E. 991, 993 (Ill. 1905); Cook v. John N. Norton Memorial Infirmary, 202 S.W. 874, 876 (Ky. 1918); Downs v. Harper Hosp., 60 N.W. 42, 43 (Mich. 1894). Another theory supporting immunity was that charities were not bound by the doctrine of respondeat superior because charities did not profit from their employees' work. *See, e.g.*, Hearns v. Waterbury Hosp., 33 A. 595, 604

During the 1940s and 1950s, the doctrine of charitable immunity fell into disrepute because it was inconsistent with the principle that a tortfeasor should bear responsibility for harm caused.[7] By 1985, almost every jurisdiction had repudiated or substantially limited the doctrine.[8] Among the reasons cited for the demise of the doctrine of charitable immunity were the development of an advanced insurance industry and the growth of the nonprofit sector.[9] Courts

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(Conn. 1895); Bachman v. Young Women's Christian Assoc., 191 N.W. 751, 752 (Wis. 1922). Other courts held that the beneficiaries of charitable organizations impliedly waived liability of the charity or assumed the risk by accepting the charities' largess. *See, e.g.*, Wilcox v. Idaho Falls Latter Day Saints Hosp., 82 P.2d 849, 853-54 (Idaho 1938); Averback v. Young Men's Christian Assoc., 61 S.W.2d 1066, 1066-67 (Ky. 1933); Winslow v. Veterans of Foreign Wars Nat. Home, 44 N.W.2d 19, 22 (Mich. 1950); Adams v. University Hosp., 99 S.W. 453, 453-54 (Mo. App. 1907); Bruce v. Young Men's Christian Assoc., 277 P. 798, 802 (Nev. 1929). Yet other courts opined that holding a charity liable in tort would deter charitable activity and donations, and therefore they concluded that charities should not pay tort judgments for policy reasons. *See, e.g.*, Cohen v. General Hosp. Soc., 154 A. 435, 436-37 (Conn. 1931).

See Fairchild, *supra* note 5, at 522-23; Schopler, *supra* note 2, at 57-73. *See also Developments in the Law, supra* note 3, at 1680; *The Quality of Mercy, supra* note 3, at 1384.

7. The "death knell" of the doctrine of charitable immunity was President & Directors of Georgetown College v. Hughes, 130 F.2d 810 (D.C. Cir. 1942). *See* RESTATEMENT (SECOND) OF TORTS § 895E, cmt. b (1977) (citing *Georgetown College* as the seminal case rejecting the doctrine of charitable immunity).

In *Georgetown College*, Judge Rutledge wrote a lengthy criticism of the doctrine of charitable immunity stating that "the accidental character of the origin has been lost in the fog of later decision." *Georgetown College*, 130 F.2d at 815. Judge Rutledge considered and rejected all of the common law justifications for the doctrine of charitable immunity. *Id.* at 822-28. Judge Rutledge concluded that charities should be liable in tort, as are private individuals, when they "[do] good in the wrong way." *Id.* at 828.

See also RESTATEMENT (SECOND) OF TORTS § 895E, cmts. b & c (1977); Fairchild, *supra* note 5, at 527-28; *Developments in the Law, supra* note 3, at 1680 n. 21; *The Quality of Mercy, supra* note 3, at 1385. For a discussion of "the accidental character of the origin" of the doctrine of charitable immunity, see *supra* note 3.

8. Case law and statutes representing the demise of charitable immunity are compiled in CHARLES TREMPER, RECONSIDERING LEGAL LIABILITY AND INSURANCE FOR NONPROFIT ORGANIZATIONS 187-201 (1989). Some jurisdictions eliminated the doctrine by statute while others did so by case law. *See, e.g.*, CONN. GEN. STAT. ANN. § 52-557(d) (West 1991); ME. REV. STAT. ANN tit. 14, § 158 (West 1964); MASS. GEN. LAWS ANN. ch. 231, § 85k (West 1985 & Supp. 1991); N.C. GEN. STAT. § 1-539.9 (1983); R.I. GEN. LAWS § 9-1-26 (1956); Malloy v. Fong, 232 P.2d 241, 246-47 (Cal. 1951); Gubbe v. Catholic Diocese, 257 N.E.2d 239, 242 (Ill. Ct. App. 1970); Harris v. Young Women's Christian Assoc., 237 N.E.2d 242, 245 (Ind. 1968); Parker v. Port Huron Hosp., 105 N.W.2d 1, 15 (Mich. 1960); Benton v. Young Men's Christian Assoc., 141 A.2d 298, 299 (N.J. 1958); Howle v. Camp Amon Carter, 470 S.W.2d 629, 630 (Tex. 1971).

See also Developments in the Law, supra note 3, at 1680. *Contra, The Quality of Mercy, supra* note 3, at 1385 (arguing that reports of the abolition of the doctrine of charitable immunity are greatly exaggerated). *See generally* Fairchild, *supra* note 5 (outlining the modern status of charitable immunity across jurisdictions).

9. *See* KEETON ET AL., *supra* note 2, at 1070-71; Charles Robert Tremper, *Compensation for Harm from Charitable Activity*, 76 CORNELL L. REV. 401, 402-11 (1991); *Developments in the Law, supra* note 3, at 1681; *The Quality of Mercy, supra* note 3, at 1395; David Bush, *The*

reasoned that any burden placed on charities because of tort liability could be alleviated if charities purchased insurance.[10] Moreover, charities had evolved from asset-poor organizations into substantial corporate powers with sufficient assets to self-insure.[11]

More recently, a trend toward affording charities greater immunity has re-emerged.[12] This trend is the result of rising insurance premiums, the reduced insurance coverage characteristic of the 1980s,[13] and several high-profile cases

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Constitutionality of the Charitable Immunity and Liability Act of 1987, 40 BAYLOR L. REV. 657, 658-59 (1988).

10. *See*, e.g., President & Dirs. of Georgetown College v. Hughes, 130 F.2d 810, 828 (D.C. Cir. 1942); Moore v. Moyle, 92 N.E. 2d 81, 84-85 (Ill. 1950) (rejecting charitable immunity on the grounds, *inter alia*, that charities could obtain insurance to spread the loss incurred by a tort judgment). *See also* Tremper, *supra* note 9, at 411; Lipson, *supra* note 5, at 495-96; *Developments in the Law, supra* note 3, at 1681; *The Quality of Mercy, supra* note 3, at 1395 (discussing the argument that charitable immunity should be abrogated because charities could simply purchase insurance).

11. *See*, e.g., Noel v. Menninger Found., 267 P.2d 934, 942 (Kan. 1954). *See also Developments in the Law, supra* note 3, at 1581; Bush, *supra* note 9, at 658-59. *Cf.* Henry B. Hansmann, *The Evolving Law of Nonprofit Organizations: Do Current Trends Make Good Policy?*, 39 CASE W. RES. L. REV. 807, 812 (1988) [hereinafter *Evolving Law*] (outlining the development of the nonprofit sector over the last 40 years); Henry B. Hansmann, *The Role of Nonprofit Enterprise*, 89 YALE L.J. 835, 835 (1980) [hereinafter *Nonprofit Enterprise*]; James Cook, *Businessmen with Halos*, FORBES, Nov. 26, 1990, at 100, 106 (discussing the economic growth and power of the nonprofit sector).

Professor Hansmann observes that, prior to World War II, most non-profit organizations were donatively supported and provided services that had the character of public goods. *See Evolving Law, supra*, at 812. He adds that the nonprofit sector and non-profit organizations within that sector were small. *Id.* However, today, the nonprofit sector has grown in size and economic power. *See Nonprofit Enterprise, supra*, at 835. A new breed of nonprofit organizations (i.e., commercial nonprofit organizations that engage in the sale of goods or services for a profit) has also emerged. *See Evolving Law, supra*, at 813. While the nonprofit sector contributed only 5.9% to the gross national product in 1973, *see Nonprofit Enterprise, supra*, at 836, nonprofit organizations were responsible for 15% of the gross national product and generated revenues exceeding $750 billion in 1987. *Forbes, supra*, at 100.

12. *See* Tremper, *supra* note 9, at 402-03; *see Developments in the Law, supra* note 3, at 1682-84; *The Quality of Mercy, supra* note 3, at 1385-86.

13. A premium is simply the consideration for a contract of insurance. *See, e.g.*, Bronson v. Glander, 77 N.E.2d 471, 472 (Ohio 1948). *See also* JOHN ALAN APPLEMAN & JEAN APPLEMAN, APPLEMAN ON INSURANCE § 7813 (1985); 2 COOLEY'S BRIEFS ON INSURANCE 1507 (1907). Premiums are usually payable annually or at fixed intervals during the year. *See* APPLEMAN & APPLEMAN, *supra*, at § 7831. "Coverage" means the payments made by the insurer to the insured when the insured makes a valid claim against an enforceable contract of insurance.

Professor Michael Singsen discussed the impact of the 1980s insurance crisis on non-profit organizations in Comment, *Charity Is No Defense: The Impact of the Insurance Crisis on Nonprofit Organizations and an Examination of Alternative Insurance Mechanisms*, 22 U.S.F. L. REV. 599, 601-09 (1988). Professor Singsen recounts several possible causes for the "hard" insurance market of the 1980s. *Id.* at 601-04. He suggests that collusion among insurers and the "litigation explosion" of the 1970s may be partially responsible for the unavailability of insurance in the 1980s.

imposing enormous liability on nonprofit corporations.[14] However, legislatures and courts generally disagree on the extent of liability that nonprofit corporations should be forced to bear, and the law around the country is currently in a state of disarray.[15]

Id. at 601-02. However, Professor Singsen seems to reject these contentions and places credence in the "cyclical" nature of the insurance industry as the cause of the insurance crisis. *Id.* Simply put, the insurance industry earns capital in two ways: underwriting profit (defined as the difference between revenue from premiums and losses paid) and investment profit (defined as profit from investing premiums in stocks, bonds, etc.). *Id.* at 601. When investment profits are high, insurers are willing to reduce premiums, while, when investment profits are low, insurers raise their premiums. *Id.* at 602. Therefore, the low profit from investments in the early 1980s caused insurers to raise their premiums. *Id.*

Professor Singsen, citing FRED S. JAMES & CO., NONPROFITS AND LIABILITY INSURANCE: THE CALIFORNIA ASSOCIATION OF NONPROFITS, INC. RISK POOLING PROJECT 5 (1987), notes that 65% of nonprofit corporations in California reported 50% increases in insurance premiums in 1986. *See* Singsen, *supra*, at 604-05. Of those corporations, 38% experienced premium increases of 200% or more. *Id.* at 605 (citing UNITED WAY OF CALIFORNIA LIABILITY INSURANCE CRISIS ISSUE BRIEF 2 (1986)). Professor Singsen reports that 22% of nonprofits had their liability insurance canceled or non-renewed between 1982 and 1987. *See* Singsen, *supra*, at 605.

14. *See, e.g.*, Infant C. v. Boy Scouts of Am., 391 S.E.2d 322 (Va. 1990) (holding that a boy who was molested by a troop leader was entitled to receive $45,000 dollars in compensation from the local organization chapter); Gary Taylor, *Goodwill Must Pay $5M in Murder by Parolee-Employee*, NAT'L L.J., June 8, 1987, at 22; David Rohn, *Pool Victims Settle: Girl Who Nearly Drowned to Get $4000 a Month*, WASH. POST, May 17, 1978, at A4 (settling lawsuit concerning a girl who almost drowned in the club's pool for over $800,000 and lifetime payments). *See also* Tremper, *supra* note 9, at 402-03; Singsen, *supra* note 13, at 600-09; *Developments in the Law, supra* note 3, at 1680-81.

15. For example, four states have placed statutory caps on damage awards allowed against certain non-profits. MASS. GEN. LAWS ANN. ch. 231, § 85k (West 1985 & Supp. 1991) (setting the damage cap at $20,000); N.H. REV. STAT. ANN. § 508:17(II) (Supp. 1991) (setting the damage cap at $250,000 per victim per occurrence); S.C. CODE ANN. § 33-55-210 (Law. Co-op. 1990) (setting the damage cap at $200,000); TEX. CIV. PRAC. & REM. CODE ANN. § 84 (West Supp. 1989) (setting damage cap at $500,000 for each person, $1,000,000 for each occurrence of bodily injury or death, and $100,000 for each occurrence of property damage). Two states have limited recovery against a charity to the extent of a charity's liability insurance. ME. REV. STAT. ANN. tit. 14, § 158 (West 1980); MD. CODE ANN. CTS. & JUD. PROC. § 5-312 (1989). Colorado and Wyoming give complete immunity to organizations providing services free of charge. COLO. REV. STAT. § 13-21-116 (West 1987); Lutheran Hosp. & Homes Soc'y of Am. v. Yepsen, 469 P.2d 409, 411-12 (Wyo. 1970). New Jersey, Virginia and Alabama completely bar suits brought by beneficiaries of a charity. N.J. STAT. ANN. § 2A:53A-7 (West 1987); Radosevic v. Virginia Intermont College, 633 F. Supp. 1084, 1086-89 (W.D. Va. 1986) (applying Virginia law); Autry v. Roebuck Park Baptist Church, 229 So. 2d 469, 473-74 (Ala. 1969). Utah grants immunity to charities if the tortious injury complained of is caused by a volunteer's criminal activity. UTAH CODE ANN. §§ 78-19-1 to -3 (1987). Arkansas retains full immunity from tort judgments for charities. Helton v. Sisters of Mercy of St. Joseph's Hosp., 351 S.W.2d 129, 131 (Ark 1961). In Georgia and Tennessee, charitable assets and property cannot be levied on as a result of a tort judgment. Mack v. Big Bethel A.M.E. Church, Inc., 188 S.E.2d 915, 916 (Ga. Ct. App. 1972); Hammond Post No. 3, Inc., Am. Legion v. Willis, 165 S.W.2d 78, 80 (Tenn. 1942). *See also* Tremper, *supra* note 9, at 411-12; *Developments in the Law, supra* note 3, at 1682-84; *The Quality of Mercy, supra* note 3, at 1385-86, 1391-94.

For example, states have generally disagreed on the issue of whether charities should pay punitive damages.[16] Fearing that large punitive damage awards would debilitate the charitable sector, some states have placed caps on the amount of an award that may be assessed against charities.[17] Yet other states have assessed punitive damage awards against charities regardless of their charitable status.[18] Five states have granted partial immunity or limited liability to organizations that engage in charitable activity.[19] For example, partial immunity or limited liability is based on the organization's tax exempt status under Internal Revenue Code § 501(c)(3) in Maryland and Utah.[20] New

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For a discussion of varying state rules regarding punitive damages with respect to charities, see *infra* notes 17-21 and accompanying text.

Another recent development has been the introduction and occasional enactment of several statutes intended to protect charity and nonprofit volunteers from liability in tort. *See, e.g.*, VOLUNTEER PROTECTION ACT OF 1989, H.R. 911, 101st Cong., 1st Sess. (1989). Several reasons are given for this movement, including former President Bush's "1000 Points of Light" program and concerns that volunteers will quit volunteering if they are held liable for their torts. *See* Tremper, *supra* note 9, at 402-03; *Developments in the Law, supra* note 3, at 1685-89. However, this note is concerned mainly with the liability of charities, not volunteers, and therefore, a discussion of the immunity of volunteers is beyond the scope of this note.

16. *See infra* notes 17-30 and accompanying text.

17. *See, e.g.*, MASS. GEN. LAWS ANN. ch. 237, § 85k (West 1985 & Supp. 1991); N.H. REV. STAT. ANN. § 508:17(II) (Supp. 1991); S.C. CODE ANN. § 33-55-210 (Law Co-op. 1990); TEX. CIV. PRAC. & REM. CODE ANN. § 84.006 (West Supp. 1989).

18. *See, e.g.*, Phillips v. Hunter Trails Community Assoc., 685 F.2d 184 (7th Cir. 1982) (applying the Federal Fair Housing Act); Mrozka v. Archdiocese of St. Paul & Minneapolis, 482 N.W.2d 806, 809-10 (Minn. 1992) (allowing punitive damages to be assessed against a catholic church where a priest molested a young male parishioner); Christofferson v. Church of Scientology of Portland, 644 P.2d 577, 607-08 (Or. 1982) (allowing punitive damages against a church where the church depleted the parishioners' assets by fraud), *cert. denied*, 459 U.S. 1206 (1983). For a discussion of other jurisdictions that have allowed large punitive damage awards to be assessed against charities, see the authorities cited at *supra* note 14.

19. *See, e.g.*, ME. REV. STAT. ANN. tit. 14, § 158 (West 1980) (setting maximum recovery against charities at the amount of the charities' insurance coverage); MASS. GEN. LAWS ANN. ch. 231, § 85k (West 1985 & Supp 1991) (setting the damage cap at $20,000 per occurrence); S.C. CODE ANN. § 33-55-210 (Law Co-op. 1990) (setting the damage cap at $200,000); TEX. CIV. PRAC. & REM. CODE ANN. § 84 (West 1989) (setting the damage cap at $500,000 for each person, $1,000,000 for each occurrence of bodily injury or death, and $100,000 for each occurrence of property damage).

20. *See, e.g.*, MD. CODE ANN. CTS. & JUD. PROC. § 5-312(a)(5) (1994); UTAH CODE ANN. §§ 78-19-1 to -3 (1994).

In order to qualify for tax exemption under I.R.C. §501(c)(3), an organization must, *inter alia*, have a charitable purpose, operate in harmony with the public interest, serve a sufficiently broad public, and adhere to the nondistribution constraint. *See* Bob Jones University v. United States 461 U.S. 574 (1982). I.R.C. § 501(c)(3) lists certain activities of an organization which are considered for tax exemption if the organization meets the other requirements of § 501(c)(3). These activities include religious, scientific, literary, and educational activities as well as testing for public safety, fostering sports competition, or prevention of cruelty to children or animals. *See also infra* notes 320-31 and accompanying text.

Hampshire, however, protects all nonprofit organizations from full liability.[21]

The debate over whether charities and nonprofit corporations should pay punitive damages is based on both the policy behind, and the practical effect of, a punitive damage award.[22] First, the general concern is that awarding punitive damages against charities will reduce their ability to produce benefits for the public.[23] Although punitive damage awards arguably deter charities from committing torts in the future,[24] punitive damage awards may also deter charities from engaging in charitable activities.[25] Second, there is little justification for taking money from the charitable sector and placing it in the hands of a private plaintiff.[26] Such a transfer is likely to result in reduced assets in the charitable sector and, consequently, a reduction in charitable

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21. N.H. REV. STAT. ANN. § 508:17 (Supp. 1991) (setting the damage cap at $250,000 per person and $1,000,000 per occurrence in suits against all organizations with I.R.C. § 501(c) status).

22. *See Developments in the Law, supra* note 3, at 1682; *The Quality of Mercy, supra* note 3, at 1386-98; Michelle Berdinis Fagin, Note, *Punitive Damages and Nonprofit Corporations: To Make the Punishment Fit the Crime*, 19 U.S.F. L. REV. 377, 377-79, 387-90 (1985). *See generally* Tremper, *supra* note 9.

23. There is some anecdotal evidence that suggests that such over-deterrence actually occurs when punitive damage awards are imposed on charities. *See, e.g., Insurance Increase Forces YMCA to Drop Youth Minibike Program*, CHRISTIAN SCI. MONITOR, Aug. 14, 1986, at 5; Kenneth Reich, *Youth Agencies Hit Hard by Soaring Insurance Costs*, L.A. TIMES, July 19, 1986, Part II, at I. *See also* Tremper, *supra* note 9, at 425-30; Fagin, *supra* note 22, at 389-90; *Developments in the Law, supra* note 3, at 1691-92.

24. The assumption that punitive damage awards deter charities from committing torts has not gone unchallenged. *See, e.g.*, Tremper, *supra* note 9, at 425-30; Fagin, *supra* note 22, at 377-78. In fact, it has been argued that imposing punitive damages on corporations for the torts of their employees has no deterrent effect at all, regardless of whether the corporations are for profit or not-for-profit. *See, e.g.*, RESTATEMENT (SECOND) OF TORTS § 909, cmt. b (1977); E. Donald Elliot, *Why Punitive Damages Don't Deter Corporate Conduct Effectively*, 40 ALA. L. REV. 1053, 1057 (1989). *But see, e.g.*, Pacific Mut. Ins. Co. v. Haslip, 111 S.Ct. 1032, 1041 (1991) (holding that a state could rationally conclude that imposing punitive damages on corporations for the torts of their employees prevents tortious conduct).

25. Professor Tremper argues that over-deterrence can occur in a number of ways. *See* Tremper, *supra* note 9, at 427-33. He first suggests that charities will be overcautious and will "remain far from the danger zone of liability." *Id.* at 427. In contrast, Professor Tremper also argues that charities may walk a "tightrope" near liability because many charities are willing to accept the abnormal risk of working with dangerous populations. *Id.* Professor Tremper concludes that charities will behave this way because they are unresponsive to the economic cues of tort law. *Id.* at 426-28. In addition, Professor Tremper argues that the charitable sector's inability to obtain insurance may also result in deterrence of charitable activities. *Id.* at 428, 430-33. *See also Developments in the Law, supra* note 3, at 1682, 1690-93.

26. *Cf.* Bass v. Chicago & N.W. Ry., 42 Wis. 654, 672 (1877) ("[I]t is difficult to understand why, if the tortfeasor is to be exemplary by punitive damages, they should go to the compensated sufferer, and not to the public on whose behalf he is punished.") (opinion of Ryan, C.J.).

activity.[27]

In contrast, if punitive damages are not awarded against charities, tortious conduct will remain undeterred.[28] Moreover, an award of punitive damages makes a social statement that the defendant's egregious conduct is not acceptable in an ordered society.[29] If punitive damages are not awarded against charities, there is a danger that immunity from punitive damages will be viewed as social acquiescence to wrongful conduct so long as that conduct occurs in the name of charity.[30]

This Note is not intended to re-open the debate over whether charities should be completely immune from tort judgments. That subject has been discussed elsewhere.[31] Even staunch supporters of charitable immunity recognize that complete immunity is not a preferable solution to the economic dilemma from potential liability in tort that charities face.[32]

This Note intends to explore the issue of whether charities and nonprofit corporations should pay punitive damages.[33] This Note argues that jurisdictions that allow the assessment of punitive damage awards to be assessed against charities run the risk of depleting the charitable sector's assets, deterring

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27. *See, e.g.*, Ettlinger v. Trustees of Randolph-Macon College, 31 F.2d 869, 873 (4th Cir. 1929):

> [T]he exemption of public charities from liability . . . rests . . . upon [the] grounds of public policy, which forbids the crippling or destruction of charities which are established for the benefit of the whole public . . . . The law has always favored and fostered public charities in ways too numerous to mention, because they are most valuable adjuncts of the state in the promotion of many of the purposes for which the state exists.

Id.

See also Tremper, *supra* note 9, at 439; *Developments in the Law, supra* note 3, at 1683. At least one state has attempted to deal with the problem of over-deterrence. *See Volunteer Protection Act*, 1991 Ala. Acts 439.

28. *See infra* text accompanying notes 97-111.

29. *See infra* notes 256 and 258 and sources cited therein.

30. *See infra* notes 254-56 and accompanying text.

31. *See infra* note 32 and sources cited therein.

32. For a strong argument against charitable immunity, see *The Quality of Mercy, supra* note 3, at 1386-99. *But cf. Developments in the Law, supra* note 3, at 1691-96; Tremper, *supra* note 9, at 444-66 (arguing in favor of limited immunity for charities while recognizing that there should be exceptions to complete immunity to prevent the injustice that arises from denying at least some recovery to a tort victim).

33. It should be noted that the issue of whether charities should be completely immune from tort judgments is highly related to the issue of whether a charity should pay punitive damages. Obviously, if a charity is completely immune from suit, it will not pay punitive damages either. In fact, many of the arguments in favor of complete immunity, outlined in *supra* note 6, are the same arguments that commentators make when arguing that charities should not pay punitive damages. *See, e.g., infra* notes 82-96 and accompanying text.

charitable activity, and punishing innocent donors and beneficiaries.[34] Such a depletion of charitable assets deprives society of the public benefits that would have otherwise been produced had the assets remained in the hands of charities.[35] However, this Note also argues that limited liability for charities will result in the undesirable effect of allowing tortious conduct on the part of charities to remain undeterred.[36]

In order to accomplish the deterrence of tortious conduct on the part of individual charities while preventing the economic ruin of charitable activity in the aggregate, this Note argues that a compromise must be struck between holding charities completely liable for punitive damage awards and allowing charities limited liability.[37] In order to accomplish such a compromise, this Note proposes a model statute that allows for an award of punitive damages against charities, but which provides that the award be split between the plaintiff and a charity providing a similar benefit to the public.[38] This Note argues that such a statute will deter tortious conduct on the part of the individual charity while insuring that the charitable assets remain, for the most part, in the charitable sector.[39] Thus, the deterrence of tortious conduct will be achieved while protecting the economic vitality of the charitable sector.[40]

As an analytic framework, this Note will briefly outline the scope of the nonprofit and charitable sectors in Section II.[41] The nature and purpose of punitive damages will be discussed in Section III.[42] This Note will then outline the traditional arguments made as to the issue of whether charities and nonprofit corporations should pay punitive damages in Section IV.[43] A few proposals for reform in the law of punitive damages as applied to nonprofit corporations

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34. *See infra* notes 173-244 and accompanying text.
35. *See infra* notes 245-53 and accompanying text.
36. *See infra* notes 254-58 adn accompanying text.
37. *See infra* notes 314-43 and accompanying text.
38. *See infra* notes 314-43 and accompanying text.
39. *See infra* notes 314-43 and accompanying text.
40. *See infra* notes 314-43 and accompanying text.
41. *See infra* text accompanying notes 50-64.
42. *See infra* text accompanying notes 65-76.
43. *See infra* text accompanying notes 77-258. The arguments traditionally made against awarding punitive damages against charities and nonprofit corporations are that nonprofit organizations and charities are not responsible for the acts of their employees and volunteers, and therefore, should not be punished; charities and nonprofit corporations are not wealth maximizing organizations, and therefore, will not respond to the economic cues of tort law; imposing punitive damages on these organizations punishes innocent beneficiaries and donors; and holding charities and nonprofit corporations liable for punitive damages will deprive society of benefits that would have otherwise been produced by these organizations if the money had been left in the nonprofit sector. *See infra* notes 77-258 and accompanying text.

and charities will be surveyed in Section V.[44] A proposal for allowing complete liability against nonprofit organizations that engage in the production of private benefits and commercial activities[45] will be made in Section VI.[46] In Section VI, this Note also will argue that charitable organizations providing public benefits should receive special treatment under tort law.[47] To that end,

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44. *See infra* text accompanying notes 259-312. Some of the proposals that have been made are Professor Tremper's "charitable redress system," placing caps on the amount of damages that can be obtained against charities and nonprofit corporations, and subsidizing charities through government funding. *See infra* notes 259-312 and accompanying text.

45. "Commercial Activities," as used in this note, means the sale of goods or services for a price. Consequently, "commercial nonprofit corporations," as used in this note, means those nonprofit corporations that engage in the sale of goods or services as their primary activity and derive nearly all of their income from the prices charged for the goods or services. *See Evolving Law, supra* note 11, at 813. "Private benefits," as used in this note, means those goods or services which benefit only the purchaser. *See Developments in the Law, supra* note 3, at 1585. Private clubs and mutual benefit associations are good examples of nonprofit corporations that produce private benefits because only the club members derive the benefit from the clubs' facilities and services. *See Evolving Law, supra* note 11, at 809.

For an in-depth discussion of the difference between "public benefits" and "private benefits" as used in this note, see *infra* notes 53-56 and accompanying text. However, for the time being, to understand the difference between nonprofit organizations that produce "public benefits" and nonprofit organizations that produce "private benefits" as used in this note, it is useful here to consider the example given by Professors William A. Klien and Joseph Bankman. Professors Klien and Bankman write:

> Consider, for example, the fee structure at one [nonprofit] west coast opera company. The nominal cost of one "Series A" box seat is $1,585. However, such seats are available after a major donation. The amount of donation that will secure such a box is said to be $20,000 - down from $100,000 in the more prosperous 1980s. In addition, holders of Series A boxes are requested to make a minimum contribution of $4500 a year.

WILLIAM A. KLIEN & JOSEPH BANKMAN, INDIVIDUAL TAXATION 498 n.2 (10th ed. 1994).

Hypothetically, one could argue that the West Coast Opera company described by Professors Klien and Bankman produces a "public benefit" by insuring the development of the arts in the community where the opera company is located. However, the opera company produces a "private benefit" in that only those who can afford to buy a ticket are given the opportunity to enjoy the services that the opera company provides. The opera company appears to be more like an exclusive, private club rather than an organization concerned about the development of the community. In addition, it appears that any benefit that the opera company produces could be produced equally well by a for-profit organization. *See* KLIEN & BANKMAN, *supra* at 498 n.2.

It can be supposed that a myriad of nonprofit organizations, such as the West Coast Opera company described above, produce only private benefits and yet receive the benefits of nonprofit status under I.R.C. § 501(c). An exhaustive listing of such organizations would be superfluous for the proposes of this note. For the sake of simplicity only, mutual benefit associations and private clubs shall be used throughout this note as examples of nonprofit organizations that engage in the production of only private benefits.

46. *See infra* text accompanying notes 313-43.

47. This note will argue that the concept of organizations that confer public benefits is encompassed by §501(c)(3) status, and that a special rule concerning punitive damages should be crafted to protect the class of organizations that meet the criteria of §501(c)(3). *See infra* text accompanying notes 313-43.

Section VI will propose a model statute that provides for splitting a punitive damages award between the plaintiff and a charity that provides a similar benefit to society as the organization sued.[48] The constitutionality of this proposal will be discussed in Section VII.[49]

II. THE NOT-FOR-PROFIT SECTOR

Prior to 1950, most nonprofit corporations were charities and could be considered as a unitary class.[50] Most nonprofit organizations, before World War II, were traditional charities that were supported by donations, and these charities provided services for a substantial segment of the public.[51] Today, however, the nonprofit sector not only includes traditional charities such as churches, soup kitchens, hospitals, the American Red Cross, and the Salvation Army, but also encompasses the National Football League, the Sierra Club, the Girl Scouts of America, the National Geographic Society, the Federalist Society, and the Ku Klux Klan.[52]

Nonprofit organizations, such as an exclusive men's club,[53] may be formed to produce a private benefit.[54] Yet other nonprofit organizations, such as the American Red Cross, may be formed to produce a public benefit.[55] Nonprofit organizations, such as Valparaiso University, may also produce both

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48. *See infra* text accompanying notes 313-43.

49. *See infra* text accompanying notes 344-78.

50. For a discussion of changes in the nonprofit sector from 1950 to the present, see *supra* note 11 and sources cited therein.

51. *See supra* note 11 and sources cited therein. Professor Hansmann cites nonprofit hospitals as a particularly conspicuous example of how charities and nonprofit corporations have changed over the last 40 years. *See Evolving Law, supra* note 11, at 813. Professor Hansmann notes that until the end of the 19th century, hospitals provided health care almost exclusively for the poor, while the rich were treated in their own homes. *Id.* Today, however, most hospitals provide services on a "fee-for-service" basis and do little to subsidize medical care for the poor. *Id.* Yet, over 75% of hospitals are still nonprofit corporations. *Id.* at 813-14.

52. *See Developments in the Law, supra* note 3, at 1581 (discussing various examples of nonprofit corporations and charities).

53. *See Developments in the Law, supra* note 3, at 1585. The benefits of a private country club inure solely to the benefit of its members, and therefore, the club produces a private benefit. For a discussion of private and public benefits, see *infra* note 54.

54. The terms public and private benefits are not meant to be construed as analogous to economic terms of art (e.g., public goods and private goods). "Private benefits" indicate goods and services that can be used only by the consumer. "Public benefits" indicate goods and services that can be used by the consumer as well as by others.

55. For example, the American Red Cross provides public benefits by providing relief to the public at large in times of disaster. The Red Cross does so regardless of whether beneficiaries have paid for the relief. *See* Henry B. Hansmann, *The Rationale for Exempting Nonprofit Organizations from Corporate Income Taxation*, 91 YALE L.J. 54, 61 (1981).

public and private benefits.[56]

In addition, the nonprofit sector has also become populated with organizations that sell personal services as their primary activity and which derive nearly all of their income from the price charged for those services.[57] The nonprofit sector generates more than $750 billion in revenues each year, totalling approximately fifteen percent of the gross national product.[58] Thus, while nonprofit corporations can incorporate for any purpose,[59] the nonprofit status of a corporation depends mainly on its adherence to the nondistribution constraint in its corporate charter.[60]

The nondistribution constraint prevents nonprofit organizations from distributing their assets to third parties, such as shareholders, thereby attempting to force nonprofit organizations to use their assets to produce a better good or service.[61] The nondistribution constraint, however, does not prevent nonprofit

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56. *See* VALPARAISO UNIVERSITY CORPORATE CHARTER (on file at Valparaiso University Office of Vice President of Business Affairs) (providing that the University's assets shall not inure to the benefit of third parties). Universities contribute to a more educated citizenry, thereby producing public benefits. Universities, however, also provide an education to the individual students which is a private benefit to those students. *See also Developments in the Law, supra* note 3, at 1581 (discussing the nonprofit status of Harvard University).

57. For a discussion of the development of commercial nonprofit corporations, see *supra* note 11.

58. For a discussion of the economic power and growth of the nonprofit sector from 1950 to the present, see *supra* note 11.

59. *See, e.g.*, IND. CODE ANN. § 23-17-4-1 (West 1994); MONT. CODE ANN. § 35-2-213(2)(a) (1993); OHIO REV. CODE ANN. § 1702.03 (Baldwin 1993); OKLA. STAT. ANN. tit. 18, § 1005 B. (West 1986); TENN. CODE ANN. § 48-52-102(9)(b)(2)(A) (1988 & Supp. 1994); REVISED MODEL NONPROFIT CORPORATION ACT § 2.02 (1988). *But see* ILL. ANN. STAT. ch. 805 para. 1051 102.10 (a)(2) (Smith-Hurd 1993) (providing that a nonprofit corporation may only be formed for the purposes enumerated in the statute); MASS. GEN. LAWS ANN. ch. 180, § 4 (West 1987 & Supp. 1994) (same). *See also Nonprofit Enterprise, supra* note 11, at 839; *Developments in the Law, supra* note 3, at 1582. It should also be noted that states once limited the purposes for which nonprofits could be formed, but the trend is toward removing these restrictions. *See* Howard L. Oleck, *Proprietary Mentality and the New Non-Profit Corporation Laws*, 20 CLEV. ST. L. REV. 145 (1971). *See also Nonprofit Enterprise, supra* note 11, at 839; *Developments in the Law, supra* note 3, at 1582 n.8.

60. *See, e.g.*, I.R.C. § 501(c)(3) (West 1994); IND. CODE ANN. § 23-17-21-1 (West 1984); ILL. ANN. STAT. ch. 32, para. 106.05 (Smith-Hurd 1991); REVISED MODEL NONPROFIT CORPORATION LAW, §§ 1.40, 13.01 (1988). *See also Nonprofit Enterprise, supra* note 11, at 838-39; *Developments in the Law, supra* note 3, at 1582.

61. *See, e.g.*, I.R.C. § 501(c)(3)(West 1994). *See also Nonprofit Enterprise, supra* note 11, at 838; *Developments in the Law, supra* note 3, at 1582.

Professor Hansmann argues that consumers are more likely to deal with nonprofit organizations when consumers are unable to evaluate the quality of goods or services purchased. *See Nonprofit Enterprise, supra* note 11, at 843-45. Consumers are more likely to deal with nonprofit organizations in this situation because such organizations are more likely to commit their funds to producing better quality goods and services and are less able, as a result of the nondistribution

corporations from earning a profit or accumulating net profits.[62] Moreover, nonprofit corporations cannot defy the laws of economics: nonprofit organizations must generate enough revenue to cover their expenditures.[63] Therefore, while nonprofit organizations may generate more revenue than needed to meet their expenses, that profit accumulates in their corporate treasuries because the profit cannot be distributed to third parties. Before discussing whether punitive damages should be awarded against nonprofit corporations and charities, a brief discussion of punitive damages is necessary.[64]

Having discussed the structure of the nonprofit sector, the next section will discuss the nature and purpose of punitive damages. A brief discussion of punitive damages is necessary before reaching the issue of whether charities and nonprofit organizations should be subjected to punitive damages. After discussing punitive damages, this Note will address the arguments on both sides of the issue of whether charities and nonprofit organizations should be subjected to punitive damage awards.

III. THE NATURE AND PURPOSE OF PUNITIVE DAMAGES

Punitive damages are imposed to punish a tortfeasor for past wrongs.[65] In addition, punitive damage awards presumably deter civil defendants and

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constraint, to exploit consumers by gaining greater shareholder profits than for-profit firms. *Id.* *See also* Henry B. Hansmann, *Consumer Perceptions of Nonprofit Enterprise: Reply*, 90 YALE L.J. 1633 (1981) (arguing that empirical data supports this theory of nonprofit corporations). *But cf.* *Steven E. Permut, Consumer Perceptions of Nonprofit Enterprise: A Comment on Hansmann*, 90 YALE L.J. 1623, 1623-32 (1981) (arguing that empirical data does not support Professor Hansmann's theory).

62. *See Nonprofit Enterprise, supra* note 11, at 838; *Developments in the Law, supra* note 3, at 1582. In fact, some state nonprofit incorporation statutes explicitly allow nonprofits to earn a profit so long as profits are not distributed to third parties. *See, e.g.*, IND. CODE ANN. § 23-7-1.1-4(c) (West 1979), *repealed by* P.L. 179-1991 § 34 (1991).

63. *See Nonprofit Enterprise, supra* note 11, at 880. *See also Developments in the Law, supra* note 3, at 1582 n.10 (discussing Professor Hansmann's model of the nonprofit sector).

64. *See Nonprofit Enterprise, supra* note 11, at 838. By saying that profits accumulate in the nonprofit corporations' corporate treasuries, this is not to say that the money will never be used. *Id.* Nonprofit corporations may use the excess profit to produce more goods and services and to pay their employees. *Id.* But because of the nondistribution constraint, they may not distribute profits to shareholders or other third parties. *Id.* *See also Developments in the Law, supra* note 3, at 1582 n.10.

65. *See* RESTATEMENT (SECOND) OF TORTS § 908 & cmt. a. (1979); 25 AM. JUR. 2D *Damages* § 733 at 785 (1988); KENNETH R. REDDEN & LINDA L. SCHLUETER, PUNITIVE DAMAGES § 2.2, at 24 (2d ed. 1989); Robert W. McMenamin, *Should the Non-Profits Pay Punitive Damages?*, NAT. L.J., Mar. 8, 1993, at 17.

others from engaging in tortious conduct in the future.[66] Punitive damages are presumed to produce a public benefit by ensuring that public order is maintained through the deterrent function of the award.[67] However, whether punitive damages actually inure to the benefit of the public is highly debated.[68]

In addition to the retributive and deterrent functions of a punitive damage award, advocates of punitive damages argue that such awards provide plaintiffs with an incentive to prosecute conduct that is technically punishable under the criminal law, but not serious enough to come to the attention of the state prosecutor.[69] This principle, under which a plaintiff is encouraged to prosecute egregious conduct by the prospect of receiving a punitive damage award, is known as the private attorney general theory.[70] In contrast, opponents of

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66. *See, e.g.*, RESTATEMENT (SECOND) OF TORTS § 908(1) and cmt. a. (1979). *See also* Lynda A. Sloane, Note, *The Split Award Statute: A Move Toward Effectuating the True Purpose of Punitive Damages*, 28 VAL. U. L. REV. 473, 474 (1993); Fagin, *supra* note 22, at 377; McMenamin, *supra* note 65, at 19.

Punitive damages are different from nominal and compensatory damages. RESTATEMENT (SECOND) OF TORTS § 908 (1979). Nominal damages entail an award of a small amount of money to signify that a plaintiff's legal right has been violated. *See, e.g.*, 22 AM. JUR. 2D *Damages* §§ 2, 11 at 33, 40 (1988). Compensatory damages are awarded to put the plaintiff back in the position that the plaintiff would have been in had the plaintiff not been injured. *See, e.g.*, 22 AM. JUR. 2D *Damages* § 26 at 52-54 (1988).

There is some authority for the proposition that punitive damages are compensatory in nature and merely have an incidental punishing effect. *See, e.g.*, 25 AM. JUR. 2D *Damages* § 735 at 788 (1988). According to this view, punitive damages compensate for intangible losses, such as emotional distress, humiliation, insult, or vexation, which arise from malicious wrongs. *Id.* However, this function of punitive damages has diminished with the development of awards for pain and suffering, mental distress, and hedonic damages. *Id. See also* Sloane, *supra*, at 481-82.

67. Punitive damages can maintain the public order in a number of ways. For example, the defendant will be less likely to engage in similar conduct in the future, fearing future liability. Punitive damages also maintain the public order by allowing the plaintiff to get even with the defendant without resort to violence. *See* Winkler v. Hartford Acc. & Indem. Co., 168 A.2d 418, 422 (N.J. Super. 1961), *cited in* Sloane, *supra* note 66, at 480 ("[Punitive] damages are allowed . . . to vindicate the rights of a party in substitution for personal revenge, thus safeguarding the public peace.").

68. For a brief outline of the debate over the propriety and utility of punitive damages, see *infra* text accompanying notes 69-71.

69. CHARLES T. MCCORMICK, HANDBOOK ON THE LAW OF DAMAGES, *Damages* § 77, at 276 (1935); Hon. Shirley S. Abrahamson, *Report of the ABA Action Commission to Improve the Tort Liability System*, ABA 1987 MIDYEAR MEETING, Feb. 16-17, 1987, at 16, *cited in* Sloane, *supra* note 66, at 476 n.17.

70. *See, e.g.*, Tuttle v. Raymond, 494 A.2d 1353, 1358 (Me. 1985) (awarding punitive damages to enforce society's rules); Tideway Oil Programs, Inc. v. Serio, 431 So.2d 454, 461 (Miss. 1983) (holding that an award of punitive damages to plaintiffs should be reserved for cases where the plaintiff has put forth "great trouble and personal expense"); Kink v. Combs, 135 N.W.2d 789, 798 (1965) (awarding punitive damages to plaintiff gives plaintiff an incentive to pursue a claim that would punish and deter socially harmful conduct). *But cf.* Clarence Morris, *Punitive Damages in Tort Cases*, 44 HARV. L. REV. 1173, 1178 (1931), *cited in* Sloane, *supra* note

punitive damage awards argue that plaintiffs, who have presumably been made whole by compensatory damages, receive a "windfall" when they are awarded punitive damages.[71]

One changing area of the law of punitive damages is the degree of culpability that is necessary to justify an award of punitive damages. At common law, the defendant must have acted willfully or maliciously for punitive damages to be imposed.[72] Today, however, most states allow awards of punitive damages where the defendant's conduct rises only to the level of mere recklessness.[73]

Another changing area in the law of punitive damages is whether organizations should pay punitive damages based on the torts of their employees or volunteers under the doctrine of *respondeat superior*.[74] Some states hold that organizations are fully liable for the torts of their employees or members, including liability for punitive damages, regardless of the culpability of the

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66, at 481 n.47 (arguing that plaintiffs are not interested in prosecuting outrageous conduct for the benefit of the public, rather plaintiffs are motivated to present inflammatory evidence to the jury in order to increase the amount of the award). For a more in-depth discussion of the history of punitive damages, see Sloane, *supra* note 66, at 479-82.

71. Newport v. Fact Concerts, Inc., 453 U.S. 247, 270-71 (1981) (describing the plaintiff's "unpredictable and, at times, substantial windfall"); Missouri Pac. R.R. Co. v. Arkansas Sheriff's Boy's Ranch, 655 S.W.2d 389, 391-92 (denying punitive damages because plaintiff would receive a windfall); Bass v. Chicago & N.W. Ry. Co., 42 Wis. 654 (1877) (same). For an in-depth discussion of the windfall that the plaintiff receives as a result of being awarded punitive damages, see Sloane, *supra* note 66, at 479-81.

72. *See* KEETON ET AL., *supra* note 2, § 2, at 8. *See also* Martin A. Kotler, *Motivation and Tort Law: Acting for Economic Gain as a Suspect Motive*, 41 VAND. L. REV. 63, 88 (1988) (discussing the policies underlying punitive damages).

73. *See, e.g.*, Hazelwood v. Illinois Cent. Gulf R.R., 450 N.E.2d 1199, 1205 (Ill. App. Ct. 1983) (allowing punitive damages where defendant acted with conscious disregard for the safety of others); Behrens v. Raleigh Hills Hosp., Inc., 675 P.2d 1179, 1186-87 (Utah 1983) (allowing punitive damages where the defendant's conduct rises to the level of reckless disregard for the rights of others). *See also* RESTATEMENT (SECOND) OF TORTS § 908, cmt. c (1977) (holding that punitive damages are allowable where the defendant's conduct rises to the level of recklessness). *But cf.* Como Oil Co. v. O'Loughlin, 466 So. 2d 1061, 1062 (Fla. 1985) (allowing punitive damages only where the defendant's conduct is willful or wanton).

Although recklessness is somewhat difficult to define, one formulation is that recklessness can be found where a defendant acts with a conscious indifference to the consequences of his or her actions. *See* KEETON ET AL., *supra* note 2, § 2 at 10. Another change in the law of punitive damages is the elevation of the burden of proof in a majority of states to a "clear and convincing" standard. *See* Sloane, *supra* note 66, at 483.

74. The doctrine of *respondeat superior* provides that a master is liable for the torts of his or her servants. *See* BLACK'S LAW DICTIONARY 909 (6th ed. 1991); 53 AM. JUR. 2D *Master and Servant* § 404 at 410-11 (1970); 3 AM. JUR. 2D *Agency* § 280 at 782-83 (1986).

organization.[75] Other states hold that an organization is not liable for punitive damages resulting from the tortious conduct of the organization's employees or members unless the tortious act of the employee or member was ratified or authorized by the organization or unless the organization bore some degree of culpability in relation to the tortious act.[76]

IV. SHOULD NONPROFIT ORGANIZATIONS AND CHARITIES PAY PUNITIVE DAMAGES?

The question of whether nonprofit corporations and charities should pay punitive damages has received relatively little attention by commentators. However, various arguments can be made in favor of exempting nonprofit organizations and charities from punitive damage awards.[77] The various arguments on both sides of the issue will be discussed in the following sections.

A. Punitive Damages Do Not Deter Nonprofit Organizations and Charities

Those who advocate exempting nonprofit organizations and charities from punitive damages argue that punitive damage awards do not deter tortious conduct in the nonprofit sector.[78] Proponents of the nonprofit sector attempt to justify this argument by relying on both the doctrine of *respondeat superior*[79] and the economic analysis of law.[80] The following sections will address and

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75. *See* Western Coach Corp. v. Vaughn, 452 P.2d 117, 119 (Ariz. 1969); Standard Oil Co. v. Gunn, 176 So. 332, 334 (Ala. 1937); Miller v. Blanton, 210 S.W.2d 293, 296 (Ark. 1948); American Fidelity & Cas. Co. v. Farmer, 48 S.E.2d 122, 131-32 (Ga. 1948); Northrup v. Miles Homes, Inc. of Iowa, 204 N.W.2d 850, 858-59 (Iowa 1973); D. L. Fair Lumber Co. v. Weems, 16 So.2d 770, 773 (Miss. 1944); Rinker v. Ford Motor Co., 567 S.W.2d 655, 669 (Mo. App. 1978); Schmidt v. Minor, 184 N.W. 964, 965-66 (Minn. 1921); Clemons v. Life Ins. Co., 163 S.E.2d 761, 767 (N.C. 1968); Stroud v. Denny's Restaurant, Inc., 532 P.2d 790, 794 (Or. 1975); Odom v. Gray, 508 S.W.2d 526, 533 (Tenn. 1974).

76. *See, e.g.*, CAL. CIV. CODE § 3294(b) (West Supp. 1984); Roginsby v. Richardson, 378 F.2d 832, 842 (2d Cir. 1967) (applying New York law). The RESTATEMENT (SECOND) OF TORTS § 909 (1977) also adheres to the view that punitive damages may be imposed on a principal for the acts of its agents only where the principal ratified or authorized the acts of its agents. *Id.*

77. Some authors ignore distinctions between nonprofits and charities. *See generally* Fagin, *supra* note 22 (arguing that nonprofit organizations should be exempt from punitive damages, except in limited circumstances). *But see* Tremper, *supra* note 9, at 409, 459 (arguing that only certain nonprofit organizations should be protected from full tort liability).

78. *See* Tremper, *supra* note 9, at 425-28, 449. *See also* Fagin, *supra* note 22, at 387-88 (arguing that imposing punitive damages on nonprofit corporations on the basis of *respondeat superior* is not justifiable because the corporations are not culpable where the act of the employee or volunteer is not ratified by the corporation).

79. For a discussion of the application of the doctrine of *respondeat superior* to nonprofit corporations and charities, see *infra* text accompanying notes 82-96.

80. For a discussion of the application of economic principles of tort law to nonprofit corporations and charities, see *infra* text accompanying notes 97-128.

attempt to refute these arguments separately.[81]

1. Respondeat Superior

Some proponents of the nonprofit sector have argued that when tortious acts are committed by volunteers or employees of nonprofit organizations or charities, the deterrent effects of awarding punitive damages against nonprofit organizations and charities may not be achieved unless the charities and nonprofit organizations are also guilty of culpable conduct.[82] If the charities and nonprofit organizations must pay the punitive damage award but are not guilty of any wrongdoing, it is argued that the award punishes the innocent organizations rather than the guilty employee or volunteer.[83] Proponents of nonprofit organizations argue that if the punitive damage award punishes innocent organizations, the deterrent effect of the punitive damage award will not be realized.[84]

One difficulty with this argument is that it provides no reason why nonprofit organizations or charities deserve different treatment than for-profit corporations.[85] If for-profit corporations must pay punitive damages because of the tortious conduct of their employees, it could be argued that the innocent corporations, rather than the culpable employees, are punished.[86] Under this rationale, both for-profit and nonprofit corporations should be equally exempt from punitive damage awards where the tortious conduct was not ratified or encouraged by the organization.[87] Therefore, the argument that imposing punitive damages on corporations for the acts of their employees punishes innocent corporations rather than the guilty employees can be made with respect

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81. *See infra* notes 82-128 and accompanying text.

82. *See* Fagin, *supra* note 22, at 388. *See also* Tremper, *supra* note 9, at 449 (arguing that only certain nonprofit corporations should be exempt from punitive damage awards).

83. *See* Fagin, *supra* note 22, at 387-88.

84. *Id.*

85. For a brief discussion of how awarding punitive damages against corporations on the basis of *respondeat superior* punishes "innocent" corporations, regardless of whether the corporation is for-profit or nonprofit, see *infra* notes 87-88 and accompanying text.

86. *See, e.g.*, Tolle v. Interstate Sys. Truck Lines Inc., 356 N.E.2d 625, 626 (Ill. App. Ct. 1976) ("[A]n assessment of punitive damages is more difficult to justify where an otherwise innocent principal is held liable solely on the basis of *[r]espondeat superior.*").

87. However, a majority of courts hold that corporations are responsible for the acts of their employees and should be held liable for punitive damages for the tortious acts of their employees. *See supra* notes 75-76 and sources cited therein. This note takes the position that corporations, whether they are for-profit or nonprofit, are responsible for the acts of their employees because corporations can implement better risk management techniques to prevent employees from engaging in harmful behavior, regardless of whether the organization is for-profit or nonprofit. *See infra* notes 93-96 and accompanying text.

to both for-profit and nonprofit organizations.[88]

In response, proponents of the nonprofit sector argue that there is a difference between for-profit corporations, nonprofit corporations, and charities, and that nonprofit corporations and charities should not be held liable for punitive damages under the doctrine of *respondeat superior*, while for-profit corporations should be held liable.[89] Proponents of the nonprofit sector argue that the doctrine of *respondeat superior* rests upon the policy that when an enterprise is carried on for one's own financial benefit, the one who receives the financial benefit from that enterprise should answer for the torts committed by one's servants in the course of achieving that financial benefit.[90] For-profit corporations gain profit from the services of their employees and thus, fit squarely within the rationale for the doctrine of *respondeat superior*.[91] On the other hand, charities and nonprofit organizations do not receive a financial benefit from the activities in which they engage, and therefore, should not be liable for punitive damages resulting from the torts of their servants under the doctrine of *respondeat superior*.[92]

However, courts have generally rejected this narrow view of the doctrine of *respondeat superior*.[93] Courts have noted that while the justification for the doctrine of *respondeat superior* is based in part on whether organizations profit from their servants, the doctrine is also based on the fact that employers have the ability to exercise authority and control over their employees.[94] While a

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88. *See* Fagin, *supra* note 22, at 391 (arguing that nonprofit organizations should not be liable for punitive damages unless the act of the employee was ratified or encouraged by the organization or unless the corporation is a sham).

89. *See infra* notes 90-92 and accompanying text.

90. *See, e.g.*, Crossett Health Ctr. v. Croswell, 256 S.W.2d 548, 550 (Ark. 1953); Hearns v. Waterbury Hosp., 33 A. 595, 604 (Conn. 1895); Heffelfinger v. Morristown, 507 A.2d 761, 767 (N.J. Super. 1985); Peden v. Furman Univ., 151 S.E. 907, 911 (S.C. 1930); Schumacher v. Evangelical Deaconess Soc. of Wis., 260 N.W. 476, 477 (Wis. 1935). *See also* 53 AM. JUR. 2D *Master and Servant* § 417, at 431-32 (1970); Schopler, *supra* note 2, at 65-66.

91. *See supra* note 90 and sources cited therein.

92. *See, e.g.*, Hearns v. Waterbury Hosp., 33 A. 595, 604 (Conn. 1895) ("[The defendant] derives no [profit] from what its servants [do], in the sense of that personal and private gain which was the real reason for the rule [of *respondeat superior*] . . . [It] does not come within the [rule] of public policy which supports the doctrine . . . ."). *See also* Bachman v. Young Women's Christian Assoc., 191 N.W. 751, 752 (Wis. 1922); Crossett Health Ctr. v. Croswell, 256 S.W.2d 548, 550 (Ark. 1953); Peden v. Furman Univ., 151 S.E. 907, 911 (S.C. 1930). For a general discussion of the doctrine of *respondeat superior*, see 53 AM. JUR. 2D *Master and Servant* § 417, at 431-32 (1970). *See also* 15 AM. JUR. 2D *Charities* § 202 at 245-47 (1976) (discussing the application of the doctrine of *respondeat superior* to charitable organizations).

93. *See supra* note 90 and sources cited therein.

94. *See supra* note 90 and sources cited therein. See also 53 AM. JUR. 2D *Master and Servant* § 417 at 431-32 (1970) (discussing generally the policies underlying the doctrine of *respondeat superior*).

punitive damage award against a for-profit corporation under the doctrine of *respondeat superior* makes the corporation answer for the torts committed by the corporation's employees in the course of achieving a financial benefit for the corporation, the punitive damage award also punishes careless employee selection and hiring, prevents ineffective employee training, and deters ineffective employee supervision.[95] Similarly, punitive damage awards against nonprofit organizations and charities would not punish innocent charities or nonprofit organizations but would encourage implementation of similar employee and member selection, training, and supervision programs.[96] Because punitive damage awards against charities and nonprofit organizations are likely to encourage implementation of employee selection, training, and supervision programs, charities and nonprofit organizations should be held liable under the doctrine of *respondeat superior* for the acts of their employees or members.

2. Economic Analysis of Law

Those who advocate exempting nonprofit organizations and charities from punitive damages also argue that awarding punitive damages against nonprofit organizations and charities may have little, if any, deterrent effect because nonprofit organizations and charities do not respond well to the tort system's economic cues.[97] According to economists, tort law promotes economic efficiency through the imposition of damages.[98] Economists assume that tortfeasors will engage in harmful conduct only when the benefits to be gained from the conduct outweigh the costs of the harmful conduct.[99] When the law

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95. *See, e.g.*, Pacific Mut. Life Ins. Co. v. Haslip, 111 S. Ct. 1032, 1041 (1991) (applying Alabama law and holding that imposing punitive damages on an employer for the tortious acts of an employee does not violate the fundamental fairness required by the Due Process Clause). In the course of the Court's opinion, Justice Blackmun reasoned that "[i]mposing exemplary damages on the corporation . . . creates a strong incentive for vigilance by those in a position to 'guard substantially against the evil to be prevented.'" *Id.* (quoting Louis Pizitz Dry Goods Co. v. Yeldell, 274 U.S. 112 (1927)). The Court further stated that a corporation would have an incentive to minimize oversight of its agents if the corporation were liable only upon a showing that it was independently at fault. *Id.*

96. Like the imposition of punitive damages on for-profit corporations, the imposition of punitive damages on nonprofit corporations will create "a strong incentive for vigilance" on the part of nonprofit corporations to prevent their employees and volunteers from engaging in tortious activity. *Cf. Haslip*, 111 S.Ct. at 1041. Moreover, if nonprofit corporations were liable only when they are at fault independently, they would have "an incentive to minimize oversight of [their] agents." *Id.*

97. *See* Tremper, *supra* note 9, at 426-28. *See also Developments in the Law, supra* note 3, at 1692 (arguing that standard tort rules may over-deter nonprofit corporations and drive these corporations out of business). For a discussion of "torts law's economic cues," see *infra* notes 98-101 and accompanying text.

98. *See, e.g.*, WILLIAM H. LANDES & RICHARD A. POSNER, THE ECONOMIC STRUCTURE OF TORT LAW 5 (1987); GUIDO CALABRESI, THE COST OF ACCIDENTS 18-19 (1970).

99. *See* LANDES & POSNER, *supra* note 98, at 6; CALABRESI, *supra* note 98, at 18-19.

imposes damages for engaging in harmful conduct, the costs of engaging in that conduct increase.[100] Therefore, harmful activities are deterred by the imposition of damages to the extent that the costs of engaging in harmful behavior are increased above the benefits to be gained from those activities.[101]

However, proponents of the nonprofit and charitable sectors argue that nonprofit organizations and charities are not utilitarian, self-wealth maximizing entities, organizations that seek to externalize benefits to society.[102] Because nonprofit and charitable organizations are not self-wealth maximizing entities, proponents of the nonprofit and charitable sector argue that economic cues, like a punitive damage award, will be distorted when such an award is imposed on nonprofit corporations and charities.[103] For example, because nonprofit

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100. The law and economics analysis of tort law assumes that everyone is economically rational, and that a person will engage in an activity if the benefit to be gained from the activity outweighs the costs of the activity. *See* RICHARD A. POSNER, ECONOMIC ANALYSIS OF LAW 3 (3d ed. 1985); Herbert Hovenkamp, *Rationality in Law and Economics*, 60 GEO. WASH. L. REV 293, 293 (1992). This is what economists call wealth-maximization. *See* POSNER, *supra*, at 3.

With this assumption in mind, consider an example where an economically rational person wants to engage in an activity because the person will gain financially from that activity or because the person will gain a certain amount of enjoyment from the activity. This hypothetical will call that person the tortfeasor. Assume that the amount of gain to be experienced from the activity is worth ten dollars to the person. However, engaging in some activities will cause someone else to experience a loss or injury. The person experiencing the loss is the victim. Assume that the loss will cost five dollars.

Tort law will force the person who gained from the activity to compensate the person who lost. The tortfeasor will have to pay the victim five dollars. But, in this situation, the tortfeasor will engage in the activity and pay damages afterwards because the tortfeasor will experience an overall gain from the activity. In other words, the tortfeasor can compensate the victim and still profit from the wrongful activity.

Now assume that engaging in the activity will cause eleven dollars of harm to the victim. The tortfeasor will experience an overall loss in this situation. Assuming that all tortfeasors are economically rational, the tortfeasor will not engage in this conduct because the tortfeasor will experience an overall loss. In other words, the activity will not be wealth-maximizing for the tortfeasor. Economists would say that this is how tort law deters harmful activity. *See* LANDES & POSNER, *supra* note 98, at 5-6. By increasing the costs of an activity, the activity becomes "non-wealth-maximizing," thereby deterring the rational tortfeasor from engaging in the activity. For simplicity sake, this note refers to this as the "tort law's economic cues."

101. While the syntax can be confusing, the law and economics model is really nothing more than Judge Learned Hand's famous formulation of negligence in United States v. Carrol Towing Co., 159 F.2d 169, 173 (2d Cir. 1947). According to Judge Hand, the law of tort should deter harmful activities only where the cost of the harm, multiplied by its probability, is greater than the cost of preventing the harm. *Id.* *See also* RICHARD A. POSNER, TORT LAW: CASES AND ECONOMIC ANALYSIS 1-9 (1982).

102. *See* Tremper, *supra* note 9, at 426. *See also Nonprofit Enterprise, supra* note 11, at 848-54 (discussing how nonprofit corporations produce public goods); *Developments in the Law, supra* note 3, at 1692 (stating that nonprofit corporations externalize the benefit of what they produce without monetary compensation).

103. *See infra* notes 104-06 and accompanying text.

organizations are not motivated by profit, those who support the nonprofit and charitable sector argue that in response to the requirement to pay tort judgments, nonprofit organizations and charities may simply avoid risky activities altogether, rather than attempt to make the activities less risky and more profitable.[104] On the other hand, those who support the nonprofit and charitable sector argue that imposing punitive damages on nonprofit corporations and charities may not encourage these organizations to avoid risky activities at all because nonprofit organizations and charities are willing to accept the extra risk involved in working with dangerous populations and activities.[105] Finally, proponents of the nonprofit and charitable sector also argue that excessive liability could drive nonprofit corporations and charities into bankruptcy because they do not internalize their profits.[106]

These arguments fail to recognize that charities and nonprofit organizations are economically rational entities, insofar as they engage in a cost-benefit analysis when they make program decisions.[107] Charitable organizations and nonprofit corporations seek to confer the greatest benefit on society that is possible with limited resources.[108] In doing so, these organizations will choose the least costly activities so that they are able to maximize the benefits that they externalize.[109] By imposing punitive damages on nonprofit corporations and

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104. *See* Tremper, *supra* note 9, at 427. Professor Tremper reasons that because nonprofit corporations and charities are not motivated by profit, they will avoid risky activities altogether, rather than jeopardize their charitable missions. *Id.*

105. Professor Tremper gives the example of an Acquired Immuno-Deficiency Syndrome hospice as an organization that would rather assume the risk of engaging in dangerous activity than avoid liability. *See* Tremper, *supra* note 9, at 429.

106. *See* Tremper, *supra* note 9, at 427-28; *Developments in the Law, supra* note 3, at 1692; *The Quality of Mercy, supra* note 3, at 1388-89.

107. *See* Tremper, *supra* note 9, at 427-28. Professor Tremper devotes most of his article to an analysis of compensatory damages. *See id.* at 456-66. Professor Tremper also makes it clear that he is concerned with the effects of liability on charities and not nonprofit corporations generally. *Id.* However, Professor Tremper devotes a section of his article to analyzing punitive damages. *Id.* at 449. This note addresses Professor Tremper's arguments because Professor Tremper focuses not only on the nature of compensatory damages, but also suggests that compensatory damages have a deterrent function. *Id.* at 426-28. This note extends Professor Tremper's analysis to all nonprofit corporations, as well as charities, to show that both types of organizations will respond to tort law's economic cues. *See infra* text accompanying notes 108-11. Because punitive damages have a deterrent function, Professor Tremper would argue that charities will not be deterred by an award of punitive damages. *Id.* at 449. Because this note argues that charities will be deterred by punitive damage awards, this note focuses on Professor Tremper's analysis at length. *See* notes 102-28 and accompanying text.

108. *See Developments in the Law, supra* note 3, at 1694. *Cf.* PETER F. DRUCKER, MANAGING THE NONPROFIT ORGANIZATION 107-12 (1990) (arguing that nonprofit corporations should create market demand for their services).

109. There is some anecdotal evidence that suggests that charities engage in such a cost-benefit analysis when making program decisions. *See supra* note 23 and sources cited therein.

charities that engage in risky activities, the costs of those activities will increase.[110] Charities will avoid these activities to protect their limited resources and will engage in other, less risky activities that will maximize the benefits the organizations confer on society.[111] Therefore, awarding punitive damages against charities and nonprofit organizations does have a deterrent effect.

However, for the sake of argument, even assuming that awarding punitive damages against charities and nonprofit corporations will not directly affect the organizations' conduct, an award of punitive damages will have an indirect effect on the activities of these organizations.[112] The nonprofit status of organizations does not magically allow organizations to defy basic principles of economic survival.[113] Charities and nonprofit corporations, like other organizations, must generate enough profit to cover their expenditures.[114] If nonprofit organizations do not alter their behavior to avoid risky activities, the organizations will have to turn to their donors for increased contributions to cover the costs.[115] If donors perceive that nonprofit corporations and charities are using resources inefficiently by engaging in too many risky activities, donors may withdraw their contributions from the organizations that confer benefits on society inefficiently, and begin contributing to other organizations that externalize greater benefits to society at lower costs.[116] If these organizations engage in too many risky activities, such that the donors are unwilling or unable to support the liability imposed by excessive awards of punitive damages, the organizations will be forced into bankruptcy.[117] Therefore, if punitive

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110. See *supra* notes 98-101 and accompanying text for an economic analysis of the deterrent function of punitive damages.

111. For some examples of occasions when charities and nonprofit organizations choose to avoid risky activities, see *supra* note 23 and sources cited therein.

112. *See infra* notes 113-17 and accompanying text.

113. This results from basic economics: a corporation cannot remain in business for long with a negative cash flow, even if the corporation is organized as nonprofit. *See Nonprofit Enterprise, supra* note 11, at 880. *See also Developments in the Law, supra* note 3, at 1582 n.10.

114. *See supra* note 113 and sources cited therein.

115. *See, e.g.*, Tremper, *supra* note 9, at 431 (arguing that losses incurred by tort judgments will be spread among the charities' donors).

116. *See* Tremper, *supra* note 9, at 428. *See also Developments in the Law, supra* note 3, at 1584 n.26. *But cf. Nonprofit Enterprise, supra* note 11, at 846-47 (arguing that charitable donors are unable to monitor the efficiency with which charities confer benefits on society because the donor is not the beneficiary of the services provided by the charity).

117. While nonprofit corporations were once exempt from bankruptcy, *see* BANKRUPTCY ACT OF MAR. 2, 1867, ch. 176, 14 Stat. 517, they are now subject to the bankruptcy laws. *See* BANKRUPTCY ACT OF 1947, ch. 39, 61 Stat. 652, *codified at* 11 U.S.C. § 303(a) (1988). *See also Developments in the Law, supra* note 3, at 1678 (discussing the application of bankruptcy law to charitable organizations). It should also be noted that driving charities and nonprofit corporations into bankruptcy may be preferable in cases where these organizations are doing more harm than good. *See infra* notes 197-200 and accompanying text.

damages are awarded against nonprofit corporations and charities, outside forces, such as bankruptcy and donors' limited resources, will indirectly deter charities from engaging in tortious activity.

In addition, whether a nonprofit organization will respond to tort law's economic cues depends on the nature of the organization in question.[118] Private clubs and mutual benefit associations do not externalize benefits to society but, rather, exist to produce private benefits for their members.[119] Private clubs and mutual benefit associations are usually run by their members.[120] Because the members will gain all the benefit from the organization and usually control the organization, the members are similar to stockholders in the for-profit sector.[121] The controlling members are likely to control the corporation in such a way that maximizes internal benefits conferred to the members at the lowest possible cost.[122] If private clubs and mutual benefit associations engage in risky behavior causing them to be subject to punitive damage awards, either the benefits conferred on the organizations' members will decrease or the cost of membership will increase.[123] To prevent increases in dues and to prevent the reduction of benefits conferred on members, the members of these organizations will impose safeguards to avoid these risky activities.[124] Therefore, private clubs and mutual benefit associations will also

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118. *See infra* notes 119-28 and accompanying text.

119. *See Nonprofit Enterprise, supra* note 11, at 892. Professor Hansmann argues that these organizations produce services for their members, such as food, drink, and recreational facilities, in return for dues paid by the members.

120. *See, e.g.*, CAL. CORP. CODE § 5056 (West 1981); WIS. STAT. ANN. § 184.5 (West 1987). *See also Nonprofit Enterprise, supra* note 11, at 889; Ira Mark Ellman, *On Developing a Law of Nonprofit Corporations*, 1979 ARIZ. ST. L.J. 153, 154.

121. *Cf.* Bourne v. Williams, 633 S.W.2d 469, 472 (Tenn. Ct. App. 1981) ("In our modern society, corporations not for profit are widely used. Many of them . . . own, or have access to and control valuable assets that belong to its [sic] members."). *See also* Tremper, *supra* note 9, at 426 (discussing, briefly, the role of shareholders in the for-profit sector). For-profit corporations exist to maximize the wealth of shareholders who control and own the corporation. *See Id.* at 426. Like for-profit corporations, private clubs and mutual benefit associations attempt to maximize the benefits conferred upon those who control the organization, their members. *Cf. Nonprofit Enterprise, supra* note 11, at 892-93.

122. *Cf. Nonprofit Enterprise, supra* note 11, at 893 (arguing that members will control private clubs and mutual benefit associations so as to insure that the organizations do not exploit the members).

123. This follows from basic accounting principles. Expense cannot exceed revenues or a corporation will face bankruptcy. *See Nonprofit Enterprise, supra* note 11, at 838; *Developments in the Law, supra* note 3, at 1582 n.10. Punitive damage awards increase organizational expenses. To bring expenses back into equilibrium with revenues, organizations must either increase their revenue or decrease their expenditures. Private clubs and mutual benefit associations can do this by either increasing the dues charged to members, thereby increasing revenues to cover the cost of the tort judgment, or by decreasing the services that they provide, thereby decreasing expenditures.

124. *See supra* note 122 and source cited therein.

respond to the economic cues of a punitive damage award.[125]

With respect to commercial nonprofit organizations that engage in providing personal services for a price, organizations will have to raise the price of their services to cover their costs if these organizations suffer punitive damage awards as a result of engaging in tortious activity.[126] If the costs of services become too expensive, the patrons of these organizations will seek substitute services, thereby reducing the revenue of commercial nonprofit corporations.[127] Therefore, to avoid reduction in their revenues, these organizations are also likely to respond to the tort system's economic cues.[128]

B. Nonprofit Corporations and Charities Are Unable to Effectively Manage the Effects of Punitive Damage Awards

Another argument in favor of exempting nonprofit corporations and charities from punitive damage awards is that the nature of charities and nonprofit organizations prevents such organizations from implementing techniques used by the for-profit sector to manage the effects of tort judgments.[129] One such method of loss spreading used by the for-profit sector is increasing the charge for services or goods rendered.[130] Another loss

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125. For a definition of "tort law's economic cues," see *supra* notes 98-101 and accompanying text.

126. *Cf.*, Neibarger v. Universal Coops., Inc., 486 N.W.2d 612, 617 (Mich. 1992) ("Placing the burden of loss on any particular business will only result in that business raising its prices to pass these costs along to consumers."). Like any for-profit corporation, commercial nonprofit corporations can raise the prices of their goods or services in response to liability.

127. Substitute goods and services are goods and services that, although not identical to the original product or service, satisfy substantially the same needs. *See* GEORGE J. STIGLER, THE THEORY OF PRICE 31-41 (3d ed. 1966). Consumers receive a certain amount of benefit from the goods and services they purchase. *Id.* at 1-2. If the cost of a good or service becomes too high relative to the benefit to be gained from the good or service, the consumer will seek goods and services that are less expensive but meet substantially the same needs. *Id.* at 31-33.

128. For a definition and discussion of "tort law's economic cues," see *supra* notes 98-101 and accompanying text. Simply put, punitive damages raise operating expenses. In order to meet those increased operating expenses, corporations will attempt to pass the loss of a punitive damage judgment on to their consumers. But if corporations attempt to pass too much of their expenses to consumers through increased prices, consumers will seek substitute goods when the costs outweigh the benefits of the goods or services. *See supra* note 127. Therefore, corporations must avoid incurring too many losses due to tort judgments because they cannot pass all of the costs of tort judgments to their consumers.

129. *See* Tremper, *supra* note 9, at 428-33. Professor Tremper discusses both insurance and raising prices as loss spreading techniques used by the for-profit sector to spread the loss incurred by tort judgments. *Id.*

130. *See, e.g.*, Beshada v. Johns-Manville Sales Corp., 447 A.2d 539, 547 (N.J. 1982) ("[Corporations] can insure against liability and incorporate the cost of the insurance in the price of the product.").

spreading technique used by the for-profit sector is insurance.[131] The next section of this Note discusses the viability of these loss spreading techniques in the nonprofit and charitable sector.[132]

1. Loss Spreading Through Increased Prices

Those who advocate exempting nonprofit organizations and charities from punitive damage awards argue that nonprofit organizations and charities cannot spread the loss incurred from an award of punitive damages by increasing the cost of the services they provide.[133] Proponents of nonprofit organizations and charities argue that nonprofit organizations and charities are unable to manage the effect of punitive damage awards because nonprofit organizations and charities do not charge a price for their services and often serve indigent populations; therefore, they are unable to pass the cost of the punitive damage award along to their "consumers."[134] This inability to spread the loss through increasing charges for goods or services may be a justification for exempting charities and nonprofit organizations from punitive damage awards.[135]

However, although charities may not be able to increase the prices of the services they provide, or may not charge any price at all for their services, charities can spread the loss incurred by a tort judgment by soliciting increased donations.[136] In other words, charities may not be able to increase their prices because they often serve indigent populations, but charities can request increased donations from their donors.[137] Thus, the real issue is not whether charities can spread the loss to the customers, but rather whether such a loss spreading practice would punish innocent donors.[138]

In addition, the nature of the nonprofit organization also affects the organization's ability to pass along the cost of the punitive damage award.[139]

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131. *See, e.g.*, KEETON ET AL., *supra* note 2, § 4, at 24-25.

132. *See infra* notes 133-72 and accompanying text.

133. *See* Tremper, *supra* note 9, at 430-31. Professor Tremper argues that while charities cannot spread the loss incurred by a tort judgment, commercial nonprofit corporations can adequately spread the loss. *Id.* However, this note argues that charities can also spread the loss by asking for increased donations from donors. *See infra* notes 136-38 and accompanying text.

134. *See* Tremper, *supra* note 9, at 430-31.

135. *Id.*

136. *See The Quality of Mercy*, *supra* note 3, at 1391. *Cf.* Tremper, *supra* note 9, at 431; Fagin, *supra* note 22, at 378 (recognizing that charities can demand increased donations from donors in response to liability, but arguing that such demands punish donors).

137. *See* Tremper, *supra* note 9, at 431; *The Quality of Mercy*, *supra* note 3, at 1391.

138. For a discussion of whether demands for increased donations have the effect of punishing innocent donors, see *infra* notes 173-200 and accompanying text.

139. *See infra* notes 140-45 and accompanying text.

Private clubs and mutual benefit associations can pass on the increased costs of operation resulting from a punitive damage award to the organizations' members.[140] Such organizations usually require dues for membership, and their members are often relatively affluent.[141] Members will either bear the increased cost of membership, or find organizations that can provide substitute services at a lower cost.[142] Thus, because private clubs and mutual benefit associations can pass along the costs of punitive damage awards to their members, such organizations should be subject to the same tort damage rules as for-profit corporations.

Moreover, those organizations that engage in the sale of services or other commercial activities are able to spread the loss by merely increasing the prices they charge for the goods or services that they provide.[143] Like any for-profit corporation, commercial nonprofit corporations may increase the price of their services in order to spread the loss incurred by a punitive damages award.[144] Thus, nonprofit organizations that engage in commercial activities should be subject to the same tort damage rules as for-profit corporations because commercial nonprofit organizations can spread the loss of tort judgments through increased prices in the same manner as for-profit organizations.[145]

2. Loss Spreading Through Insurance

Commentators also argue that the nature of the services performed by nonprofit organizations and charities puts them at a disadvantage in obtaining insurance.[146] Insurers loathe extending insurance coverage to nonprofit organizations and charities because such organizations are often deemed by

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140. *Cf. Nonprofit Enterprise, supra* note 11, at 892-93 (stating that private clubs and mutual benefit associations are like for-profit corporations in that they provide services to their members in return for a price).

141. *Id.*

142. For a definition of substitute goods and services, see *supra* note 127.

143. *See infra* notes 144-45 and accompanying text.

144. *Cf., e.g.*, Escola v. Coca Cola Bottling Co., 150 P.2d 436, 441 (Cal. 1944) (Traynor, J., concurring) ("[T]he risk of injury can be insured by the manufacturer and distributed among the public as a cost of doing business.").

145. *See* Tremper, *supra* note 9, at 464 (recognizing that nonprofit corporations that engage in commercial activities can spread the loss incurred by tort judgments). Even when the doctrine of complete charitable immunity was in full force, some jurisdictions recognized exceptions to immunity where charities were engaged in commercial activities, reasoning that they could adequately spread the loss. *See, e.g.*, Morton v. Savannah Hosp., 96 S.E. 887, 888 (Ga. 1918); Lincoln Memorial Univ. v. Sutton, 43 S.W.2d 195, 196 (Tenn. 1931).

146. Insurers typically complain about the use of volunteers in the nonprofit sector. *See* Singsen, *supra* note 13, at 608-09. Singsen argues that nonprofit organizations often work with "dangerous" populations, such as children and the disabled. *Id. See also* Tremper, *supra* note 9, at 429-30; *Developments in the Law, supra* note 3, at 1690.

insurance companies to engage in overly risky activities.[147] Moreover, recent trends in the insurance industry, such as increased premiums[148] and reduced coverage,[149] greatly restrict the organizations' ability to obtain insurance that will completely cover losses incurred by tort judgments.[150] This raises the argument that nonprofit organizations and charities should be exempt from punitive damage awards because they are unable to spread the loss of a tort judgment by obtaining insurance.[151]

However, proponents of this argument again fail to make distinctions between nonprofit organizations and charities.[152] Non-traditional nonprofit organizations, such as private clubs, mutual benefit associations, and commercial organizations that engage in the sale of personal services, do not typically deal with dangerous populations, nor do they engage in the types of risky activities that lead insurers to deny coverage.[153] Rather, these organizations engage in the production of a private benefit for their members and consumers.[154] These organizations should be able to obtain insurance as easily as any for-profit corporation.[155]

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147. *See supra* note 146 and sources cited therein. Even when insurers will extend coverage to high risk organizations, the premiums charged for the insurance coverage are usually extremely high. *See* Ralph Nader, *Loss Prevention and the Insurance Function*, 21 SUFFOLK U. L. REV. 679, 680-81 (1987).

148. For a definition of premiums, see *supra* note 13.

149. For a definition of coverage, see *supra* note 13.

150. For a discussion of recent trends in the insurance market causing increased premiums and reduced coverage, see *supra* note 13 and sources cited therein. *See also* Tremper, *supra* note 9, at 429-30; *Developments in the Law*, *supra* note 3, at 1690; *Contra, The Quality of Mercy*, *supra* note 3, at 1395-96 (arguing that favorable insurance regulations will enable charities and nonprofit corporations to obtain insurance).

151. *See* Tremper, *supra* note 9, at 429. *See also Developments in the Law*, *supra* note 3, at 1690 (arguing that, although states have passed protective regulations to enable nonprofit corporations to obtain insurance, because of "gaps" in the laws, nonprofit corporations are still unable to obtain insurance, and "liability concerns" remain).

152. *See infra* notes 153-72 and accompanying text.

153. These commercial nonprofit corporations engage in the sale of goods and services to those who can afford them. *See Evolving Law*, *supra* note 11, at 813. The risks involved in selling goods and services differ significantly from the risks engaged in by charities, such as working with disabled and indigent populations.

154. For a discussion of how commercial nonprofit corporations, mutual benefit associations, and private clubs produce private benefits, see *supra* notes 119 and 153.

155. There is no guarantee that commercial nonprofit organizations will in fact be able to obtain insurance. Even for-profit corporations have experienced difficulty in obtaining insurance. *See* George L. Priest, *The Current Insurance Crisis and Modern Tort Law*, 96 YALE L.J. 1521, 1521-22 (1987) (reporting that insurers have raised premiums on, *inter alia*, commercial trucking, general aircraft, and day care activities). But if commercial nonprofit organizations cannot obtain liability insurance, they can always spread the loss of a tort judgment by raising their prices. *See supra* notes 143-45 and accompanying text.

Traditional charities, on the other hand, deal with populations that tend to lead insurers to deny or restrict coverage.[156] Some states, though, have enacted recent legislation and administrative regulations that will aid charities in obtaining affordable insurance.[157] Some states have prohibited mid-term policy cancellations[158] and premium increases.[159] Other states have developed Market Assistance Programs[160] and Joint Underwriting Authorities.[161] While this legislative activity is intended to benefit insurance policy holders generally, charities should also find it easier to obtain insurance as a result of this legislation.[162] Therefore, because charities will be able to obtain affordable, reliable insurance, they will be better able to spread the loss incurred

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156. For a discussion of the activities that charities tend to engage in that insurers deem too risky to insure, see *supra* note 146.

157. These statutes and administrative regulations are compiled in Brenda Trolin, *Controlling Liability Insurance Costs: State Initiatives in the Area of Insurance Regulation*, 11 STATE LEGIS. REP., May 1986 (Denver, Colorado).

158. *Id.* at Chart B. Insurance contracts usually specify several grounds for the termination of coverage. *See* ROBERT E. KEETON & ALAN I. WIDISS, INSURANCE LAW, A GUIDE TO FUNDAMENTAL PRINCIPLES, LEGAL DOCTRINES, AND COMMERCIAL PRACTICES § 5.11(a), at 601 (1988). A term insurance policy is one that provides coverage for a specified period of time but is usually renewable at the end of the period. BLACK'S LAW DICTIONARY 806 (6th ed. 1990). A mid-term policy cancellation, therefore, is the exercise of a contractual right of an insurer to cancel a policy of insurance before the end of the specified coverage period. *See* KEETON & WIDISS, *supra*, § 5.11(a), at 601. The statutes and administrative regulations, listed in Trolin, *supra* note 157, at Chart B, either prohibit the exercise of this right or prohibit the insertion of such a provision into an insurance contract.

159. *See* Trolin, *supra* note 157, at Chart 2. For a definition of premiums, see *supra* note 13.

160. By 1986, 33 states had enacted Marketing Assistance Programs [MAPs]. *See* Singsen, *supra* note 13, at 609 n.64. *See, e.g.*, CAL. INS. CODE § 11890(a) (West 1988). *See also The Quality of Mercy, supra* note 3, at 1397.

"MAPs are voluntary pools of insurers that agree to provide insurance for the designated risk group." Singsen, *supra* note 13, at 609. *See also The Quality of Mercy, supra* note 3, at 1397. Under MAPs, the state can also order insurers to reevaluate organizations that have been denied coverage and to explain why the organizations were denied coverage. *See The Quality of Mercy, supra* note 3, at 1397 n.98.

161. *See, e.g.*, CAL. INS. CODE § 11891(a) (West 1988). Under Joint Underwriting Authorities [JUAs], state insurers are required to offer policies to certain lines of businesses, including charities. *See The Quality of Mercy, supra* note 3, at 1397 n.98. For a more in depth discussion of JUAs, see Singsen, *supra* note 13, at 609-10.

162. *See The Quality of Mercy, supra* note 3, at 1397. Because of the insurance regulations discussed at *supra* notes 157-62 and accompanying text, insurance is presumably made more reliable, more available, and less expensive. Charities, even though they present higher than average risks, should be better able to obtain insurance in the favorable market created by this legislation. *See The Quality of Mercy, supra* note 3, at 1397. But even if this assumption is false, charities can self-insure by employing the methods, such as risk pooling and group purchasing, discussed at *infra* notes 164-72 and accompanying text.

by a tort judgment.[163]

In addition, other methods of risk management, such as risk pooling, would allow charities to protect themselves against punitive damage awards.[164] By forming their own insurance pool, charities will not have to rely on the commercial market for insurance.[165] Similarly, charities could increase their ability to obtain insurance through group purchasing.[166] Through group purchasing, charities could obtain more favorable rates and better coverage.[167]

In addition, charities could implement better risk management, which should increase their ability to obtain insurance.[168] Risk management, which decreases the likelihood of a loss, makes an organization more attractive to insurers.[169] Some examples of risk management techniques that charities could employ are: improved employee and volunteer selection criteria, better employee and volunteer training programs, and improved employee and volunteer supervision programs.[170]

Because various techniques are available to allow charities to obtain insurance and because there are insurance "substitutes" available to charities, the lack of available insurance for charities is exaggerated.[171] Charities can spread the loss of a punitive damage award by obtaining insurance through group

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163. There is no guarantee that charities will in fact be able to obtain insurance. But again, charities can use the other methods to spread the loss of a tort judgment if the commercial insurance market fails to provide adequate insurance options. *See infra* notes 164-72 and accompanying text.

164. Although the technical aspects of risk pooling are beyond the scope of this note, the general idea is that a group of charities agree to put some of their assets into a fund that is used to pay for losses incurred by all the charities in the fund. *See The Quality of Mercy, supra* note 3, at 1396. For a more in depth discussion of risk pooling, see Singsen, *supra* note 13, at 612-14.

165. *See The Quality of Mercy, supra* note 3, at 1396.

166. By negotiating as a group with an insurance company, the group can use its numbers and assets as leverage in obtaining more favorable policy terms. *See* Singsen, *supra* note 13, at 611-12; *The Quality of Mercy, supra* note 3, at 1397. Although such group purchasing has traditionally been limited to life and health insurance, Congress has enacted legislation designed to encourage broader group purchasing practices. *See* 15 U.S.C. § 3901-3906 (1988). *See also* Singsen, *supra* note 13, at 611-12.

167. Group purchasing occurs when a group of organizations negotiates with a single insurer under a "master agreement" of insurance covering all of the organizations in the group. *See* Singsen, *supra* note 13, at 611; *The Quality of Mercy, supra* note 3, at 1396.

168. *See The Quality of Mercy, supra* note 3, at 1397.

169. *See* C. ARTHUR WILLIAMS, JR. & RICHARD M. HEINS, RISK MANAGEMENT AND INSURANCE 200 (6th ed. 1989); Singsen, *supra* note 13, at 610-11.

170. *See* Jefferey D. Kahn, *Organization's Liability for Torts of Volunteers*, 133 U. PA. L. REV. 1433, 1449-50 (1985).

171. *See supra* notes 157-70 and accompanying text.

purchasing, risk pooling or risk management.[172] Therefore, concerns about the ability of charities to spread the loss of punitive damage awards are overstated.

C. *An Award of Punitive Damages Punishes Innocent Charitable Donors, Thereby Deterring Charitable Donations*

Those who advocate exempting charities and nonprofit organizations from punitive damage awards also argue that awarding punitive damages against nonprofit organizations and charities may not deter tortious conduct by these organizations if the punitive damage awards punish the innocent donors rather than the organizations.[173] Those who support this argument further assert that donors may cease to make contributions to charities if the punitive damage award punishes the innocent donors rather than the charities and nonprofit corporations.[174] Although there is no empirical data to support the contention that awarding punitive damages against a charity deters charitable donations, proponents of this argument further assert that any reduction in charitable donations will directly result in a reduction in the amount of public benefits that charities and nonprofit corporations will be able to produce.[175] Proponents of the argument that awarding punitive damages against charities and nonprofit organizations punishes innocent donors have made an analogy to municipal immunity and have argued that such an award also frustrates the intent of charitable donors.[176] The following sections will address each of these arguments separately.[177]

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172. Although there is some disagreement among the states as to whether liability insurance covers punitive damage claims, the issue is usually determined as a matter of contract between the insurer and the insured. *See* JOHN W. MORRISON, THE INSURABILITY OF PUNITIVE DAMAGES 3-4 (1985). Charities can insure against punitive damages by bargaining for coverage. Although such coverage is likely to be expensive, charities could use measures such as group purchasing to reduce the costs of insuring against such losses. *See supra* notes 164-70 and accompanying text.

173. *See* Tremper, *supra* note 9, at 431; Fagin, *supra* note 22, at 387-88; *Developments in the Law, supra* note 3, at 1692; McMenamin, *supra* note 65, at 17. The general idea presented by these authors is that punishing the donors is not justified if they are not responsible for the tortious conduct of the charities or nonprofit corporations. *See, e.g.*, Tremper, *supra* note 9, at 431. If the donors are not responsible for the tortious conduct, punishing the donors will have no deterrent effect. *See, e.g.*, Fagin, *supra* note 22, at 378 n.9.

174. *See* Tremper, *supra* note 9, at 431; *Developments in the Law, supra* note 3, at 1692; McMenamin, *supra* note 65, at 17.

175. *See* Tremper, *supra* note 9, at 431. *See also Developments in the Law, supra* note 3, at 1692 (arguing that the threat of liability has, in the past, caused donors and volunteers to stop donating their time and money).

176. *See infra* notes 178-82 and accompanying text.

177. *See infra* notes 178-200 and accompanying text.

1. Immunity of Municipal Governments

Arguing that punitive damage awards against nonprofit organizations and charities punish innocent donors, commentators have analogized charities and nonprofit organizations to municipal governments.[178] Various cases and statutes reason that municipal governments should be exempt from punitive damage awards.[179] Courts and legislatures have argued that the goals of punitive damages are not advanced when innocent taxpayers are made to pay the costs of such an award.[180] In other words, courts and legislatures have recognized that the municipality is likely to pass the cost of the punitive damage award to the taxpayers in the form of increased taxes, thereby punishing the innocent taxpayer rather than the municipality.[181] By analogy, proponents of nonprofit organizations and charities argue that nonprofit organizations and charities may attempt to pass the cost of a punitive damage award to innocent donors in the same way that a municipality would pass the cost of a punitive damage award to its innocent taxpayers.[182]

However, the analogy between the unfairness of punishing innocent taxpayers and the unfairness of punishing innocent donors fails to consider the differences between various types of nonprofit organizations.[183] For example, in cases involving private clubs and mutual benefit associations, those who make donations to the clubs and associations are also members of the clubs and associations.[184] Because the "donors" are also members, the donors are able to control the clubs and associations through participation in the organization's decisionmaking bodies.[185] Although imposing punitive damages on these

178. *See, e.g.*, Fagin, *supra* note 22, at 380-83 (analogizing nonprofit corporations to municipal governments).

179. *See infra* note 180 and sources cited therein.

180. *See, e.g.*, CAL. GOV'T CODE § 818 (West 1980); MINN. STAT. ANN. § 466.04 (West 1994); Newport v. Facts Concerts, Inc., 453 U.S. 247, 267 (1981) (interpreting 42 U.S.C. § 1983 (1988)).

181. *Facts Concerts*, 453 U.S. at 267. In *Facts Concerts*, the Court held that Congress did not intend for plaintiffs to be able to obtain punitive damages against municipalities in actions brought under 42 U.S.C. § 1983. *Id.* at 271. Although the Court recognized that municipalities were generally treated like corporations, the Court stated that awarding punitive damages against municipalities would be contrary to public policy "because such awards would burden the very taxpayers and citizens for whose benefit the wrongdoer was being chastised." *Id.* at 263.

182. *See, e.g*, Fagin, *supra* note 22, at 380-83 (analogizing nonprofit corporations to municipalities).

183. *See infra* notes 184-200 and accompanying text.

184. *See Nonprofit Enterprise, supra* note 11, at 892.

185. Professor Hansmann, in *Evolving Law, supra* note 11, at 892, explains that these organizations provide services to their patrons, such as food, drink, and recreational facilities. *Id.* Because the patrons are also members of the organization and exercise control over the organization's affairs, they can make sure that they are never exploited by the organizations. *Id.* at 893.

organizations might be said to have a punishing effect on these organizations' "donors" in the form of either decreased services or increased dues,[186] punishing "donors" in the case of clubs and associations would be preferable because donors would be motivated and able to control the organization in such a way that avoids increases in dues and decreases in services.[187] In other words, even if awarding punitive damages against mutual benefit associations and private clubs actually punishes these organizations' "donors," it is not unfair to punish these donors because they will be able to prevent the respective organization from committing future torts.

In addition, with respect to commercial nonprofit organizations, the analogy between punishing innocent taxpayers and punishing innocent "donors" becomes even weaker.[188] If commercial nonprofit organizations are to pass the costs of punitive damages to their "donors," they will have to do so in the form of increased prices.[189] As in private markets, if the products marketed by commercial nonprofit corporations become so expensive that they are not wealth-maximizing, consumers will look elsewhere for substitute goods to satisfy their needs.[190] Therefore, the punitive damage award will not have any punitive effect on the donors because the donors will merely seek replacement goods and services elsewhere if the cost of the goods and services provided by the commercial nonprofit organization becomes exorbitant or economically inefficient.[191]

Finally, with respect to traditional charities, it should first be noted that awarding punitive damage awards against traditional charities may not deter

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186. Again, expenses cannot exceed revenues or a corporation will face bankruptcy. *See Developments in the Law, supra* note 3, at 1582 n.10; *Nonprofit Enterprise, supra* note 11, at 880. To bring expenses back into equilibrium with revenues after a punitive damage award, private clubs and mutual benefit associations can either increase the dues charged to members, or decrease the services that they provide, thereby decreasing expenditures.

187. *Cf. Nonprofit Enterprise, supra* note 11, at 893 (arguing that members of private clubs and mutual benefit associations will control these organizations in such a way as to prevent exploitation of the members).

188. *See infra* notes 189-91 and accompanying text.

189. *See, e.g.*, Neibarger v. Universal Cooperatives, 486 N.W.2d 612, 626 (Mich. 1992) (reasoning that commercial organizations pass the cost of tort judgments to consumers by increasing the prices of the goods and services that they produce).

190. For a definition of substitute goods and a discussion of how substitute goods operate as a constraint on the marketing behavior of nonprofit corporations, see *supra* note 127.

191. If commercial nonprofit corporations attempt to pass the costs of successive tort judgments to consumers, the prices of their goods and services will, at some point, become prohibitively expensive for consumers. Consumers will then turn to other producers, whether they be nonprofit or for-profit, for substitute goods and services. *See generally* STIGLER, *supra* note 127. This will result in a reduction of the tortfeasor-nonprofit corporation's revenue. Therefore, commercial nonprofit corporations will be motivated to avoid harmful conduct in order to maintain the prices of their goods at an affordable level.

donors from making charitable contributions at all.[192] While traditional charities, like municipalities, will no doubt attempt to pass along the cost of a punitive damage award to donors in the form of requests for increased donations,[193] it is difficult to see how the charitable donor would feel punished by such action. The charitable donor, unlike the taxpayer, is free to make increased contributions and may refuse to meet the charity's demands for increased contributions.[194] Because donors are free to refuse to meet the demands for increased donations, an attempt by charities to pass the costs of a tort judgment to donors will not have a punitive effect on the donors.

However, in the case of traditional charities, assuming that an award of punitive damages against charities punishes the charitable donors, donors may be deterred from making future charitable contributions.[195] If charitable contributions are reduced, the ability of charities to produce social benefits will similarly be reduced since charities will simply lack sufficient funding to continue operations.[196] Yet in some situations, it may be preferable to deter charitable donations.[197] Some charities may produce more social harm than social benefit, and in such cases, there is no reason why these charities should not be deprived of their ability to operate by punishing donors, thereby striking at their assets and revenue generating ability.[198] If punitive damages in fact

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192. *See infra* notes 193-94 and accompanying text.

193. *See supra* note 182 and accompanying text.

194. A taxpayer is required, under threat of fine and imprisonment, to pay personal income taxes. *See, e.g.*, I.R.C. § 7201 (1988) (providing for criminal sanctions for federal tax evasion). While charitable donors may feel morally obligated to make contributions to charity, donors are not threatened with dire consequences if they refuse to give to charity.

195. *See* Tremper, *supra* note 9, at 431. *See also Developments in the Law, supra* note 3, at 1692 (stating that the threat of liability has, in the past, dissuaded donors from giving their resources to charities and nonprofit corporations).

196. *See, e.g,* Cook v. John N. Morton Memorial Infirmary, 202 S.W. 874, 876 (Ky. 1918) (opining that if charities were liable in tort, donors would withhold donations, resulting in the destruction of the charitable sector). *See also* Tremper, *supra* note 9, at 431; *Developments in the Law, supra* note 3, at 1690.

197. *See infra* notes 198-200 and accompanying text.

198. *See Developments in the Law, supra* note 3, at 1693; *The Quality of Mercy, supra* note 3, at 1388-91. While it is difficult to define social benefits absent political and socio-economic value laden judgment, *see infra* notes 292-94, an overly simplified example may illustrate this point. Assume, for example, that a charity provides a service worth 10 dollars, including the reduction in transaction costs that results from the charitable sector, rather than the government, producing the service. Also assume that the charity is very accident prone and causes 11 dollars worth of injury for each 10 dollars worth of services it produces. Thus, while the charity has produced social benefits, however one chooses to define that term, the charity has produced that service at a net loss to society.

Yet, while the charity is producing a net loss, the charity may be able to remain in business because donors are either unable or unwilling to monitor the efficiency of the charity. Therefore, assuming that awarding punitive damages against charities does deter charitable donations, a point which this note does not concede lightly, this result may be preferable when a charity is

deter donors from making charitable donations, then such an award against charities would be an effective way to prevent socially harmful charities from generating operating revenue.[199] Charities that do more harm than good would be unable to obtain funding for their activities and would be driven out of business.[200]

2. Awarding Punitive Damages Against Charities and Nonprofits Frustrates the Intent of Donors

Assuming that charitable donations are made with the expectation that the donation will be used to produce some social benefit, commentators have argued that, if charitable donations are diverted from producing public benefit and used instead to satisfy tort judgments, the intent of the donors will be frustrated.[201] Based on this reasoning, commentators conclude that punitive damages should not be awarded against nonprofit corporations and charities because doing so will frustrate the intent of the donors.[202] Therefore, commentators argue, if the intent of charitable donors is frustrated, donors will discontinue charitable donations.[203]

Again, however, this argument ignores the distinctions between traditional charities and modern-day nonprofit corporations.[204] For example, with respect to commercial nonprofit organizations that engage in the sale of goods and personal services, "donors" do not intend that their donations be used to produce public benefits.[205] Rather, "donors" intend to receive personal benefits from

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economically inefficient or when a charity produces more harm than good. However, deterring only those charities that produce more harm than good presents significant difficulties because there is no accurate measure to determine how much "public good" charities are producing. *See infra* notes 224-26 and accompanying text.

199. Charities are usually supported by donations. *See supra* note 11 and sources cited therein. Because donations are usually a charity's only source of revenue, deterring donations would halt the charitable sector's flow of income.

200. *Cf. supra* note 63 and sources cited therein.

201. *See, e.g.*, Parks v. Northwestern Univ., 75 N.E. 991, 993 (Ill. 1905):

> An institution . . . doing charitable work of great benefit to the public without profit . . . is not to be hampered in the acquisition of property and funds from [donors] by any doubt that might arise in the minds of such intending donors as to whether the funds supplied by them will be applied to the purposes for which they intended to devote them, or diverted to the entirely different purpose of satisfying [tort] judgments . . . .

Id. at 993. *See also Developments in the Law, supra* note 3, at 1692.

202. *Cf.* Tremper, *supra* note 9, at 431 (arguing that holding charities fully liable in tort will burden donors with requests for increased donations).

203. *Id.*

204. *See infra* notes 205-26 and accompanying text.

205. *See infra* note 206 and sources cited therein.

the goods and services that they purchase.[206] Although imposing punitive damages against these commercial nonprofit organizations may increase the price of the services provided by these organizations, the increase in price will not affect the benefit that the "donors" receive from the goods or services purchased.[207] In other words, those who make "donations" to commercial nonprofit corporations are simply ambivalent as to whether the price they pay for goods and services is used to pay a punitive damage judgment.

On the other hand, with respect to private clubs and mutual benefit associations, awarding punitive damages against these organizations would probably frustrate the intent of the "donors" of such clubs and associations.[208] Again, noting that members and "donors" of such clubs are usually one in the same,[209] typical club members rarely intend their dues to be expended to pay tort judgments.[210] However, even if the "donors'" intent is frustrated by a punitive damage award against such clubs and associations, frustrating the intent of "donors" may be preferable to immunity with respect to organizations that produce only private benefits.[211] In these organizations, "donors" are usually in a position to both control the organization's activities and prevent future harm from occurring.[212] If awarding punitive damages against these organizations punishes "donors" by causing their dues or fees to be diverted to pay tort judgments, rather than being applied to produce better goods and services for members of the clubs and associations, the "donors" will be both motivated and willing to alter the conduct of these organizations so as to prevent the organization from engaging in tortious conduct in the future.[213]

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206. Some examples of commercial nonprofit corporations that provide services at a cost are daycare centers, residential nursing care institutions, and hospitals. *See Nonprofit Enterprise, supra* note 11, at 863-66. A patient at a nonprofit hospital is, in a way, a donor to a nonprofit organization. The patient will make a monetary "contribution" to the hospital, but the patient expects a benefit (i.e. medical treatment) in return for the "contribution." By contrast, when a donor makes a contribution to a traditional charity, such as the American Red Cross, the donor expects no benefit in return except that the Red Cross use the contribution for the benefit of others. *See generally Nonprofit Enterprise, supra* note 11.

207. Again using Professor Hansmann's example in *Evolving Law, supra* note 11, at 813, a patient at a nonprofit hospital receives medical services for a price. *Id.* Awarding punitive damages against the hospital will arguably affect the cost of the medical services, but the patient will receive the same benefit from a "contribution."

208. *See infra* notes 209-13 and accompanying text.

209. *See supra* note 120 and accompanying text.

210. Rather, members intend to receive services in return for their dues. *See Nonprofit Enterprise, supra* note 11, at 892.

211. *See infra* notes 212-13 and accompanying text for a discussion of why it may be preferable to punish members of private clubs and mutual benefit associations by imposing punitive damages on the organizations to which they belong.

212. *See supra* note 185 and sources cited therein.

213. *See, e.g., Nonprofit Enterprise, supra* note 11, at 893 (arguing that members will control the organization in such a way as to prevent exploitation of the members).

However, in the case of traditional charities, whether imposing punitive damage awards on traditional charities would frustrate the donors' intent by diverting donations from producing public good to paying tort judgments depends on whether the donors ever intended the charity to use the donation for the public benefit.[214] On one hand, charitable donors may give resources to charities intending that the resources be used for the benefit of others in society.[215] If donors perceive that the resources are used to pay tort judgments and are not used for the public benefit, donors arguably will discontinue contributions.[216] In that case, the charitable sector's ability to produce social benefits would be reduced or destroyed.

On the other hand, it is unclear what motivates charitable donors, and the donor's motivation in giving is central to a determination of whether awarding punitive damages against charities will deter future charitable donations to traditional charities.[217] For example, instead of a desire to produce public benefits, donors may be motivated by the tax incentives given to charitable donors.[218] If donors contribute to charitable organizations because of tax incentives, it is unlikely that donors will be deterred by an award of punitive damages against charities, because the donor will receive a "tax break" regardless of whether charities use the donations for the public good or to pay punitive damage judgments.[219] In addition, there are many other self-centered interests that may cause one to give to charities, including social climbing, guilt, or self-aggrandizement.[220] Similar to donating for purposes of receiving a "tax break," if donors contribute for some self-centered purpose, it is unlikely that donors will be deterred by an award of punitive damages against charities, because donors will receive the expected benefit from their donations regardless of whether charities use the donations for the public good or to pay punitive damages judgments.

Moreover, deterring donations to charities may be preferable in some

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214. *See infra* notes 215-20 and accompanying text.

215. *See* I.R.C. § 170 (1988) (providing that contributions to charitable organizations are exempt from personal income taxation). *See also* Joseph V. Sliskovich, *Charitable Contributions or Gifts: A Contemporaneous Look Back to the Future*, 57 U.M.K.C. L. REV. 437, 437 (1989); Edward M. Fjordbak, *Philanthropy at the Crossroads*, 125 TR. AND EST., Aug. 1986, at 25, 27.

216. *See Developments in the Law, supra* note 3, at 1692.

217. For some conjecture as to the motivation behind charitable donations, see *infra* notes 218-20 and accompanying text.

218. *See* I.R.C. § 170 (1988). *See also* KLIEN & BANKMAN, *supra* note 45, at 490-92, 498 n.2.

219. Contributions to charities, as defined in the Internal Revenue Code, are deductible from personal income taxation regardless of how the charity spends the contribution. *See* I.R.C. § 170 (1988).

220. *See* Fjordbak, *supra* note 215, at 27.

circumstances.[221] If charities are producing more harm than good, it would be preferable to award punitive damages against those charities, while exempting other charities that produce more social good than harm.[222] Such a rule would deter donations to only "harmful" charities.[223] However, the difficulty with such a rule is that it is unworkable in practice.[224] How to measure "public good" and how to determine what constitutes public good involve value laden judgments that may allow for discrimination against less popular and less politically powerful charities.[225] Therefore, a rule that treats all charities equally, regardless of the amount of "public good" they produce, is preferable to avoid the practical problems of administering a rule that requires a determination of what constitutes a public good.[226]

D. An Award of Punitive Damages Against Nonprofits and Charities Punishes Innocent Beneficiaries

Those who support charities and nonprofit organizations also argue that awarding punitive damages against nonprofit organizations and charities may punish innocent beneficiaries.[227] The argument is that such an award prevents nonprofit corporations and charities from producing benefits for their intended beneficiaries, thereby depriving the beneficiaries of the benefit they would have received had the nonprofit organizations and charities not been liable.[228] Further, these advocates argue that punishing the beneficiaries is not justifiable because the beneficiaries are not responsible for harm caused by the charities, and, therefore, they are not culpable.[229]

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221. *See infra* notes 222-26 and accompanying text.

222. *See Development in the Law, supra* note 3, at 1693.

223. *Id.* The author of *Developments in the Law, supra* note 3, at 1693, proposes a plan of government subsidization for charities that produce more public good than harm. *Id.* at 1693-96. This proposal will be discussed in more detail at *infra* notes 313-43 and accompanying text.

224. See *infra* notes 225-26 and accompanying text for a discussion of the difficulties inherent in determining which charities produce more harm than good.

225. *See Developments in the Law, supra* note 3, at 1694-96.

226. This note proposes a plan that would treat charities equally with respect to liability for punitive damages. *See infra* notes 319-43 and accompanying text. This note recognizes that awarding punitive damages may have negative effects on the charitable sector, such as deterring charitable work and punishing innocent beneficiaries. *See infra* notes 241-44 and accompanying text. However, these negative effects must be balanced against the law's desire to prevent future harms by imposing punitive damages on tortfeasors. *See infra* notes 318-19 and accompanying text.

227. *See* Tremper, *supra* note 9, at 431-32; *see also* Fagin, *supra* note 22, at 389-90 (arguing that imposing punitive damages on nonprofit corporations punishes innocent beneficiaries and members of these organizations).

228. *See* Tremper, *supra* note 9, at 431 ("[T]he impact of tort liability falls most directly upon beneficiaries who would have received services but for the liability-related expenses of a charitable organization.").

229. *See* Fagin, *supra* note 22, at 378. *But see The Quality of Mercy, supra* note 3, at 1391 (arguing that society should shift the cost of harm to the beneficiaries of charities).

Again, it should be noted that this argument is directed at traditional charities, rather than modern day nonprofit corporations.[230] Commercial nonprofit corporations will attempt to pass the costs of a punitive damage award to their consumers by raising their prices in response to liability.[231] However, consumers do not have to pay these increased prices and can seek substitute services to satisfy their needs.[232] Because consumers possess this freedom, the increased prices really have no punitive effect on the "beneficiaries" of these commercial nonprofit corporations.[233]

With respect to mutual benefit organizations or private clubs, awarding punitive damages against such organizations may in fact have a punitive effect on the beneficiaries of these organizations.[234] Again, in the case of private clubs and mutual benefit organizations, the members are usually both "donors" and "beneficiaries" of the organization.[235] Because the members will have made donations to the organization, they will be deprived of the benefit they would have received from that donation had the organization not been subjected to a punitive damage award.[236]

However, such a punishing effect on the beneficiaries may be preferable in the case of private clubs and mutual benefit associations.[237] If private clubs and mutual benefit associations are liable for punitive damage awards, the beneficiaries, who are also members, will be punished through increased dues or decreased services.[238] In order to avoid increased dues and decreased services, the members will be motivated to control these organizations to avoid

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230. *See infra* notes 231-33 and accompanying text.

231. Again, nonprofit corporations, like for-profit corporations, cannot defy the laws of economics: corporate expenses cannot exceed revenues. *See Nonprofit Enterprise, supra* note 11, at 880; *Developments in the Law, supra* note 3, at 1582 n.10. Punitive damage awards against a corporation increase operating expenses. To meet those increased expenses, corporations will increase the price of the goods or services they produce.

232. For a definition of substitute goods and services, see *supra* note 127. For an explanation of how substitute goods operate as a constraint on marketing behavior in the nonprofit sector, see *supra* note 128.

233. See *supra* note 127 for a discussion of how consumers will seek substitute goods and services to satisfy their needs.

234. *See* Fagin, *supra* note 22, at 378.

235. *See Nonprofit Enterprise, supra* note 11, at 892-93.

236. *See* Fagin, *supra* note 22, at 378 n.9, 389-90.

237. For a discussion of why it may be preferable to punish and deter members of private clubs and mutual benefit associations by imposing punitive damages on the organizations, see *supra* notes 212-13 and accompanying text.

238. Again, this is a result of basic economics: revenues must be greater than expenses. *See Nonprofit Enterprise, supra* note 11, at 880. *See also Developments in the Law, supra* note 3, at 1582 n.10. Because a punitive damage award increases operating expenses, private clubs and mutual benefit associations will have to either increase revenues through increased dues, or decrease expenses by decreasing the amount of services they produce for their members.

tortious conduct in the future.[239] Therefore, a punitive damage award against these types of organizations will have the preferred effect of deterring future harmful activities, because the members of the organization will control the organization in the future in such a way that will avoid organizational liability.[240]

On the other hand, imposing punitive damages against traditional charities is likely to deprive their beneficiaries of benefits.[241] Traditional charities usually provide services at little or no cost to indigent populations.[242] These beneficiaries are usually unable to purchase substitute services and often rely on charities for goods and services necessary for survival.[243] Depleting the resources of charities by imposing punitive damages would result in a reduction of the services provided to less fortunate populations and would work as a punishment on innocent beneficiaries.[244] Therefore, the punishing effect of a punitive damage award on beneficiaries is a valid reason for reforming the law of punitive damages as applied to traditional charities.

E. Imposing Punitive Damages on Nonprofits and Charities Deprives Society of Social Benefits

Those who favor exempting nonprofit organizations and charities from punitive damage awards also argue that charities and nonprofit organizations provide redress for social problems, thereby reducing the burden on the government and the private sector.[245] The concern is that imposing punitive

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239. *Cf. Nonprofit Enterprise, supra* note 11, at 892-93 (stating that members of private clubs and mutual benefit associations will control these organizations in such a way as to prevent them from exploiting the members).

240. *See supra* notes 238-39 and accompanying text.

241. *See infra* notes 242-44 and accompanying text.

242. *Cf.* Tremper, *supra* note 9, at 432.

243. *See id.*:

> [In consumer markets,] consumers are free (within their economic means) to pay a higher price that includes a pro rata [sic] share of loss costs. This option is not available to [beneficiaries] of free charitable services. The dynamics of the free service delivery system produce a dichotomy in the availability arrangement: . . . beneficiaries either receive a service without charge or they do not receive it at all.

Id.

244. *See id.* at 431-32; Fagin, *supra* note 22, at 378. *But see The Quality of Mercy, supra* note 3, at 1391 (arguing that charities should bear part of the costs associated with charitable activities).

245. *See, e.g.*, Weston's Adm'x v. Hospital of St. Vincent of Paul, 107 S.E. 785 (Va. 1921):

> The states and the municipalities maintain hospitals for the insane, for the deaf, dumb, and blind . . . for the treatment of the sick, and for surgical operations on those in need of it . . . . Now public charities, privately conducted from mere benevolence, are great adjuncts to such charities conducted by the state or municipality, . . . ; and, while it may not be safe or desirable to place them above the law, it is manifestly desirable that

damages against nonprofits and charities will deprive society of these social benefits.[246] In turn, the burden of producing these benefits would fall on state governments if the nonprofit and charitable sector did not produce these benefits for society.[247]

One answer to this argument is that many nonprofits do not provide social benefits but rather provide private benefits.[248] Commercial nonprofit organizations, private clubs, and mutual benefit associations provide services at a cost to those who can afford the services.[249] Therefore, these organizations produce no more benefit to society than for-profit corporations.[250]

However, as applied to traditional charities, the concern that imposing punitive damages will deprive society of these social benefits is valid.[251] Traditional charities provide remedies for social problems, reduce burdens on government and the private sector, and reduce the transaction costs of providing services to indigent populations.[252] Imposing punitive damages on traditional charities arguably will have the effect of reducing the ability of traditional charities to provide these social benefits, and may deter socially beneficial activities.[253]

F. A Charitable Purpose Should Exempt Tortfeasors From Liability

A strong argument can be made in favor of imposing punitive damages on both traditional charities and modern nonprofit corporations.[254] The law of tort is based, at least in part, on the social judgment that individuals should not

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they should be encouraged in their good work . . . .

Id. at 790. *See also* H.R. REP. NO. 1860, 75th Cong, 3d Sess. 17 (1938), *quoted in infra* note 252.

246. *See* Tremper, *supra* note 9, at 435; *Developments in the Law, supra* note 3, at 1692; *The Quality of Mercy, supra* note 3, at 1388.

247. *See supra* note 245 and *infra* note 252 and sources cited therein (discussing how charities alleviate burdens on government by supplying public welfare services).

248. *See supra* notes 45, 53 for a discussion of how commercial nonprofit corporations, private clubs, and mutual benefit associations produce private, rather than public benefits.

249. *See Nonprofit Enterprise, supra* note 11, at 892-93; *Evolving Law, supra* note 11, at 813.

250. It is arguable that even for-profit corporations produce social benefits by generating products and services to satisfy the needs and demands of consumers.

251. *See infra* notes 252-53 and accompanying text.

252. *See, e.g.*, H.R. REP. NO. 1860, 75th Cong. 3d, Sess. 19 (1938):

> The exemption from taxation on money or property devoted to charitable . . . purposes is based on the theory that Government is compensated for the loss of revenue by its relief from financial burdens which would otherwise have to be met by the appropriation of public funds, and by the benefits resulting from the promotion of the general welfare.

Id.

253. *Cf.* Tremper, *supra* note 9, at 425-28, 430-32 (arguing that full liability will over-deter charitable activity and deplete the assets of the charitable sector).

254. *See infra* notes 255-58 and accompanying text.

harm others.[255] A punitive damage award signals to tortfeasors that society disapproves of the conduct in which the tortfeasors engaged, and that such conduct will not be tolerated in American society.[256]

Yet, some commentators argue that the lack of malice, presumed to be present in charitable activity, should exonerate charities from punishment.[257] But despite good intentions, if charities recklessly injure others in accomplishing their charitable works, punitive damages should be imposed on charities to encourage them to make their future activities safer in the future.[258] Imposing punitive damages on charities in appropriate cases may endanger the ability of charities to produce public benefits. However, punitive awards will also insure that charities produce benefits for society safely and efficiently, rather than in a way that injures others.

V. PROPOSALS FOR REFORM

There are persuasive arguments on both sides of the issue of whether

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255. *See* KEETON ET AL., *supra* note 2, § 4, at 20-23. *See also* George Fletcher, *Fairness and Utility in Tort Theory*, 85 HARV. L. REV. 537 (1972).

256. *See, e.g.*, Rookes v. Barnard [1964] App. Cas. 1129, [1964] 1 All E.R. 367, *cited in* Kotler, *supra* note 72, at 89:

> Where a defendant with a cynical disregard for a plaintiff's rights has calculated that the money to be made out of his wrongdoing will probably exceed the damages at risk, it is necessary for the law to show that it cannot be broken with impunity. *This category is not confined to moneymaking in the strict sense. It extends to cases in which the defendant is seeking to gain at the expense of the plaintiff some object . . . . Exemplary damages can properly be awarded whenever it is necessary to teach a wrongdoer that tort does not pay.*

Id. (emphasis added).

This is arguably a modern conception of the function of punitive damages. *See* Kotler, *supra* note 72, at 89-90. But this view of punitive damages has gained recent acceptance in the United States. *See, e.g.*, Grimshaw v. Ford Motor Co., 174 Cal. Rptr. 348, 388 (1981); Gryc v. Dayton-Hudson Corp., 297 N.W.2d 727, 740 (Minn. 1980), *cited in Kotler, supra* note 72, at 91, 103 (awarding punitive damages because the defendant callously weighed costs and benefits of dangerous conduct).

257. *See, e.g., Development in the Law, supra* note 3, at 1694. "Because society benefits from the activities of . . . nonprofits, society should . . . help pay for their accident costs." *Id.*

258. *See, e.g.*, Bing v. Thunig, 143 N.E.2d 3, 8 (N.Y. 1957) ("It is not alone good morals but sound law that individuals and organizations should be just before they are generous. . . ."). *See also* 15 AM. JUR. 2D *Charities* § 190, at 232 (1976) ("Carelessness is not kindness; it is actionable wrongdoing, albeit by a charity."). *See also The Quality of Mercy, supra* note 2, at 1387 ("[I]mmunity is forgiveness for wrongdoing—for willful [wrongdoing] or for failure to take due care—and the overall goodness of a wrongdoer does not, in law, excuse the wrong."). *See also* McMenamin, *supra* note 65, at 19 ("[S]ociety demands additional punishment for a callous disregard or indifference to the rights of others . . . . Non-profits must not be exempt from rules of reasonable societal behavior.").

traditional charities should pay punitive damages.[259] First, a punitive damage award will have a deterrent effect on charities because charities must prosper or perish under economic constraints.[260] To save their limited resources from being depleted by punitive damage awards, charities will avoid overly risky activity or will implement risk management techniques to avoid liability.[261] Moreover, imposing punitive damages on charities is necessary to achieve the social function of tort law.[262] A punitive damage award signals to both the tortfeasor and society that tortious conduct is not acceptable and a mere charitable purpose will not excuse a wrongdoer from liability if the actor is aware that the contemplated conduct will probably result in harm to others.[263]

Yet there is a possibility that imposing punitive damages on charities will reduce the amount of charitable activity in society.[264] A punitive damage award may over-deter charities, thereby reducing the benefits gained by society from charitable activity.[265] In addition, there is little justification for charities taking money that will be used for the public good and placing it in the hands of a private plaintiff, where it will be used for a private benefit.[266]

These conflicting policy considerations have led to at least three suggestions for reform in the law of punitive damages with respect to traditional charities.[267] First, Professor Tremper outlined a detailed "charitable redress system" and suggested that charities should only pay punitive damages where the tortious conduct of charity employees or volunteers is sanctioned by a charity

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259. For a general discussion of the arguments on both sides of the issue of whether nonprofit corporations and charities should pay punitive damages, see *supra* notes 77-258 and accompanying text.

260. See *supra* notes 97-128 and accompanying text for a discussion of how tort law's economic cues apply to nonprofit corporations and charities.

261. *See supra* notes 95-172 and accompanying text.

262. *See supra* notes 254-58 and accompanying text.

263. *Id.*

264. *See supra* notes 195-200, 214-16 and accompanying text.

265. *See supra* notes 214-16 and accompanying text.

266. *See supra* note 26 and sources cited therein.

267. One suggestion is to allow punitive damages against charities only when the charities have sanctioned the tortious conduct of their volunteers or employees. *See* Tremper, *supra* note 9, at 449. Another suggestion is to subsidize only those nonprofit corporations that produce more public benefits than harm. *See Developments in the Law, supra* note 3, at 1693-95. A proposal adopted by some states is to place a cap on the amount of damages that can be levied against charities. *See supra* note 19 and sources cited therein.

Ms. Fagin has also suggested a proposal for reform. *See* Fagin, *supra* note 22, at 391. Like Professor Tremper's "charitable redress system," Ms. Fagin's proposal would allow punitive damages against a nonprofit corporation only where the nonprofit corporation ratified the tortious conduct of its employees and volunteers, or where the nonprofit corporation is a sham. However, because this proposal is so similar to Professor Tremper's proposal, it will not be treated separately in the text of this note.

with the knowledge that the contemplated conduct would cause unjustifiable harm.[268] In addition, under this "charitable redress system," only the state attorney general would be empowered to bring punitive damage claims against charities.[269]

This suggested reform presents significant problems.[270] First, Professor Tremper argues that imposing punitive damages is justified only where the award will have its expected deterrent effect.[271] This leads Professor Tremper to conclude that a punitive damage award will have a deterrent effect only where the tortious conduct is sanctioned by charities.[272] Under Professor Tremper's system, punitive damages should be awarded against traditional charities only where the organization itself knew of and approved of the tortious conduct.[273] However, if punitive damages were awarded only where charities sanction tortious conduct, charities would have no motivation to implement risk management techniques to avoid injurious conduct.[274] Professor Tremper's arguments ignore the punitive damage award's effect of encouraging implementation of risk management techniques to avoid injury caused by the tortious acts of employees and volunteers.[275]

In addition, Professor Tremper's "charitable redress system"[276] also presents significant constitutional problems.[277] Because this system provides that only the state attorney general may sue for punitive damages against a charity,[278] the system implicates the Excessive Fines Clause of the Eighth Amendment.[279] The Supreme Court of the United States, in *Browning-Ferris Industries v. Kelco Disposal, Inc.*,[280] held that the Excessive Fines Clause is

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268. *See* Tremper, *supra* note 9, at 445-49. Even though Professor Tremper proposes that punitive damages should be imposed on charities only when they have sanctioned tortious conduct, he does not define what degree of culpability is necessary for charities to attain the level of "sanctioning" tortious conduct. *Id.* at 449.

269. *Id.*

270. *See infra* notes 271-87 and accompanying text.

271. *See* Tremper, *supra* note 9, at 449.

272. *See id.*

273. *Id.*

274. *See supra* notes 94-96 and accompanying text.

275. *Id.* Again, awarding punitive damages against charities would provide an incentive for those organizations to exercise greater control over their employees and volunteers.

276. *See* Tremper, *supra* note 9, at 445, 449.

277. *See infra* notes 278-87 and accompanying text (discussing the constitutionality of Professor Tremper's "charitable redress system").

278. *See* Tremper, *supra* note 9, at 449.

279. U.S. CONST. amend. VIII. The Eighth Amendment provides: "Excessive bail shall not be required, nor excessive fines imposed, nor cruel and unusual punishments inflicted." *Id.*

280. 492 U.S. 257 (1989).

generally not applicable to an award of punitive damages to private plaintiffs.[281] However, the Court implied that the rights protected by the Excessive Fines Clause can be infringed where the government either has prosecuted the action for punitive damages or has a right to receive a share of the damages awarded.[282]

Under the eighth amendment standard established in *Browning-Ferris*,[283] Professor Tremper's "charitable redress system"[284] is likely to be held unconstitutional. By empowering the state attorney general to bring an action for punitive damages, the "charitable redress system" would run afoul of the Eighth Amendment's implicit limitation on "penalties" if a large punitive damage award was levied against a charity.[285] Therefore, this "charitable redress system" is not only difficult to justify in policy,[286] but is also limited by constitutional concerns.[287]

Another reform suggested by one commentator is that charities should be fully liable in tort, but the government should provide direct accident cost subsidies to charities to help them bear the financial burden of tort judgments.[288] The legislature would determine the amount of subsidy that should be allocated to each charity through a legislative determination of the amount of public benefit produced by the charity.[289] The author of this proposal reasons that the accident cost subsidies and public benefits should be "linked" to insure that those organizations producing more harm than good are driven out of business, while those charities producing more good than harm will be able to continue their good works.[290]

The initial problem with this proposal is that it would be unworkable in practice.[291] The author recognizes that it will be difficult to measure the

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281. *Id.* at 262. In reaching this question, the Court did not reach the question of whether the Eighth Amendment applies to the states through the incorporation doctrine. *Id.* at 276 n.22.

282. *Id.* at 262-64 n.3.

283. *Id.*

284. *See* Tremper, *supra* note 9, at 445.

285. *See Browning-Ferris*, 492 U.S. at 262-64 n.3.

286. *See supra* notes 270-75 and accompanying text.

287. *See supra* notes 277-86 and accompanying text.

288. *See Developments in the Law, supra* note 3, at 1693-96. Under this plan, the state either could directly subsidize charities, allowing them to purchase liability insurance, or could establish state-run insurance pools to protect charities from liability. *Id.* at 1693.

289. *Id.* at 1694-95. Even though this proposal suggests that government subsidies should be given to charities based on the amount of public benefits they produce, it does not suggest how "public benefits" should be defined or measured. *Id.*

290. *Id.* at 1694-96.

291. *See infra* notes 292-96 and accompanying text.

amount of public benefit produced by charities.[292] The author also recognizes that this plan will have the effect of under-subsidizing unpopular and less politically powerful charities.[293] Yet the author dismisses these problems by suggesting that the democratic political process will fix the amount of subsidy at the proper level.[294]

Although it is questionable whether the political process could fix the amount of subsidy at the proper level, the author of this proposal ignores the fact that states are currently facing economic hardships and are unlikely to have the substantial resources to fund all charities that produce public benefits.[295] In addition, this author's proposal simply goes too far toward supporting the viability of the charitable sector. If the states had sufficient funds to subsidize most charitable activity, it is likely that the states would provide those services themselves. Moreover, under this system, the burden of a punitive damage award would fall on taxpayers and would have the effect of punishing innocent taxpayers, in the form of increased taxes.[296]

Yet another proposal, adopted by some states, is to place a limit on the amount of punitive damages that can be awarded against charities.[297] By limiting the amount of punitive damages that can be assessed against charities, charities are protected from large awards that can debilitate the charities' ability to produce benefits for the public good.[298] However, one problem with such damage caps is that they are arbitrary and bear no relation to the degree of harm done by the tortious conduct.[299] Another problem with such damage caps is that they encourage utilitarian cost-benefit calculations to determine if the benefit

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292. *See Developments in the Law, supra* note 2, at 1694-95.

293. *Id.* at 1695-96.

294. *Id.*

295. *See* Peter Dreier, *America's Urban Crisis: Symptoms, Causes, Solutions*, 71 N.C. L. REV. 1351, 1371-72 (1993) (reporting that over recent years, Bridgeport, Connecticut, East Saint Louis, Illinois and Chelsea, Massachusetts declared bankruptcy and that 53.9% of cities were running budget deficits in 1992).

296. Such a burden on innocent taxpayers would work as a punishment in the form of increased taxes. As in the cases where punitive damages have been sought against municipalities, such a punishment on innocent taxpayers has been criticized as contrary to public policy. *See, e.g.*, Newport v. Facts Concerts, Inc., 453 U.S. 247, 270-71 (1981). *See also supra* notes 173-76, 201-26 and accompanying text (discussing the punishment of innocent charitable donors by imposing punitive damages on nonprofit corporations and charities).

297. *See, e.g.*, MASS. GEN LAWS ANN. ch. 231, § 85k (West 1986) (setting a damage cap at $20,000). *See also supra* note 19 and sources cited therein (listing states that have enacted damage caps to protect charities from full liability in tort).

298. *See, e.g.*, English v. New England Medical Ctr., Inc., 541 N.E.2d 329, 333-34 (1989) (applying the Massachusetts damage cap provision and holding that damage caps do not violate substantive due process protection afforded by the Fourteenth Amendment to the United States Constitution).

299. *See The Quality of Mercy, supra* note 3, at 1392-93.

produced by the activity outweighs the risk of liability.[300] Even though a charity is aware that its activities might cause harm, the charity can more easily weigh the benefit to be gained from the activity against the risk of liability if the cost is fixed by the statutory damage cap.[301] Such weighing of costs and benefits, with disregard for the welfare and rights of the victims, has been criticized by courts as contrary to public policy.[302] The unpredictable nature of punitive damage awards imposed by juries prevents this cost-benefit analysis by making the costs of a wrong somewhat variable.[303]

Finally, it should be noted that applying general split award statutes[304] in cases where punitive damage awards have been obtained against charities may also deprive society and beneficiaries of the benefits that charities produce.[305] Split award statutes provide for awards of punitive damages obtained by private plaintiffs to be "split" between the plaintiffs and the state.[306] One of the purposes of these general split award statutes is to ensure that punitive damage awards are used for their proper purpose: the production of public benefits.[307]

However, applying these split award statutes to charities may be problematic.[308] First, some of these statutes do not require the state to use the

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300. *See* Amelia J. Toy, Note, *Statutory Punitive Damage Caps and the Profit Motive: An Economic Perspective*, 40 EMORY L.J. 303, 325-326 (1991) ("[A]n arbitrary cap on punitive damages awards . . . sacrifice[s] the goals of punitive damages. A statutory cap reveals to a potential tortfeasor his maximum expected costs.").

301. *Cf. id.* at 324-26 (arguing that damages caps make it possible to weigh costs and benefits of tortious conduct).

302. *See, e.g.*, Rookes v. Barnard [1964] App. Cas. 1129, [1964] 1 All E.R. 367 (permitting recovery of punitive damages were the defendant has disregarded the plaintiff's rights by calculating costs and benefits). *See also* Grimshaw v. Ford Motor Co., 174 Cal. Rptr. 348, 388 (1981); Gryc v. Dayton-Hudson Corp., 297 N.W.2d 727, 740 (Minn. 1980) (awarding punitive damages because the defendant's callous weighing of costs and benefits rose to the level of recklessness), *cited in Kotler, supra* note 72, at 89, 91, 103.

303. *See, e.g.*, Newport v. Fact Concerts, Inc., 453 U.S. 247, 270-71 (1981) (describing the "unpredictable and, at times, substantial" nature of punitive damage awards). *See also* Toy, *supra* note 300, at 324-26 (discussing the variable nature of punitive damage awards).

304. *See, e.g.*, FLA. STAT. ANN. § 768.73(2)-(4)(West 1986); OR. REV. STAT. § 18.540(3) (1987), *cited in* Sloane, *supra* note 66 (providing that punitive damage awards be "split" between the plaintiff and the state).

305. For a discussion of how applying split award statutes to charities may deprive both society and beneficiaries of benefits, see *supra* notes 245-53 and accompanying text.

306. *See, e.g.*, GA. CODE ANN. § 51-12-5.1(e) (1987) (providing that 75% of punitive damage awards obtained by private plaintiffs be given to the state), *cited in* Sloane, *supra* note 66. *See also supra* note 304 and statutes cited therein.

307. *See* Sloane, *supra* note 66, at 490 (arguing that split award statutes attempt to actualize the true purpose of punitive damages by "improv[ing] the quality of life in society").

308. *See infra* notes 309-12 and accompanying text.

money it obtains from punitive damage awards for the public good.[309] Transferring funds from charities to the state without any statutory guarantee that the money will be used for the public good could arguably result in a reduction of public benefits produced by the charitable sector.

On the other hand, some split award statutes require that the states use the money they obtain from these "split award" schemes for specific public welfare programs.[310] But transferring funds from one charity to public welfare programs would not guarantee that the beneficiaries of a particular charity would continue to receive the same benefits that they received from the charity had the money remained in the charitable sector.[311] Therefore, to prevent deprivations of benefits to society and beneficiaries, it would be preferable to return punitive damage awards to the charitable sector.[312]

VI. A NEW PROPOSAL - SPLITTING THE AWARD BETWEEN THE PRIVATE PLAINTIFF AND THE CHARITABLE SECTOR

While the proposals discussed above do not provide workable solutions to the dilemmas created by imposing punitive damages on charities, this does not mean that reform is not needed. First, there is no good reason to exempt commercial and mutual benefit nonprofit organizations from punitive damage award liability.[313] Commercial nonprofit organizations and mutual benefit organizations engage in the production of private benefits for those "beneficiaries" who can afford to pay the price charged.[314] If the price of the goods or services provided by the commercial nonprofit organization becomes too high, the beneficiaries can seek substitute goods or services elsewhere.[315] Moreover, even though a punitive damage award against mutual benefit

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309. *See, e.g.*, UTAH CODE ANN. § 78-18-1 (3) (1989) (providing that punitive damage awards obtained by the state through the split award mechanism be used in the state's general fund), *cited in* Sloane, *supra* note 66, at 477 n.24.

310. *See, e.g.*, MO. REV. STAT. .§ 537.675(1) (1987) (providing that monies obtained by the state from split award schemes be used in a tort victim's compensation fund), *cited in* Sloane, *supra* note 66, at 477 n.24.

311. For example, consider beneficiaries of a charity homeless shelter in Missouri. Under Missouri's split award statute, MO. REV. STAT. § 537.675 (1987), *cited in* Sloane, *supra* note 66, at 477 n.24, if a punitive damage award was obtained against the shelter, the money would go to the state's Tort Victim Compensation Fund. The beneficiaries of the homeless shelter would then be deprived of benefits that they would have received from the shelter, because the shelter will have fewer assets to produce benefits and the state will use the money it obtained to compensate tort victims, not to make sure that the beneficiaries of the homeless shelter continue to receive benefits.

312. For a proposal that would leave punitive damage awards in the charitable sector, see *infra* notes 313-43 and accompanying text.

313. *See infra* notes 314-17 and accompanying text.

314. *See Nonprofit Enterprise, supra* note 11, at 892-93; *Evolving Law, supra* note 11, at 813.

315. *See supra* notes 119-28 and accompanying text.

associations and private clubs may punish the organizations' members, such an effect may be preferable to immunity because members are in a position to control the future conduct of the organization.[316] Finally, awarding punitive damages against these organizations will deter harmful conduct and will make a statement that society will not tolerate tortious conduct.[317]

However, with respect to traditional charities, while punitive damage awards may have a deterrent effect on charities' tortious actions, there is little justification for taking money from the charitable sector, where it will presumably be used for public benefit, and placing the money in the hands of a private plaintiff.[318] Charities will be deterred from committing future torts by punitive damage awards regardless of whether the punitive damage award inures to the benefit of a private plaintiff or whether the punitive damage award is used for the public good. In addition, there is no good reason why a private plaintiff should gain a windfall from a punitive damage award when that money would otherwise be used for the public good.

A balance between the competing policies of deterring tortious conduct on the part of charities and preventing the depletion of resources of the charitable sector can be achieved by holding charities liable for punitive damages while returning the award to the charitable sector. Yet the money taken from one charity would have to be refunded to a different charity to achieve a deterrent effect. The following model statute which provides for the return of a punitive damage award obtained against charities to the charitable sector would deter individual charities while ensuring that the assets of the charitable sector are not depleted. This addresses the concern that awarding punitive damages against charities will prevent the charitable sector from being able to produce benefits for the public.[319] In addition, even if a punitive damage award over-deters charities from engaging in socially beneficial conduct, that over-deterrence will be offset by refunding the award to the charitable sector.

DEFINITION

A charity within the meaning of this statute is any organization determined by the Internal Revenue Service to meet the requirements of Internal Revenue Code § 501(c)(3).

Commentary: The definition of a charity under Internal Revenue Code § 501(c)(3) has been interpreted to require that the organization have a charitable

316. *See supra* notes 185-87 and accompanying text.
317. *See supra* notes 254-58 and accompanying text.
318. *See supra* note 26 and sources cited therein.
319. *See supra* notes 251-53 and accompanying text.

purpose,[320] operate in the public interest,[321] and serve a sufficiently broad public.[322] These criteria comport with the common law notions of what it means for an organization to be a "charity."[323] In fact, a few states already use these criteria to determine charitable status for the purpose of tort immunity.[324]

While the standard set forth in Internal Revenue Code § 501(c)(3) is intended to delineate the criteria for tax exemption,[325] there is no reason why it cannot be used in the context of tort law as well.[326] First, although the Code lists certain purposes that qualify as "charitable,"[327] the term is open-ended and has been construed to include organizations that engage in activities that do not fit within the listed purposes.[328] Second, the organization must serve the public interest.[329] This requirement encompasses those organizations that produce public benefits.[330] Finally, by requiring that the organization serve a sufficiently broad public, the tax code insures that the benefit of charitable status flows to a broad class of beneficiaries.[331]

These requirements comport with the policy justifications for engineering

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320. *See* I.R.C. § 501(c)(3) (1988) (providing that an organization must have, *inter alia*, a charitable purpose to qualify for tax exemption).

321. *See* Bob Jones Univ. v. United States, 461 U.S. 574 (1982). In *Bob Jones*, the Supreme Court upheld an Internal Revenue Service ruling denying tax exempt status to organizations that engage in racially discriminatory practices. *Id.* at 595-96.

322. Rev. Rul. 67-325, 1967-2 C.B. 113; Rev. Rul. 56-403, 1956-2 C.B. 307.

323. I.R.C § 501(c)(3) (1988) does not require that an organization serve only the poor in order to obtain tax exempt status. However, as was recognized at the common law, while organizations may not serve the needy, they can still produce public benefits and be considered "charitable." *See* Rev. Rul. 71-447, 1971-2 C.B. 230 ("Both courts and the Internal Revenue Service have long recognized that the statutory requirement of being 'organized and operated exclusively for religious, charitable, . . . or educational purposes' was intended to express the basic common law concept [of charity]."). *See also supra* note 2 and sources cited therein for a discussion of the common law notion of "charitable."

324. *See, e.g.*, MD. CODE ANN. CTS. & JUD. PROC. § 5-312(a)(5) (1994). *See also supra* note 20 and sources cited therein.

325. *See* I.R.C. § 501(a) (1988) (stating that an organization defined in § 501(c) is entitled to tax exemption).

326. *See supra* notes 294-302 and accompanying text.

327. I.R.C. § 501(c)(3) lists the following purposes as entitled to tax exemption: religious, charitable, scientific, literary, educational, or testing for public safety.

328. *See* TREAS. REG. § 1.501(c)(3)-1(d)(2) (as amended 1976).

329. *See* Bob Jones Univ. v. United States, 461 U.S. 574, 586-90 (1983). In the course of its opinion, the Court discussed the policies underlying tax exemption for charities. *Id.* at 585. The Court stated that in enacting I.R.C. § 501(c)(3) (1988), "Congress sought to . . . encourage the development of private institutions that serve a useful public purpose . . . ." *Id.* at 587.

330. *Id.* at 586-90.

331. *See* REV. RUL. 67-325, 1967-2 C.B. 113; REV. RUL. 56-403 1956-2 C.B. 307.

a special rule of punitive damages with respect to charities.[332] Assessing punitive damages against charities may deprive the public of benefits that would otherwise be produced had the charity been exempt from punitive damages.[333] A broad class of beneficiaries also may suffer if charities are held liable for punitive damages.[334] Therefore, defining charities by the work that they do and the people that they serve is useful both in terms of tax exempt status and in terms of punitive damage liability.

Using tax exempt status for determining whether an organization is charitable also has another major advantage. Tax exempt status is predetermined by the Internal Revenue Service.[335] This predetermination will prevent expensive and time consuming litigation over the issue of whether an organization is charitable.

LIABILITY

Nonprofit organizations, including charities, shall be liable for punitive damages in all cases where punitive damages are available under state law, regardless of their nonprofit or charitable status.

Commentary: This section forwards the policy that nonprofit organizations are deterred by punitive damage awards. This section also recognizes that punitive damages have a deterrent effect on charities as well. However, this statute is not intended to interfere with state law regarding the burden of proof nor the standard of culpability necessary for the imposition of punitive damages.[336] In other words, this section merely contemplates that nonprofit organizations and charities will be liable for punitive damages under state law, as would any other defendant.

SPLITTING THE PUNITIVE DAMAGE AWARD

Only in cases where a charity is a defendant, upon entry of a final judgment against a defendant-charity for punitive damages, the judge shall have discretion to compute the percentage of the punitive damage

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332. *See supra* notes 264-66 and accompanying text.

333. *See supra* notes 214-16 and accompanying text.

334. *See supra* note 241-44 and accompanying text.

335. Using tax exempt status to determine whether organizations should be treated favorably by tort law is not an entirely new concept. Some states already use I.R.C. § 501(c)(3) status to determine whether an organization qualifies for limited or qualified immunity. *See, e.g.*, MD. CODE ANN. CTS. & JUD. PROC. ANN. § 5-312(a)(5) (1994); UTAH CODE ANN. § 78-19-1(3) (1994). *Cf.*, Tremper, *supra* note 9, at 459 (arguing that modified I.R.C. § 501(c)(3) criteria should be used to determine whether an organization should be treated favorably under tort law).

336. *See supra* notes 72-76 and accompanying text.

award to be awarded to the plaintiff by considering the amount reasonably necessary to reward the plaintiff for pursuing the punitive damage claim, including reasonable attorney fees. That amount shall be awarded to the plaintiff. The remaining amount of the award shall be awarded by the court to a charity that is substantially similar to the defendant-charity.

Commentary: This section attempts to implement a modified private attorney general policy by recognizing that some reward should be given to the plaintiff for prosecuting egregious conduct that should be punished and deterred.[337] This section also recognizes that very few claims for punitive damages will be brought if the plaintiff has to bear the cost of litigating a punitive damage claim without any prospect of reimbursement for the expense of litigating the claim.

On the other hand, this statute does not allow the entire punitive damage award to inure to the benefit of a private plaintiff. The statute provides that a percentage of the award shall be returned to the charitable sector by the trial judge. This scheme has several advantages. First, it returns the award to the charitable sector to be used for the public benefit, while deterring the individual charity that committed the tort. Second, because the money will return to the charitable sector, the beneficiaries of the charities will still receive the benefits that they would have received before the punitive damage award was assessed. Third, this scheme achieves a minimal depletion of the resources of the charitable sector. Fourth, if the assessment of punitive damages has any over-deterrent effect on charitable activity, that over-deterrence will be countered by subsidizing charitable activity through the return of the punitive damage award to the charitable sector. Finally, other nonprofit organizations, such as commercial nonprofit organizations, mutual benefit associations, and private clubs, are not included in this distribution scheme because, as discussed in this Note, there is no good policy justification for protecting these organizations from punitive damage awards.[338]

DISTRIBUTION

In determining whether a charity is substantially similar to the defendant-charity, the judge shall consider: the nature of the charitable activities in which the defendant engages, the intended beneficiaries of the charity, and the public benefit produced by the charity. The judge shall not consider the religious affiliation of the

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337. See *supra* notes 69-70 and accompanying text for a discussion of the "private attorney general" theory.

338. *See supra* notes 313-17 and accompanying text.

charity in making this determination. The defendant charity shall bear the burden of proving which charities are substantially similar to the defendant charity.

Commentary: A judge will face a myriad of choices when attempting to decide whether a charity is substantially similar to the defendant charity. However, the purpose of the distribution scheme suggested in this statute is to protect society, beneficiaries, and donors from potential adverse effects of assessing punitive damage awards against charities. The judge must consider the purpose of the charitable activity in which the defendant charity engages and the beneficiaries of that charitable activity when deciding which charity shall receive the charity portion of the punitive damage award.

To ensure that the trial judge does not have unbridled discretion in choosing a charity that is substantially similar to the defendant-charity, the defendant charity shall have the burden to bring to the court's attention those charities that are substantially similar to the defendant charity. The defendant-charity should have an important interest in ensuring that the punitive damage award will be returned to a charity that will serve the same population and produce the same public benefits. At any rate, this should not be an onerous burden on the defendant charity because the defendant charity will presumably be familiar with the charities in the community that provide similar services.

Admittedly, this scheme may present several problems. First, the judge will be presented with the question of whether a charity with a religious affiliation provides special public benefits because of its religious character. The judge may be inclined to ask whether religion is a public benefit or whether one charity is substantially similar to another merely because of similar religious affiliations. Such considerations would arguably expose this statute to the constitutional limitations of the Establishment Clause.[339] However, this statute avoids such constitutional challenges by providing that such considerations by the judge are prohibited in determining which charity will receive the award.[340]

Another problem presented by this statute is that it arguably creates an inefficient transfer.[341] By taking money from the hands of one charity and placing it in the hands of another with the resources being used in substantially

339. *See* U.S. CONST. amend. I. *See also infra* notes 367-78 and accompanying text (applying establishment clause tests to the model statute proposed).

340. *See infra* notes 357-78 and accompanying text.

341. *Cf.* McMenamin, *supra* note 65, at 19 (arguing that split award statutes that provide for punitive damage awards to be divided between the plaintiff and the state, as applied to nonprofit corporations, create an "inefficient transfer").

the same manner, it could be argued that all that is achieved is the transfer of money and nothing else. However, this ignores the argument that the defendant charity will be deterred from future tortious conduct. The transfer, therefore, is not inefficient because it produces a deterrent effect on the tortfeasor charity that would not otherwise be present if the transfer had not been made.

Yet the judge making the award should consider the potential inefficiency of the statute. This statute clearly contemplates that the award should not find its way back into the hands of the defendant charity. The judge, therefore, should make sure that the charity receiving the award is organizationally distinct from the defendant charity.

ENFORCEMENT

After a percentage of the award is awarded to a charity that is substantially similar to the defendant charity, the substantially similar charity designated by the court shall be deemed a judgment-lien creditor secure to the amount of the award.

Commentary: This section allows the designated charity the ability to enforce the punitive damage award in court. The charity, rather than a state actor, should have this enforcement power to avoid the constitutional difficulties associated with the Excessive Fines Clause.[342] By providing that the charity is a judgment-lien creditor, there is no need for the state to become a party to the action. Moreover, under this scheme, no part of the award is given to the state. Therefore, this statute should withstand analysis under the Excessive Fines Clause enunciated in *Browning-Ferris*.[343]

JURY INSTRUCTION

The jury shall not be instructed about the distribution scheme in this statute at any time during the litigation.

Commentary: The purpose of this section is to ensure that the jury does not inflate the punitive damage award as a result of this distribution scheme. If made aware of this statute, the jury may inflate the award in an attempt to insure that the plaintiff receives a larger award. In addition, the jury may also see themselves as benefiting society by inflating the award if they know that a percentage of the award will go to charity.

342. *See supra* notes 281-82 and accompanying text.

343. Browning-Ferris Indus. v. Kelco Disposal, Inc., 492 U.S. 257, 262 (1989).

VII. THE CONSTITUTIONALITY OF THE PROPOSED STATUTE

Several general split award statutes have been challenged under the Takings Clause[344] of the Fifth Amendment.[345] Because the model statute proposed by this Note suggests a split award scheme, this model statute is also likely to be challenged under the Takings Clause.[346] In other words, it could be argued that by requiring a plaintiff to split a punitive damage award, the statute contemplates a taking of the plaintiff's property right in the punitive damage award.[347]

Under the Takings Clause, the Supreme Court has refused to develop any set formula for determining when governmental action constitutes a taking.[348] Rather, the Court has engaged in ad hoc factual inquiries to determine when a taking has occurred.[349] In making this inquiry, the Court has focused on basically three factors: the character of the government action; the economic impact of the regulation on the property owner; and the owner's reasonable investment backed expectations.[350] However, in order for a taking to occur, the owner must have property that is affected by the government action.[351]

Therefore, in analyzing a takings clause challenge to this model statute, it is particularly important to recognize that punitive damages are not awarded as of right.[352] A plaintiff does not have a vested right to punitive damages under

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344. U.S. CONST. amend. V. The Fifth Amendment provides, in pertinent part: "nor shall private property be taken for public use, without just compensation." *Id.*

345. This note does not attempt to present an exhaustive discussion of takings clause jurisprudence. Rather, the purpose of the following discussion is to merely show that the split-award statute proposed by this note would be held constitutional. For an in-depth discussion of cases challenging general split award statutes based on the Takings Clause, see Sloane, *supra* note 66, at 495-99 (discussing Kirk v. Denver Publishing Co., 818 P.2d 262 (Colo. 1991); Gordon v. State 585 So. 2d 1033 (Fla. Dist Ct. App. 1991); Sheperd v. Brice Petrides, 473 N.W.2d 612 (Iowa 1991)).

346. *See infra* notes 347-56 and accompanying text.

347. *See* Sloane, *supra* note 66, at 495-99 (discussing takings clause challenges to general split award statutes).

348. Penn Central Transp. Co v. New York City, 438 U.S. 104, 124 (1978).

349. *Id.* at 124.

350. *Id.* at 124-25.

351. *See, e.g.*, Skip Kirchdorfer, Inc. v. United States, 6 F.3d 1573, 1580 (Fed. Cir. 1993) *citing* United States *ex. rel.* Tenn. Valley Auth. v. Powelson, 319 U.S. 266, 281 (1943) ("A taking compensable under the Fifth Amendment inherently requires the existence of 'private property.' As a part of a takings case, the plaintiff must show a legally-cognizable property interest.").

352. *See, e.g.*, Gordon v. State, 608 So. 2d 800 (Fla. 1992) (reasoning that the right to have punitive damages awarded is not a property right and that a state could abolish punitive damages altogether), *cert. denied* 113 S. Ct. 1467 (1993). *Accord* Shepherd Components, Inc. v. Brice Petrides-Donohue & Assoc., Inc., 473 N.W.2d 612, 619 (Iowa 1991); Mack Trucks, Inc. v. Conkle, 436 S.E.2d 635, 639 (Ga. 1993), *cited in* Sloane, *supra* note 66, at 495-99.

the common law.[353] However, a plaintiff may obtain a right to a punitive damage award if a statute creates such a right.[354]

The proposed statute in this Note does not give the plaintiff a property interest in the punitive damage award.[355] The proposed statute provides only that the judge has the discretion to give a part of the award to the plaintiff to compensate the plaintiff for the time spent litigating the punitive damage claim.[356] Therefore, because the statute gives the plaintiff no vested property interest in the punitive damage award, giving the award to a charity under the statute does not amount to an unconstitutional taking.

A second challenge to this model statute could be made under the Establishment Clause.[357] If a punitive damage award is given to a religious charity under the scheme provided by the model statute proposed in this Note,

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353. *See, e.g.,* Allstate Ins. Co. v. A.M. Pugh Assoc., Inc., 604 F. Supp. 85, 99 (M.D. Pa. 1984); Smith v. Printup, 866 P.2d 985, 992 (Kan. 1993) (holding that plaintiffs have no right to punitive damages at common law).

354. *See, e.g.,* Nollan v. California Coastal Comm'n, 483 U.S. 825, 857 (1987) ("It is axiomatic, of course, that state law . . . constitute[s] a property owner's bundle of property rights.").

355. *See supra* notes 320-43 and accompanying text.

356. *See supra* text accompanying notes 336-38.

357. U.S. CONST. amend. I. The Establishment Clause provides that: "Congress shall make no law respecting an establishment of religion." *Id.* The First Amendment applies to the state through the Fourteenth Amendment. *See* Murdock v. Pennsylvania, 319 U.S. 105, 108 (1943). It should be noted that this note does not intend to present an exhaustive discussion of establishment clause jurisprudence. Rather, the purpose of this discussion is to show that the model statute proposed by this note is constitutionally firm. For an in-depth discussion of establishment clause jurisprudence, see Jack Alan Kramer, Note, *Vouching for Educational Choice: If You Pay Them, They Will Come*, 29 VAL. U. L. REV. 1005, 1026-1039 (1995).

It should also be noted the model statute proposed by this note could also be challenged under the Free Exercise Clause of the First Amendment. The Free Exercise Clause provides that: "Congress shall make no law prohibiting the free exercise of religion." U.S. CONST. amend. I. Religious charities could argue that subjecting them to punitive damage awards under the model statute proposed in this note involves an unconstitutional infringement of their right to free exercise of their religion. Religious charities could argue that such an award would punish them for exercising their religious beliefs if tenets of their respective religions required them to engage in charitable activity. Religious charities could also argue that allowing punitive damage awards against them would deplete their assets, thereby making them financially unable to exercise their religious beliefs.

However, such a challenge is likely to fail. While the Free Exercise Clause affords an absolute right to hold religious beliefs, it does not absolutely protect religious conduct. Employment Div. Dep't of Human Resources v. Smith, 494 U.S. 872, 877-79 (1990). Courts have rejected free exercise clause challenges to awards of punitive damages against religious institutions reasoning that punitive damages punish conduct which results in secular harm and that such conduct is not protected under the First Amendment. *See, e.g.,* Mrozka v. Archdiocese of St. Paul & Minn., 482 N.W.2d 806, 811 (Minn. Ct. App. 1992) (rejecting a free exercise clause challenge to punitive damage award against diocese of Roman Catholic Church).

the award could be challenged as favoring one recipient religion over others. The model statute could also be challenged under the Establishment Clause if, over time, several punitive damage awards were given to the same religious charities.

The traditional test for determining whether government action violates the Establishment Clause was set forth in *Lemon v. Kurtzmann.*[358] Under the *Lemon* test, governmental action does not violate the Establishment Clause if the action is motivated by a valid secular purpose, if it does not have the primary effect of advancing religion, and if the government action does not foster excessive entanglement with religion.[359] Under the first prong of the *Lemon* test, the Supreme Court has given great deference to legislatures in determining if a statute has a valid secular purpose.[360] Under the second prong of the *Lemon* test, the Court has looked to several factors to determine whether government action has the primary effect of advancing religion.[361] The Court has stated that a statute does not have the primary effect of advancing religion where the government action benefits a large class of beneficiaries.[362] The court has also held that government action does not have the primary effect of advancing religion if the government action confers benefits without regard for the religious nature of the recipient of those benefits.[363] Finally, the Supreme Court has held that government aid to religious organizations constitutes excessive entanglement only where there is significant interaction between the church and the state in the administration of the aid.[364] However, the trend of the Court is toward applying a less stringent "endorsement test" in establishment clause cases.[365] Under this test, the Court would ask whether government action "convey[s] or attempt[s] to convey a message that a particular religion or religious belief is favored or preferred."[366]

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358. 403 U.S. 602, 612-13 (1973).

359. *Id.*

360. *See, e.g., Mueller v. Allen*, 463 U.S. 388, 394-95 (1983). *See also* Wallace v. Jaffree, 472 U.S. 38, 74-75 (1985) (O'Connor, J., concurring) ("If a legislature expresses a plausible secular purpose . . . then courts should generally defer to that stated intent.").

361. *Lemon*, 403 U.S. at 612-13. The factors that the Court has considered are, *inter alia*, whether the government action aids a broad class of beneficiaries and whether the government action confers benefits without regard for the secular nature of the recipient of the aid. For a discussion of these factors, see *supra* notes 330-31 and accompanying text.

362. *See, e.g.*, Texas Monthly, Inc. v. Bullock, 489 U.S. 1, 17 (1989); Mueller v. Allen, 463 U.S. 388, 397-98 (1983).

363. *See, e.g.*, Zobrest v. Catalina Foothills Sch. Dist., 113 S. Ct. 2462, 2467 (1993).

364. *See, e.g.*, Aguilar v. Felton, 473 U.S. 402, 409 (1985); Tilton v. Richardson, 403 U.S. 672, 688 (1971).

365. *See, e.g.*, Zobrest v. Catalina Foothills Sch. Dist., 113 S. Ct. 2462, 2467 (1993); Texas Monthly, Inc. v. Bullock, 489 U.S. 1, 15 (1989); *Wallace*, 472 U.S. at 67-84 (1985) (O'Connor, J., concurring).

366. *See, e.g., Wallace*, 472 U.S. at 70 (O'Connor, J., concurring).

The model statute proposed by this Note should survive all of the establishment clause tests set out by the Supreme Court.[367] First, the model statute should be held constitutional under the "endorsement test."[368] Even if a judge awards a punitive damage judgment to a religious charity under the scheme proposed by this model statute, the award should not be seen as conveying a message that "a particular religion or religious belief is preferred."[369] The award will have the effect of favoring charities, not religions or religious beliefs. If punitive damage awards are given to religious charities under the model statute proposed by this Note, it is because they are substantially similar to the defendant charities; it is merely coincidental that they are also religiously affiliated.

Finally, the proposed model statute should also survive a *Lemon* test analysis.[370] First, the statute has a secular purpose: deterring charities from engaging in tortious activity while protecting the charitable sector from economic ruin.[371] Second, the statute has the primary effect of advancing charities; it does not have the primary effect of advancing religion.[372] Even if an award of punitive damages is given to religious charities under the model statute, the award will be given to religious charities without regard for their religious affiliation.[373] Moreover, if an award of punitive damages is given to religious charities under this model statute, the award will benefit a large class of beneficiaries by ensuring the viability of the charitable sector.[374] Finally, the proposed model statute does not encourage excessive government entanglement with religion.[375] In determining what charities are substantially similar to the

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367. See *infra* text accompanying notes 368-78.

368. For a discussion of the endorsement test, see *supra* text accompanying notes 365-66.

369. Justice O'Connor enunciated the endorsement test using this language in *Wallace*, 472 U.S. at 69 (O'Connor, J. concurring).

370. *Lemon*, 403 U.S. at 612-13. For a discussion of the *Lemon* test and its development and place in first amendment jurisprudence, see *supra* text accompanying notes 358-66.

371. *See supra* text accompanying notes 337-38.

372. *See supra* text accompanying notes 320-34.

373. The model statute specifically directs the trial judge to ignore the religious nature of the charity when deciding if the charity is substantially similar to the defendant-charity. *See supra* text accompanying notes 339-40.

374. In fact, the punitive damage award, even if given to religious charities, will benefit the state, taxpayers, and society. Society has an interest in seeing that charities remain economically viable because charities reduce social problems and remove a welfare burden from the state. If charities are financially strapped by punitive damage awards or are over-deterred by being held fully liable in tort, the state will have to compensate for the reduction of charitable services by increasing welfare services. This will, in turn, result in increased taxes. Therefore, the model statute proposed by this note goes beyond benefiting a broad class of charitable beneficiaries: the scheme benefits society in general.

375. *See infra* text accompanying notes 376-78.

defendant charity, the judge cannot consider religion.[376] The judge also may not "oversee" the award after it is given to the religious charities.[377] Therefore, the proposed model statute satisfies all three prongs of the *Lemon* test and should be held constitutionally valid, even as applied to awards of punitive damages to religious charities.[378]

VIII. CONCLUSION

The proposed model statute advanced by this Note attempts to strike a workable balance between competing policy justifications. First, the proposed model statute recognizes that modern nonprofit corporations, mutual benefit associations, and private clubs should not be exempt from punitive damage awards. However, the proposed model statute also imposes full liability on charities while attempting to leave a large portion of the resources for use in the charitable sector. By imposing this scheme, the proposed statute contemplates that punitive damages have a deterrent effect on charities and will prevent future tortious conduct. Yet the statute confronts the problems of over-deterrence of charitable activity and depletion of charitable resources by ensuring that a part of the punitive damage award remains in the charitable sector.

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376. It would be constitutionally impermissible for a judge to inquire as to whether a particular religion benefits society. The proposed model statute in this note avoids this problem by putting this inquiry beyond the power of the trial judges. *See supra* text accompanying notes 339-40.

377. Under the model statute, after the judge makes the award to a charity, the involvement of the judge is over unless the religious charity brings proceedings to enforce the judgment. The judge will not have to oversee the award after it is distributed from the defendant charity. This should satisfy the "excessive entanglement" prong of the *Lemon* test by avoiding significant interaction between church and state in the administration of the aid.

378. Lemon v. Kurtzmann, 403 U.S. 602, 612-13 (1973). For a discussion of the application of the *Lemon* test to the model statute proposed in this note, see *supra* text accompanying notes 367-77.