204 Punitive Damages: How Real and Big Is the Threat?

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Mr. Clark served as a member of the North Carolina Bar Association's study commission that created the state's highly successful mediated settlement conference program. Currently he provides pro bono litigation services to the Gaston County Volunteer Lawyers Program, and is a member of the board of directors of the Davidson Housing Coalition, an affordable housing provider.

Mr. Clark received his undergraduate degree from the University of North Carolina at Chapel Hill. He is a graduate of the Washington & Lee University School of Law, where he served as editor-in-chief of the *Washington & Lee Law Review*.

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IN THE SUPREME COURT OF ALABAMA

EXXON CORPORATION,	)	
	)	
Appellant,	)	
	)	**SUPREME COURT**
vs.	)	**NO. 1001053**
	)	
STATE OF ALABAMA	)	
DEPARTMENT OF CONSERVATION	)	
AND NATURAL RESOURCES	)	
and RILEY BOYKIN SMITH, etc.,	)	
	)	
Appellees.	)	

BRIEF OF APPELLANT EXXON CORPORATION

ON APPEAL FROM THE 15TH JUDICIAL CIRCUIT
(MONTGOMERY COUNTY) CV 99-2368

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STATEMENT OF THE CASE

I. NATURE OF THE CASE

Exxon Mobil Corporation, formerly Exxon Corporation ("Exxon"), appeals the judgment below awarding the State of Alabama compensatory damages of $87.7 million and punitive damages of $3.42 ***billion*** for alleged "fraudulent" underpayment of royalties under offshore gas leases in Mobile Bay. The punitive award would be grossly excessive even if the State's fraud claim – a counterclaim filed in response to Exxon's action for a declaratory judgment of its rights and obligations under the leases – had substance. The punitive damages are 39 times the compensatory damages (which were themselves grossly inflated), 13 times the 3:1 ratio the Alabama Legislature has set as the upper limit for such awards, and over 1100 times the largest punitive award this Court has approved since the United States Supreme Court handed down its landmark decision in *BMW of North America, Inc. v. Gore*, 517 U.S. 559 (1996).

But the State's fraud claim has no substance whatever. The dispute in this case concerns the meaning of a complicated contractual royalty clause. Exxon did not hide its interpretation of that clause, but disclosed it openly to the State's royalty collectors and auditors. It did not hide its production and disposition of gas and other products, but reported them every month, under oath, to the Alabama Oil & Gas Board as required by state law. And, pending resolution of the contractual dispute, Exxon has paid all royalties due under the interpretation it advances (over $400 million since production

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began in 1993). As the State itself admitted at trial: "if Exxon is correct in their interpretation of the lease, then they don't owe *any* additional royalty." R28/1469:19-21 (Snyder) (emphasis added).[1]

The case went awry because the trial court, over Exxon's assertion of attorney-client privilege, ordered production and admission into evidence of a confidential legal opinion by an Exxon in-house lawyer assessing the strengths and weaknesses of various interpretations of the royalty clause. The lawyer found the legal risks "acceptable" for most of the potential issues, but as to one issue he evaluated the chances of success in litigation as "less than 50%." Still, he saw "reasonable arguments" against the State's anticipated interpretation and "some support in the case law" for an interpretation more favorable to Exxon, and accordingly he advised Exxon to make a "risk decision" on these questions. PX49.

The introduction of this privileged legal opinion ended any prospect of a fair trial for Exxon. Repeatedly mischaracterizing the opinion to the lay jury as evidence that Exxon "knowingly" breached its royalty obligations in defiance of its own lawyer's advice, the State tried the entire case on the false legal premise that "intentional" breach

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[1]Throughout this brief, we cite the reporter's transcript of the trial in the format "R[volume]/[page]: [line] ([witness, where applicable])" and the trial exhibits ("PX" or "DX") by number and page, where applicable. We cite the separate transcript and exhibits for the post-trial proceedings, including the *Hammond* hearing, as "HR," "HPX," and "HDX," and all other materials in the clerk's record "C [volume]/[page]." A record of all exhibits with appropriate references to the page of the reporter's transcript at which the exhibit was received into evidence or rejected is found at R21/2-10; HR33/2-14.

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of contract is fraud. With witness after witness, the State harped on Exxon's supposed knowing and intentional breach. In closing argument, the State called on the jury to punish Exxon because it "knew" its lease interpretation was wrong. But breach of contract is not fraud, and punitive damages for breach of contract, even a supposedly "intentional" breach, are not allowed.

Worse, the trial court, whose errors created this incurable prejudice, abdicated its duty to control or rectify the injustice that followed. Over Exxon's objection, the trial court allowed the State to argue, without legal or evidentiary basis, that Exxon should pay a multibillion dollar penalty for trying to "cheat the State" out of hundreds of millions of dollars in future damages. It summarily denied Exxon's post-trial motions for judgment or new trial, denying Exxon the opportunity even to *brief* them. And, at the conclusion of the mandatory *Hammond* hearing to review the size of the punitive award, the court simply adopted, largely verbatim, an unsupportable order drafted by the State's lawyers denying all relief.

The proceedings below made a mockery of the attorney-client privilege, of the right to litigate contract disputes in fair proceedings, of the principle that punitive damages are reserved for gross frauds proved by clear and convincing evidence, and of the common law, statutory, and constitutional limitations on the size of punitive awards. The grossly excessive award sends a chilling message to all companies conducting or considering business with the State, or indeed within Alabama. Exxon respectfully urges

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the Court to reverse this unjust $3.5 billion verdict and to render judgment for Exxon on the fraud and punitive damage claims.

II. COURSE OF PROCEEDINGS AND DISPOSITION BELOW

Exxon filed this action against the Alabama Department of Conservation and Natural Resources ("DCNR") on July 28, 1999, seeking judicial resolution of a dispute over how to compute royalties under offshore gas leases issued by the State. C1/1. On August 24, 1999, the State counterclaimed for breach of contract and fraudulent misrepresentation and suppression, alleging that Exxon had "underpaid" royalties since gas production under the leases began in October 1993. C1/8. On October 5, 2000, the State filed a second amended counterclaim requesting punitive damages on its fraud claim. C5/851.

The case was assigned to Circuit Judge Tracy S. McCooey. Without written opinion, she denied all motions for summary judgment. R21/151:10-153:19; C5/891; C5/962. Over Exxon's objection, the court realigned the parties to allow the State to proceed as plaintiff. R21/57:20-23, 161:9-25. Over Exxon's repeated objections, the trial court ordered production of a confidential legal opinion by Exxon's in-house lawyer analyzing the lease interpretation issues.[2] The trial court also ordered the lawyer to

[2] C1/45; C3/536; C* (Exxon's 9/20/00 Brief Regarding Materials Submitted for *In Camera* Inspection); C3/585; C7/1277; C* (10/27/00 Request for Submission *In Camera*); C7/1300; C7/1321; C9/1775; R21/125:19-129:19; R22/218:7-221:2; R26/1148:18-1150:3. Documents in the record but under seal are cited "C* (description of document)."

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submit to a deposition, and permitted the State to introduce at trial both the legal opinion and the deposition (played to the jury on videotape).[3]

Trial began on December 4, 2000 and lasted 12 days. On December 19, 2000, after deliberating for two hours, the jury returned a verdict awarding the State compensatory damages of $87,692,695 (the precise figure requested by the State) and punitive damages of $3,420,000,000. C10/1987-89. The $3.42 billion punitive award is by far the largest ever made in Alabama, amounting to $769 for every man, woman and child in the State. HDX181 at 24; HR36/632:17-24 (Borden). The total personal benefit of the award to a married juror with two children was thus $3076. On January 17, 2001, Exxon moved for judgment as a matter of law or a new trial on the State's counterclaims. C11/2003, 2027, 2085. At a status conference on January 29, 2001, the trial judge announced her intention to deny Exxon's motions summarily, and instructed the parties not to waste time briefing them. HR33/30:22-31:4, 37:2.[4] On February 1, 2001, the trial court issued a two-page order denying Exxon's claim for declaratory relief, reciting in conclusory fashion that Exxon had failed to meet its royalty obligations under the leases, and providing *no* guidance as to how to calculate royalties going forward. C11/2073.

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[3]R21/125:13-128:11; R26/1148:18-1150:3, 1153:6-R27/1235:20.

[4]Judge McCooey initially stated at the conference that she had read the response to the motion and the briefs. HR33/30:2-31:4. In fact, the State had not submitted a response and neither party had yet submitted a brief.

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Exxon also requested that the trial court hold a hearing under *Ala. Code* § 6-11-23 and *Hammond v. City of Gadsden*, 493 So. 2d 1374 (Ala. 1986), to consider a remittitur of the punitive award. C10/1997. At the *Hammond* hearing on April 17-18, 2001, the trial court heard evidence relating to the size of the punitive damages. On May 3, 2001, after receiving briefs from both parties, the trial court entered an order denying any remittitur and denying all other post-judgment motions. C19/3762. The trial court took its ruling almost verbatim from the proposed order submitted by the State. *Compare* C19/3762 *with* C14/2759 (proposed order). This timely appeal followed.

STATEMENT OF ISSUES PRESENTED FOR REVIEW

Review of all questions presented is *de novo.*

1. Was the evidence legally insufficient to support a verdict for fraud, thus rendering impermissible *any* award of punitive damages?

2. Was the State's claim for fraud (and therefore any claim for punitive damages) barred by the statute of limitations?

3. Do *Ala. Code* § 6-11-21(*l*) (Supp. 2000) and/or the Due Process Clauses of the Fourteenth Amendment of the U.S. Constitution and Article I, § 13 of the Alabama Constitution bar the recovery of any punitive damages by the State?

4. Does the $3.42 billion punitive award exceed any punishment permissible under:

a. *Ala. Code* § 6-11-21 and this Court's cases;

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b. the Due Process Clauses of the Fourteenth Amendment of the U.S. Constitution and Article I, § 13 of the Alabama Constitution; and/or

c. the Excessive Fines Clauses of the Eighth Amendment of the U.S. Constitution and Article I, § 15 of the Alabama Constitution?

5. Was the evidence at trial legally insufficient to support the $87.7 million compensatory damages verdict where:

a. the award improperly included damages for a former Mobil Oil lease (Tract 77A) governed by an earlier and different lease form whose terms the State never offered into evidence;

b. the award was unjustifiably inflated by the State's failure to account for the physical fact that natural gas shrinks in volume, and consequently increases in heat content per cubic foot, when treated (as it was here) to remove hydrogen sulfide and carbon dioxide; and

c. the award included damages for failure to obtain favorable prices offered only on pipelines lacking the physical capacity to take Exxon's gas?

6. Did the trial court commit prejudicial error by refusing to instruct the jury that matters disclosed by Exxon to the Alabama Oil & Gas Board, one of the two State agencies responsible for administering the Mobile Bay field, should be treated as having been disclosed to the State?

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7. Did the trial court commit reversible error by ordering Exxon to produce, and then admitting into evidence, the privileged legal opinion of Exxon's counsel?

STATEMENT OF FACTS

I. BACKGROUND: EXXON'S MOBILE BAY PROJECT

In 1979, Mobil Oil Company (then independent of Exxon) discovered natural gas in Mobile Bay. R25/814:19-24 (Macrory). In the wake of this find, the State of Alabama put out for competitive bid the rights to explore for and produce offshore oil and gas on designated tracts in State territorial waters. PX112; R25/815:10-15 (Macrory). Exxon bid successfully for 22 of these offshore leases in 1981 and 1984, paying the State $576.7 million in non-refundable bonuses. PX6-PX27; HDX181 at 2. After eight years of exploratory drilling (costing another $181 million), Exxon decided in 1990 that 10 of the leases contained enough gas to justify the huge investment required to produce them. HR34/306:11-19 (Condray); HDX181 at 2. The other 12 leases were returned to the State, and Exxon forfeited the bonuses it had paid for them. Exxon then spent another $1.2 billion to build three offshore production platforms, 16 offshore wells, and related facilities. PX208 at 0020248-49; HDX181 at 2.

The Mobile Bay wells produce so-called "sour" gas, containing predominantly methane but also significant quantities of hydrogen sulfide (H_2S) and carbon dioxide (CO_2). PX208 at 0020248-49; DX1096 at 3.[5] All the hydrogen sulfide and most of the

[5]Citations to DX1096 use the page numbers found in the lower right-hand corner.

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carbon dioxide must be removed to make the gas "sweet," and suitable for transportation by commercial pipelines. Two of the five producers currently operating in Mobile Bay deliver their sour gas at the platform to third parties who in turn perform the necessary "sweetening" operations. R24/644:11-21 (Hite). Exxon decided instead to build an integrated Onshore Treating Facility (OTF) to carry out these tasks. PX208 at 0020249. The OTF, located in Theodore, Alabama, accounts for a substantial portion of Exxon's capital investment in Mobile Bay.

Production of gas occurs at the offshore wells and platforms. PX208 at 0020248-49; R30/1902:16-20 (Pierce). The raw wellstream at Mobile Bay includes (besides gas) both salt water and wax-like heavy hydrocarbons known as diamondoids. DX1096 at 3; PX208 at 0020248, 020250. To prevent the salt and diamondoids from gumming up flowlines and production equipment, Exxon pumps into the wells fresh water (to dissolve the salt) and fresh diesel (to dissolve the diamondoids). DX1096 at 3. The complete production stream at the wellhead thus includes both raw gas (methane, H_2S and CO_2) and liquids (water and diesel).

This gas/liquid mixture travels by flowline from the wellhead to the production platform, where the gas is separated from the liquids and dehydrated. PX208 at 0020249. At this point the gas – still sour – is ready for transport to the Onshore Treating Facility. A 26-mile offshore pipeline network known as the "gathering system" moves the gas from the platforms to the OTF. *Id.*

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There Exxon subjects the commingled gas to an expensive chemical wash to remove all hydrogen sulfide and most carbon dioxide. PX208 at 0020249, 0020260; R29/1782:23-1783:15 (Haynes); DX1096 at 3. Typically hydrogen sulfide makes up 0.1 to two percent of the total volume of the gas before treatment, and carbon dioxide makes up three to four percent of the volume. PX208 at 0020250. Treatment thus has the effect of reducing the gas volume, referred to as "shrinkage." R30/1859:6-1860:12 (Bolin); HR37/981:8-16 (Borden); DX1096 at 5, 35-43, 51-58. Having been made "sweet," the gas is now available at the OTF "tailgate" for sale to customers via local delivery or delivery into any of three interstate pipelines. R27/1266:21-24 (Woodbury); R30/1982:3-1983:3 (Browning).

In addition to gas that is sold, a small portion of the treated gas is retained by Exxon for its own use. PX208 at 0020269; DX1096 at 5. This is so-called "fuel gas." PX208 at 0020269. It provides energy for most operations of both the OTF and the offshore platforms. *Id.* Exxon also uses fuel gas to generate electricity for cooling turbines and other uses requiring electrical power. *Id.* at 0020276. If there is surplus electricity (so-called "co-gen" power), it is sold to Alabama Power Company. *Id.*; DX1096 at 6.

Exxon uses the hydrogen sulfide extracted from the sour gas to make sulfur. PX208 at 0020249. The H_2S is heated to 2000 degrees, the resulting vapors are condensed, and any unvaporized residue passes through catalytic converters.

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R29/1785:1-1788:25 (Haynes). Sulfur is sold to customers at the OTF. DX1096 at 6; R27/1272:7-16 (Woodbury).

Exxon also recovers the "spent" diesel (*i.e.*, the diesel containing dissolved diamondoids) from the produced liquids stream. DX1096 at 6. Called "slop oil," this is sold to customers at the OTF. *Id.*; R31/2151:13-2152:6 (Brown).

A diagram illustrating the flow of gas from wellhead to tailgate is provided in the Appendix at Tab 4.

II. THE DISPUTED LEASE PROVISIONS

Oil and gas leases traditionally require the lessee (Exxon) to bear the costs of exploration and production, but provide for the lessor (the State) to bear a share of post-production costs that enhance the value of the produced gas. R30/1903:4-1905:9 (Pierce). This is achieved by "cost-netting" – that is, the deduction from the royalty base of post-production costs of gathering and treatment. R26/1182:13-16 (Broome). Oil and gas leases also traditionally do not impose a royalty on gas used as fuel in the development and operation of the lease. R30/1910:20-1911:11 (Pierce).

The underlying dispute in this case largely concerns the extent to which the State's leases permit Exxon to pass on to the State some of the post-production costs of operating the gathering system and the OTF, and to use fuel gas without paying royalty on it. The dispute concerns only a fraction of the royalties Exxon actually pays to the State, which averaged about $60 million per year. HDX 181 at 26. Similarly, the dispute concerns only a fraction of Exxon's post-production costs, since Exxon has

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never sought to deduct any portion of its *capital* expenditures on the gathering system or the OTF; capital expenses make up about 85 percent of Exxon's post-production costs. R25/961:3-13 (Macrory); DX1107C(1). Thus, the dispute is limited to whether under the leases the State must share the relatively modest *non*-capital expenditures associated with post-production gathering and treating operations.

The State issued the 1981 lease form, without negotiation, as the required basis for all bids in the 1981 and 1984 lease sales. R25/817:24-818:16 (Macrory); HR34/315:24-316:6 (Condray). The State official who drafted the form, Robert Macrory, drew on a hodgepodge of sources. For the key paragraph on royalties, Macrory started with language from a Texas form, incorporated some language from a Florida form, and then replaced most or all of that with language from an obscure *onshore* lease form published in the Nebraska Law Review in the 1960s, which he proceeded to modify in non-standard fashion on his own. R25/829:20-845:8, 922:14-962:11 (Macrory). The effect of Macrory's drafting method was to create a lease whose provisions were unlike any previously used, had never been construed by a court, and therefore were incapable of definitive interpretation on the basis of established legal

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precedents.[6] R26/1191:14-18 (Broome); R24/746:9-17, 761:2-6 (Weaver); R27/1312:5-8 (Burney).

The key language appears in paragraphs 5(a) and 5(b), which provide in pertinent part:

> 5. When production of oil, gas or any other liquid or gaseous hydrocarbon mineral from the leased area is obtained, LESSEE agrees to pay or cause to be paid to LESSOR, during the time hereof, the following royalties:
>
> (a) The value of [25%] of the gross proceeds from all oil, distillate, condensate, gas, natural gasoline or other product covered by this lease, produced and sold from the leased area at the price received therefor or at the best price realizable in the exercise of reasonable diligence, whichever is higher; however, if any oil or gas is produced from any well drilled, whether or not sold or used off the leased area, LESSEE agrees to pay to LESSOR royalty on the oil or gas produced on the above basis, except that no such royalty shall be due for gas produced and flared for well testing purposes.
>
> (b) If gas, of whatsoever nature or kind, including oil well or casinghead gas and any gaseous substance produced from any well is used, on or off the leased area, by the LESSEE for purposes (including the manufacture or extraction therefrom of gasoline or other products not covered by the royalty provisions of subparagraph (a) above) other

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[6]Macrory hoped to short circuit the need for judicial interpretation of the lease by inserting a provision stating that any ambiguities in the lease are to be construed in favor of the State. PX50, paragraph 27; R25/847:11-17. But under well-settled rules of contractual interpretation, this type of clause comes into play only if no reasonable construction giving fair effect to all the language is possible. *See Homes of Legend, Inc. v. McCollough*, 776 So. 2d 741, 746 (Ala. 2000) (court construing a contract must "give effect and meaning to all of its terms" and may construe ambiguities against a specified party only "if all other rules of contract construction fail"); *Lackey v. Central Bank of the South,* 710 So. 2d 419, 422 (Ala. 1998) ("[T]he rule of *contra proferentem* is generally a rule of last resort that should be applied only when other rules of construction have been exhausted").

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> than solely in the development and operation of the leased area as provided herein, LESSEE shall pay [25%] of the net amount realized by LESSEE or affiliate from the sale or disposition of the manufactured or extracted products and [25%] of the best price realizable in the exercise of reasonable diligence for all gas used and not sold. On all residue gas sold by LESSEE or affiliate after manufacture or extraction of products, royalty shall be paid under subparagraph (a) in addition to the royalty on manufactured or extracted products.... The phrase "net amount realized" shall be arrived at by establishing the gross sales values of the manufactured or extracted products realized by LESSEE or affiliate and deducting therefrom the reasonable direct costs of manufacture and transportation from the leased area incurred by LESSEE or affiliate; provided (though not to be construed as all inclusive) amortization of pipelines, processing plants, or other facilities owned entirely or in part by LESSEE or affiliate and rate of return thereon are specifically excluded as deductible items of cost.

PX50 (exemplar reproduced in Appendix at Tab 1); PX6-27.[7]

III. EXXON'S LEASE INTERPRETATION

The leases were signed in 1981 and 1984. No royalties were due until there was production, however, and that did not occur until late 1993. R25/818:24-819:3 (Macrory); R26/1181:25-1182:7 (Broome). During 1993, with production imminent, Exxon undertook a detailed review of the lease form with a view to deciding how the royalties ought to be paid. It did so in the way any reasonable company should. It examined the lease form, obtained a legal analysis, quantified the amounts involved, and made a good faith decision how to calculate royalty payments.

[7]The specific royalty rate ranges from 25 percent to 28 percent depending on the lease, with some leases providing for an initial lower rate until "payout" (*i.e.* recovery of specified drilling and development costs). In other respects the operative language of the 1981 and 1984 leases is identical.

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A. The Broome Legal Opinion

To ensure that it would pay royalties properly, Exxon asked Charles Broome, an in-house Exxon lawyer, to provide his legal opinion on lease interpretation issues. C7/1357 at 1363:2-13, 1365:9-17. He did so in an April 1993 letter to R.J. Kartzke, Exxon's Mobile Bay project manager. *Id.*; R26/1181:22-24 (Broome); PX49. This letter was erroneously ordered produced over Exxon's assertion of its attorney-client privilege, and its introduction at trial will require a new trial of any issue not resolved as a matter of law. A copy of Broome's letter is included in the Appendix at Tab 3.

Broome's analysis began by interpreting the provision of paragraph 5(a) of the lease that royalty was payable on gas "covered by this lease *produced and sold from the leased area*." Consistent with the principle of contract construction that every word in a contract should be given an independent meaning, *Homes of Legend,* 776 So. 2d at 746; *Sullivan, Long & Hagerty v. Southern Elec. Generating Co.*, 667 So. 2d 722, 725 (Ala. 1995), he concluded that "produced and sold from the leased area" should be interpreted so that the point of valuation for royalty purposes was the "leased area" – that is, the point at which the gas left the platform. PX49 at 2. If, on the other hand, gas "produced and sold from the leased area" were interpreted as meaning merely gas "covered by the lease" (as the State was later to contend) then the words "produced and sold from the leased area" would be completely redundant, and exactly duplicative of the language that immediately preceded them. *Id.* Under well-known principles of oil and gas law, valuing the gas as it left the platform meant that at least some of the costs

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of post-production transportation and treatment would be deductible from the royalty base. *See* pp. 20-21 *infra* and note 10.

Broome also considered paragraph 5(b) of the lease, which imposed a royalty on gas "used . . . by the Lessee on or off the leased area . . . other than solely in the development and operation of the leased area as provided herein," and a royalty on products manufactured or extracted from the gas. The royalty on "products" covered by paragraph 5(b) was based on Exxon's "net realized amount," which was defined as the gross sales price less "reasonable direct costs of manufacture and transportation *from the leased area*," but not including amortization or costs of capital invested. Broome read this provision as consistent with his views that the basic valuation point was the "leased area" (or platform) and that *some* off-platform costs were therefore deductible. PX49 at 2 (OTF fuel as an example). On the other hand, because of its restriction on deductions of capital costs, Broome read paragraph 5(b) as *inconsistent* with the idea that *all* off-platform costs were deductible. PX49 at 2. Accordingly, he proposed that the two provisions should be "harmonized," so that the gas was valued at the platform, but only "direct" post-production costs (not capital costs) would be deducted from the sales price in order to arrive at the value of the gas at the platform.[8] *Id.*

[8]Unknown to Broome, the draftsman of the State's lease actually *shared* Broome's view on this point in 1981. A memo Macrory wrote to obtain final approval of his lease form told the Commissioner of DCNR that paragraph 5 would permit deduction of direct costs of manufacture and transportation "when gas is treated or processed." DX243.

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Broome recognized that he was dealing with a complicated and unusual lease form, that there was "no Alabama case on point," and that Exxon should "anticipate a quick audit and subsequent litigation." PX49 at 1, 3; *see also* R26/1191:2-18; R27/1206:19-25, 1210:24-1211:2 (Broome). He noted that if his interpretation of the lease were not upheld, Exxon would be exposed to a 12 percent interest penalty for underpayment of royalties. PX49 at 3; *Ala. Code* § 9-17-33(d). He advised his client that his interpretation had "some support in the case law," but added candidly that "the likelihood of prevailing in court on this interpretation [was] less than 50%." PX49 at 2. This sensible and unexceptionable recognition by a careful lawyer of the risks to Exxon of litigating royalties in an Alabama courtroom, with the State of Alabama as plaintiff, was twisted out of recognition by the State's lawyers at trial. *See* pp. 118-19 *infra*.

Broome thought the other interpretation issues raised by the lease were straightforward. He thought it clear that platform fuel was royalty free, since the paragraph 5(b) royalty provision for "used" gas expressly exempted gas used "in the development or operation of the leased area." PX49 at 2-3. He concluded that royalties were not due on electricity as such, since electricity was not a product "manufactured or extracted" from gas. *Id.* at 3. As for diesel sales, Broome thought they were royalty free so long as the revenue from spent diesel did not exceed the cost of fresh diesel. *Id.* On all these issues, he saw "some risk," but believed it was "acceptable." *Id.*

B. Management's Decision

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Later in 1993, the issue came to Exxon management as part of a broader review not only of State royalty issues, but also of State severance tax and federal royalty issues. PX182. The management package outlined a series of potential lease interpretation options that, if adopted in their entirety, would have reduced the coming year's projected $40 million State royalty obligation by an estimated $19.4 million. PX182 at 0045770.

The largest option involved deduction of the *capital* cost of the OTF and the gathering system, yielding estimated royalty savings of $8.4 million. *Id.* Broome had concluded that this interpretation had "little chance of being upheld," and Exxon *rejected* it. PX49 at 2; R25/961:3-13 (Macrory); HR34/322:18-22, 324:6-21 (Condray). Similarly, Exxon *rejected* an interpretation allowing deduction of the costs of the offshore production platforms; such an interpretation would have saved an additional $8 million annually, but was equivalent to reading the lease as valuing the gas as if it were sold "from the wellhead" rather than (as Broome interpreted it) "from the leased area."[9]

[9]A handwritten note at the end of the presentation package gives the breakdown of the annual $8 million offshore platform expense as $800,000 for operations and maintenance and $7.2 million for amortized capital expenditures. PX182 at 0045780. Citing this note, the State claimed in its post-trial briefing that Exxon actually had decided to deduct the $800,000 non-capital portion of the platform expense, and had lied in the *Hammond* hearing about not doing so. C14/2726 at 2733-34. The State then inserted language in its proposed post-trial order (adopted verbatim by the trial court) citing this as evidence of "cover up." C14/2759 at 2769; C19/3762 at 3772-73. The note at the end of PX182 does not, however, say that Exxon decided to deduct *any* of these expenses, and evidence at both the trial and the post-trial hearing was uncontradicted that Exxon did *not* deduct expenses of operating and maintaining the offshore *platforms* (as distinguished from expenses of operating and maintaining the offshore gathering system)

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Exxon management thus rejected options that accounted for $16.4 million out of the potential *total* royalty saving of $19.4 million annually.

On the remaining items, management adopted interpretations estimated to produce combined annual royalty savings of $3 million. PX182 at 0045770; HR34/347:9-348:3 (Condray). Exxon understood that Shell, which the State was then auditing, was deducting sulfur manufacturing costs. Management was advised that it was both the "State and Shell's position" that these costs were properly deductible. PX182 at 0045770. Likewise, management was told that Shell was treating platform fuel as royalty free, and that the "State is not expected to object." *Id.* Exxon also understood that both Shell and Mobil were taking positions similar to Exxon's on the issue of spent diesel. *Id.*

Exxon expected deduction of the non-capital expenses of operating the gathering system and the OTF to be a point of debate. Deducting these costs was proper if gas was valued at the platform following Broome's approach of giving meaning to the words "sold from the leased area" in paragraph 5(a) and "harmonizing" paragraphs 5(a) and 5(b). Even though Broome had advised that his cost-netting interpretation had less than a 50 percent chance of success, Exxon's management decided that it would pursue items with a "25% or greater chance of success." PX49 at 2; PX182 at 0045765. The

in computing the State's royalty under the 1981 lease form. PX196 at 0122; PX199 at 0379; R26/1089:23-1090:9, 1103:1-4 (Bremer); HR34/322:18-324:21 (Condray).

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senior Exxon executive responsible for the decision testified that he believed, from his experience with the very cautious views of Exxon's in-house counsel, that if they were willing to venture the opinion that Exxon had a 25 percent chance of success in litigation, that meant Exxon had a "pretty good argument." HR34/372:16-24 (Condray).

Accordingly, Exxon interpreted the leases as follows:

1. Gas sold should be valued *at the platform*, even though delivery to customers was made at the OTF tailgate. In Exxon's view, this followed from the provisions of paragraph 5(a) imposing royalties on the value of gross proceeds of gas "sold from the leased area." Consistent with case law and industry practice concerning the analogous problem with leases that provide for valuation "at the well" when gas is not delivered to customers there, Exxon calculated "gross proceeds" at the platform by deducting from the sales price post-production gathering and treatment costs, except for

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capital expenditures which were expressly excluded by paragraph 5(b).[10] R27/1267:6-10, 1268:3-6 (Woodbury); R30/1902:5-1903:3 (Pierce).

2. No royalty was due on gas used as fuel on the platforms because paragraph 5(b), dealing with the royalty obligation for "used" gas, expressly excludes any gas used "solely in the development or operation of the leased area." This means no royalty is owed on gas used on the platforms, which are physically situated on the leases.[11] Exxon also construed the leases to exempt from royalty any gas used for fuel

[10] *See*, *e.g.*, *Scott Paper Co. v. Taslog, Inc.*, 638 F.2d 790 (5th Cir. Unit B 1981) (Alabama law); *Piney Woods Country Life School v. Shell Oil Co.*, 726 F.2d 225, 240 (5th Cir. 1984); *Atlantic Richfield Co. v. California*, 262 Cal. Rptr. 683, 688 (Cal. Ct. App. 1989). At trial, the State argued that the reference to "gross proceeds" in the lease meant that no deductions whatever could be taken from the sales price received at the tailgate. But the phrase "gross proceeds" as used in oil and gas leases does not, standing alone, imply any particular royalty valuation point. *See* 3 H. Williams & C. Meyers, *Oil and Gas Law* § 645 at 596 (1988) ("There arises then a question concerning the costs which are borne by the operator alone out of his share of production and the cost which the royalty owner or other non-operator may be called upon to share. The question may be posed in a number of ways, *e.g.*, … [a]t what place must his share of oil and gas (or its value or the proceeds thereof) be delivered to the royalty or other non-operating owner 'free of costs'?"); *Schroeder v. Terra Energy, Ltd.*, 565 N.W.2d 887 (Mich. Ct. App. 1997) (under lease requiring payment of royalty based on "gross proceeds at the wellhead," lessee could properly deduct post-production costs of transporting and treating gas that was sold, after treatment to remove impurities, off the leased premises); *see also Lafitte Co. v. United Fuel Gas Co.*, 177 F. Supp. 52, 60 (E.D. Ky. 1959) (where lease provided for payment of royalties based on "gross income received . . . from the sale or disposition . . . of gas produced and sold or marketed . . . from the demised premises," gas should be valued at the well).

[11] The State was later to contend that royalty is due on platform fuel gas under the "however" clause of paragraph 5(a), construing that language as imposing a royalty obligation on all gas sold or used without any exception for fuel gas. R21/141:10-25. But this construction renders nugatory both the first sentence of paragraph 5(a), which specifically addresses "sold" gas, and also the first sentence of paragraph 5(b), which

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at the OTF; although the OTF is not physically part of the "leased area," it is engaged in the "development and operation" of the leased area. R27/1266:3-9 (Woodbury). In the alternative, as Broome had pointed out, if royalty is due on OTF fuel gas, the royalty is a reasonable cost of post-production treatment of "sour" gas, and therefore properly deductible for the reasons stated above. PX49 at 2.

3. Sulfur was a product "manufactured or extracted" from the gas within the meaning of paragraph 5(b). R29/1785:1-1788:25 (Haynes). Accordingly, royalty was due only on Exxon's "net realized amount" – that is, the amount by which sulfur revenues exceed the direct cost of manufacture. R27/1273:8-14 (Woodbury).

4. The spent diesel sold as "slop oil" at the OTF contains both dissolved diamondoids and fresh diesel that Exxon added to the wellstream. DX1096 at 6; R31/2151:13-2152:6 (Brown). Exxon pays royalty only on the incremental value of the diamondoids, that is, on the amount by which revenues from slop oil sales exceed the cost of the diesel injected by Exxon. PX67 at 2; PX182 at 0045770. Diesel oil injected

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specifically addresses "used" gas. Moreover, the interpretive notes to the *Nebraska Law Review* model lease, from which Macrory took the "however" clause, show that it was intended to protect the lessor in the situation where gas is *lost* (e.g., by flaring), so that it is neither sold nor used. PX132 – Glen L. Houston & Maurice H. Merrill, *A Suggested Oil and Gas Lease Form*, 43 Neb. L. Rev. 471, 474 n.4 (1963). Reading the "however" clause, consistent with its origin, as dealing only with "lost" gas avoids the conflict with paragraph 5(b) and the rest of paragraph 5(a), and fits well with the proviso immediately following, which excludes from royalty gas "lost" through flaring *for well testing purposes* only.

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into the wells is manifestly not "produced or sold from the leased area," so no royalty on it (as opposed to the diamondoids) is owed. R27/1275:5-7 (Woodbury).

5. Electricity generated using fuel gas is not a product "manufactured or extracted" from the gas within the meaning of paragraph 5(b). Exxon therefore does not pay royalties on electricity as such. Exxon does pay royalties on "co-gen" fuel gas, that is, gas used to generate the electricity sold to Alabama Power, but not on other fuel gas used to generate electricity used by Exxon to power operations of the platforms or the OTF. PX67; R25/984:9-985:2 (Macrory).

When production began in 1993, Exxon began paying royalties on this basis, and it has done so ever since. Both in 1993 and later, of course, Exxon's decision-makers recognized that the State might challenge its interpretation, and therefore that there was a prospect of litigation over the proper interpretation of the lease. HR34/321:1-9 (Condray). The 1993 decision package advised expressly that the "State [is] expected to audit within one year of first production."[12] PX182 at 0045770. Exxon believed in

[12]One of the State's least plausible contentions in this case is that a reference in the decision package to the fact that DNCR's "regulatory staff and processes" were "inexperienced" (something that in 1993 was manifestly true, since large-scale gas production in Alabama was new as compared with other states like Texas or Louisiana) meant that Exxon thought that its interpretation of the lease would not be detected. PX182 at 0045769. That is the one thing the reference cannot possibly mean, since the very same document reported Exxon's expectation that there would be a prompt audit. *Id.* at 0045770. It is only common sense that "inexperienced" regulators are the most likely to seek outside assistance, and to make up for their inexperience by hiring an aggressive outside auditor. And that is just what the State did. DX277.

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good faith it had a reasonable position about the proper interpretation of a new and untested lease form. PX182 at 0045765, 0045769-70; HR34/313:21-314:3 (Condray). Exxon knew that its royalty position would be fully disclosed during the audit, which Exxon knew was inevitable, and that whether Exxon's interpretation was correct would ultimately be determined in litigation, if agreement with the State could not be reached.

IV. EXXON'S REPORTING AND THE STATE'S AUDITS

Exxon's dealings with State regulators confirm that Exxon had nothing to hide and hid nothing. Before production began in 1993, Exxon applied to the Alabama Oil and Gas Board ("AOGB") for an order approving metering, allocation and reporting procedures for its Mobile Bay project. DX1096; R30/1854:19-1855:4 (Bolin). The public file of that proceeding discloses precisely how Exxon measures, allocates and reports production of hydrocarbons in Mobile Bay, and provides a roadmap for tracing the disposition of every cubic foot of gas (and every other hydrocarbon) that Exxon produces. DX1096. AOGB invited DCNR to comment on

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the proposed procedures.[13] R30/1855:9-1857:15 (Bolin). In response, DCNR State Lands Director Jim Griggs confirmed to AOGB that:

> *The exhibits [setting forth the proposed metering, allocation and reporting procedures] were reviewed by our in-house petroleum engineer and our auditor* with regard to only those matters which bear on royalty revenues to the state....
>
> With regard to the overall metering and allocation process for produced gas and liquids our staff finds no objection. It appears that *the Exxon configuration and the incorporated Oil and Gas Board staff suggestions adequately protect the state's ability to assure that it is accurately paid the revenues to which it is entitled.*

DX1096 at Ex. 9 (emphasis added).

Consistent with the procedures approved by AOGB and DCNR, Exxon has filed sworn monthly production reports with AOGB (Form OGB-15) disclosing, for each offshore well in Mobile Bay: (1) the dry wellstream volume of sour gas; (2) the shrinkage from removal of H_2S and CO_2; (3) the disposition, by volume, of the resulting

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[13]AOGB and DCNR are sister state agencies jointly responsible for development of the State's mineral resources. Recognizing the overlapping responsibilities of the two agencies, in 1973 the Legislature established the Minerals Resource Management Committee, composed of the Secretary of AOGB, the Commissioner of DCNR, and the State's Director of Finance. *Ala. Code* § 9-5-1 *et seq.* As stated in § 9-5-3:

> The major function of the minerals resource management committee is to maximize the income realized by the state from oil, gas and other mineral resources owned by the state. In order to fulfill this function, the minerals resource management committee is hereby empowered and authorized to coordinate the activities of all state departments and agencies, but particularly the department of conservation and natural resources and the state oil and gas board relating to the development of the mineral resources owned by the state.

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sweet gas – whether sold or used as platform fuel, OTF fuel, co-gen fuel, or flare gas; and (4) the volume and disposition of produced "condensate."[14] DX599; R30/1841:17-1846:1 (Bolin). Exxon also filed each month a sworn report (Form OGB-18) showing similar information for the OTF on a plant-wide basis, together with monthly sulfur production and disposition. DX 599; R30/1846:2-1848:20 (Bolin). These reports are public records available to anyone, including DCNR. R28/1410:6-1411:2 (Cone); R28/1472:6-1475:3 (Snyder); R30/1852:1-1854:2 (Bolin). In recent years, AOGB has posted Exxon's production information on the Internet. R30/1853:19-1854:2 (Bolin). As required by statute, AOGB monitors the accuracy of Exxon's metering and the resulting reports on a continuous basis. R30/1849:2-1851:25 (Bolin). No one contends that these reports were false or misleading; indeed, the State's auditors and its damage expert used them to check the accuracy of Exxon's internal production reports. PX196 at 0167; R30/1860:13- 1863:14 (Bolin); R28/1472:6-1475:3 (Snyder); R29/1724:8-17 (Solomon).

Paragraph 6 of the 1981 lease form required Exxon also to file sworn monthly reports of hydrocarbon production, disposition and proceeds, by lease, with DCNR. Unlike AOGB, however, DCNR had no standard reporting form. R28/1411:3-21

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[14]Exxon also disclosed to AOGB that production of "condensate" (*i.e.*, "spent" diesel volume attributable to dissolved diamondoids) would be reported only when the revenues began to exceed the costs of fresh diesel injected into the wells. PX196 at 0121. That first occurred in January 1996, and Exxon has duly reported all production and disposition of "condensate" ever since. *Id*.

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(Cone).[15] For the first year of production, Exxon duly paid royalties but inadvertently did not file these additional reports. HR34/341:11-342:18 (Condray). When, in late 1994, DCNR revenue analyst Nancy Cone contacted Exxon and asked for more information, Exxon's royalty reporting personnel told her that they had assumed that Exxon's reports to AOGB were sufficient. DX391; R27/1379:24-1380:15, 28/1403:22-1404:18, 28/1411:3-1413:6 (Cone).

Following Cone's contact, Exxon's royalty group set out to develop a format for additional reports satisfactory to DCNR. PX66; PX67; DX391. By February 1995, after further discussions and a meeting at Cone's offices, Exxon and DCNR settled on a report format that disclosed, for each royalty-bearing category, (1) the gross value received at the tailgate; (2) the "netted gross" value (gross value less deductible gathering and treating costs) and (3) the volumes on which the gross and net values were computed. Tab I to PX197, 201 & 203. In addition, Exxon filed a separate monthly report of gross and net sulfur values. PX198, Tab Q; PX201, Tab R; PX204, Tab R. Exxon has reported this information to DCNR every month since March 1995; and DCNR accepted these reports, without complaint, from March 1995 through the time of trial. R28/1417:18-1418:7, 1422:14-19 (Cone).

The royalty reports showed on their face that Exxon was cost-netting. Tab I to PX197, 201 & 203; R28/1417:4-17; 1421:14-1422:19 (Cone). They reported the gross

[15]Indeed, DCNR had no standard form for reporting royalties until March 2001, after the trial of this case. HDX253; HDX255; HDX256.

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values received by Exxon, and they reported the "netted gross" values on which royalty is paid. *Id.* The figures were different. *Id.* No one could read the reports and not know that deductions were being taken from the gross values for royalty purposes. Similarly for sulfur: the reports show gross and netted values. PX198, Tab Q; PX201, Tab R; PX204, Tab R. They make plain that gross and "netted gross" are not the same, and that royalties are being paid only on the "netted gross." *Id.* No claim is possible that DCNR was deceived on any of these points.

In fact DCNR unquestionably knew *all* the relevant facts. In the course of the discussions that began in late 1994, Exxon disclosed candidly to DCNR Exxon's position on all the lease interpretation issues now in dispute. R28/1403:22-1404:18, 1421:14-1422:19 (Cone). In March 1995, Nancy Cone wrote DCNR State Lands Director Griggs and Assistant DCNR Commissioner Macrory to report that Exxon had advised her: (1) that it was taking cost-netting deductions for post-production expenses; (2) that it was paying royalties on "co-gen" fuel gas *only*, that is, Exxon was *not* paying royalties on other gas used for fuel; (3) that it was not then paying royalties on sulfur sales because manufacturing costs exceeded revenues; and (4) that it was not then paying royalties on slop oil sales because the cost of fresh diesel injected into the wells to dissolve diamondoids exceeded the sales value of the slop oil that resulted. PX67. A copy of this memorandum is included in the Appendix at Tab 2 because of its importance: it shows plainly that there was no fraud and that DCNR fully understood – even if it did not agree with – Exxon's royalty position. Cone advised Exxon that the

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disputed items would be taken up when the State audited Exxon's royalty payments, something that was by then imminent. PX67; R27/1383:1-9, 1384:6-17, 1387:6-1388:3 (Cone).

From the outset, the State had intended to audit every single month of production, just as Exxon anticipated.[16] In 1995 the State hired an aggressive outside auditor (George Kaess), who held himself out as a specialist in auditing gas leases. R28/1439:16-22 (Snyder); R31/2025:19-22 (Kaess); DX277. Kaess began with AOGB production reports, as any auditor would have; he also obtained additional detailed information from Exxon directly.[17] R31/2046:8-21, 2079:1-22 (Kaess); PX196 at 0137.

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[16]PX67; DX277; DX391; R27/1383:1-11 (Cone). As DCNR Director Griggs said in deposition testimony offered in support of Exxon's unsuccessful summary judgment motion:

> Q. Before first production began from the bay, the department never intended simply to take a representative sampling; it was going to audit every month of the production?
> A. That's correct.
> Q. They weren't going to rely on anything or any month that the producers gave to them?
> A. That's correct.
> Q. They were going to audit every single month themselves?
> A. That is correct.

C9/1673 at 1717.

[17]This information included (1) internal reports showing the production, allocation and disposition of all produced gas [Tab E of PX196, 200, & 202]; (2) internal reports detailing all sales made, prices received, and transportation costs paid each month [PX199 at 1-374]; (3) internal source reports for volumes and value of gas produced

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Exxon provided an explanation of its cost-netting methodology, together with data on the relevant costs. PX196 at 0122; PX199 at 0375-0414. When the audit was over, Kaess and DCNR's in-house auditors thanked Exxon for its assistance and cooperation. DX371.

Kaess's initial audit report covered the period October 1993 through December 1995. DX371. As expected, his claim in that audit (and in a subsequent one covering 1996-97) included all the disputed lease interpretation issues flagged in the earlier discussions between Exxon and DCNR. PX196 at 0005-6; PX200 at 0004-5. More than one-half of Kaess' $132.1 million claim from the two audits, however, rested on an entirely new theory that Exxon had failed to obtain a high enough price for the gas it sold.[18] PX196 at 0003-6; PX200 at 0003-5. The State abandoned Kaess' "best price"

during the initial months of production before Exxon and DCNR had developed Exxon's detailed royalty reporting format [PX197, Tab I at 0276-0442]; and (4) similar information for sulfur, condensate, co-gen fuel, and electricity. For sulfur volume information, *see* PX198, Tab O; 201, Tab P; 204, Tab P. For sulfur price, *see* PX198, Tab P; 201, Tab Q; 204, Tab Q. For condensate volume, *see* PX198, Tab R; 204, Tab S. For condensate price, *see* PX198, Tab S; 204, Tab T. For co-gen fuel, *see* PX198, Tab M; 201, Tab M, O; 203, Tab M; 204, Tab O. For electricity, *see* PX198, Tab N; 201, Tab N; 204, Tab N.

[18]Under paragraph 5(a), royalty on gas sold is due on the higher of the price received or the "best price realizable in the exercise of reasonable diligence." Gas prices fluctuate during each month. R29/1689:7-1690:3 (Solomon). Exxon pays royalty based on the weighted average of prices actually received during the month, multiplied by the volume of gas sold. HR35/445:4-446:5 (Nicholson); HR36/691:11-22 (Borden). Kaess contended that the "best price" clause meant that royalty for the entire volume of gas sold in a month should be based on the highest price received at any time during the month for *any* volume of gas sold, regardless of whether that price was obtainable on any other day. R31/2058:11-2059:5; C5/962.

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computation only shortly before trial, after State Lands Director Griggs and an expert retained by the State testified in deposition they disagreed with it. C7/1371 at 1371-74, 1384-85, 1387-90; R29/1628:25-1629:13 (Solomon).

In 1997 and 1998, Exxon met with DCNR representatives on several occasions to try to resolve the audit issues. PX196 at 0137-38. Exxon continued to provide information as requested by the auditors. *Id.* After the 1998 gubernatorial election, the new administration hired outside counsel, on a contingency fee basis, to pursue claims against Exxon and other Mobile Bay gas producers. Further settlement talks failed, and on July 28, 1999, Exxon filed this declaratory judgment action.

V. PROCEEDINGS AT TRIAL

Trial commenced December 4, 2000. The trial court denied all parties' motions for summary judgment concerning interpretation of the lease, on the ground that "there isn't anything clear about that lease." R21/150:8-9. Nevertheless, she allowed the State to argue to the jury that the meaning of the lease was so palpably clear that any interpretation differing from the State's was "fraudulent." She instructed Exxon not to tell the jury that the trial court itself had found the lease unclear. R22/377:21-378:1. And in post-trial proceedings, reversing herself *sub silentio*, she upheld the $3.42 billion award of punitive damages on the ground that Exxon's lease interpretation position was "frivolous." C19/3762 at 3781. "There isn't anything clear" had become "There isn't anything *un*clear." *Compare* R21/150:8-9 *with* C19/3762 at 3764-66, 3781.

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The trial evidence falls into three categories: lease interpretation evidence, evidence about the amount of royalties allegedly underpaid, and evidence supposedly relevant to "fraud."

A. Lease Interpretation Evidence

The State called Macrory, the author of the leases. He testified about the materials he had used to cobble together the lease form. R25/829:13-852:17, 922:14-962:11 (Macrory). The trial court allowed him to tell the jury, over Exxon's objection, what he had "intended" to achieve in drafting the lease. R25/829:13-882:22; 913:18-21 (Macrory).[19] It was undisputed that Macrory's subjective intent in preparing the lease form was never communicated to Exxon at any time before the lease was signed. Settled Alabama law accordingly rendered this evidence inadmissible. *Chastain & Blass Real Estate & Ins., Inc. v. Davis*, 195 So. 2d 782, 784 (Ala. 1967).

The State also called two law professors, who gave generally cumulative testimony to the effect that, because the State's lease form was "unique" and different from all industry-drafted forms, it must be read to disallow *any* deductions from gross

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[19]Macrory's "intentions," as reported from the stand 20 years after the fact, differed considerably from his contemporaneous documents, which generally supported Exxon's interpretation of the lease. Thus his 1981 memorandum requesting the DCNR Commissioner to approve the final lease language stated that paragraph 5 would permit deduction of reasonable direct costs of manufacture and transportation "when gas is treated or processed." DX243. And his 1981 outline of the lease terms emphasized that paragraph 5(a) provided for "royalty based on production of any covered mineral and its sale from the leased area" [DX203 (underlining in original)], implying (as Exxon later concluded) that the proper valuation point for royalty calculation was not the tailgate but the leased area.

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proceeds. R24/746:9-748:11, 761:2-6 (Weaver); R27/1299:9-22, 1304:18-1305:9, 1312:5-8 (Burney). This testimony was offered, also over Exxon's objection, on the theory that the law professors were opining about "industry custom and practice" – a theory of admissibility that contradicted their basic position, on the merits, that these leases were *different* from normal industry leases. R24/746:9-750:6, 761:2-6 (Weaver); R27/1304:14-1312:-8 (Burney). In fact, the law professors did no more than give legal opinions favoring the State's position; and if the trial court had applied Alabama law she would have excluded their testimony, too. *Phillips v. Harris*, 643 So. 2d 974, 976 (Ala. 1994); *Kennedy Elec. Co. v. Moore-Handley, Inc.*, 437 So. 2d 76, 82 (Ala. 1983).

Its objections having been overruled, Exxon presented rebuttal testimony from an eminent oil and gas law expert, David Pierce of Washburn University School of Law.[20] Pierce pointed out that the language of the State's form, while certainly non-standard, failed by its terms to exclude customary deductions for free fuel or post-production costs (other than capital costs of pipelines and plants). R30/1911:12-21 (Pierce). He also testified that the language specifying payment of royalty on gas "produced and sold from the leased area" could be read, consistent with conventional lease language establishing a royalty valuation point at the well or lease, to permit limited cost-netting deductions of the type Exxon took. R30/1902:5-1909:9 (Pierce).

[20]Pierce is coauthor of *Kuntz on the Law of Oil and Gas*, a leading treatise on oil and gas law. R30/1895:2-1896:15 (Pierce).

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None of this mattered. Once the trial court allowed the introduction of Broome's privileged legal opinion, the niceties of oil and gas lease interpretation disappeared. As soon as the lay jury heard that Exxon's own lawyer thought Exxon's chances of prevailing in court were "less than 50%," the result was foreordained. Though Broome reached that conclusion only as to one issue (limited cost-netting), that did not stop the State from distorting what he said beyond recognition. *See* pp. 118-19 *infra*. The Broome letter became the centerpiece of the State's argument. It deprived Exxon of a fair chance to win the lease interpretation issues with the jury (or any jury); and it set up the State's argument that a "knowing" breach of contract constituted "fraud," the false premise that underlay the State's entire case for punitive damages. *See* pp. 61-63, 118-19 *infra*.

The State drove this point home with constant references to what it called the "nine documents that prove fraud." R32/2212:18-19; R23/414:11-15, 425:7-8, 461:13-16; R32/2217:20-24, 2258:20-21, 2261:23, 2363:1-10. Besides the Broome letter and the package presented to Exxon management in 1993 (which the State counts as three of its nine documents), there were five of them:

! PX29 was one of the standard bid letters used in the 1981 sale. The State repeatedly characterized the bid form as a promise to pay royalty on *all* gas "used on or off the lease," with no exceptions.[21] But of course the State's own bid solicitation

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[21]*See also* PX31-32 and 42-45 (other 1981 bid letters on identical form). Although the bid letters were submitted on Exxon letterhead, their form was specified by the State.

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made plain that the lease controls, and the language of the bid form was merely a shorthand reference to the terms of the lease. PX112; R27/1245:20-1251:9 (Woodbury); *compare* PX29 *with* PX6. Moreover, the State acknowledges that under the lease there are at least two situations, neither mentioned in the bid form, where no royalty is due on gas used by the lessee (gas flared for well testing and gas recycled to improve "gas lift"). R25/870:16-871:11 (Macrory). Thus, nothing in the bid form is inconsistent with the idea that the lease might contain other exceptions that the bid form does not mention. The bid letter, in short, was a summary document, and the State's argument that it required payment of royalties on "used" gas without any exceptions is inconsistent with the lease.

! PX73 is a 1988 letter from Exxon's Mobile Bay project manager Kartzke to the head of AOGB, commenting on how the State could make investment in State leases more attractive. Kartzke pointed out that the lease form did not "permit deductions from proceeds for unusual *development* costs or expenses." PX73 at 0016635. And of course that is true: Alabama's 1981 lease form does not permit the lessee to deduct the costs of developing the leases. The question here, however, is not whether *development* costs may be deducted, but whether any portion of post-production *gathering* and *treatment* costs may be deducted. That is an entirely different matter.

R25/890:2-16 (Macrory).

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Nothing in Kartzke's letter is contrary to the lease interpretation that Broome offered, or that Exxon adopted.

! PX151 is an undated summary of *some* of the royalty language, apparently prepared in 1988. It does not address the question of where gross proceeds are to be valued for royalty purposes. It proves nothing at all about whether Exxon was correct in concluding that the valuation point was the "leased area."

! PX152 is a provisional summary of deductions potentially available under the lease. It was prepared in 1988, before Exxon had begun, let alone completed, its 1993 legal analysis of the language. But it is not inconsistent with Broome's interpretation. It shows that in 1988 Exxon read the lease as *clearly* allowing free use of platform fuel and deduction of sulfur manufacturing costs; and it treats all the deductions Exxon eventually decided to pursue (and several others it decided not to pursue) as ones potentially allowed. The document does not support *any* inference that Exxon "knew" the deductions it took in this case were "wrong."

! PX179, finally, is a stray workpaper for a 1990 "base case" Mobile Bay funding scenario prepared before Exxon decided to proceed with Mobile Bay development. It assumes a conservative approach in which only sulfur manufacturing costs would be deducted, but does not speak to whether any other costs might be deducted after closer analysis of the lease (which did not occur until 1993).

Perhaps a jury – even one not already inflamed by the Broome letter – could have concluded from these documents that more than one interpretation of the lease was

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possible. But none of the documents has any tendency to show that Exxon was acting in bad faith, or that it "knew" its interpretation of the lease was "wrong." Much less, despite the State's mistaken legal theory and its inflammatory rhetoric, did they show anything even remotely relevant to *fraud*.

B. Amount of the Alleged Underpayments

The State claimed compensatory damages of $87.7 million, which the jury awarded *in toto*. C10/1987; PX146b; R29/1613:24-1614:4 (Solomon). $27.6 million was statutory interest at 12 percent, leaving an actual damages claim of $60.1 million. R29/1746:21-1747:1 (Solomon). Of this, about $22 million represented a claim for royalties on so-called "unpaid volumes" – gas for which Exxon allegedly owed royalties but had paid nothing; $33 million was the State's claim for "paid volumes" – gas for which Exxon had paid royalties, but had paid less than the State contended was due; and $5 million represented the State's claims related to sulfur, electricity, and slop oil. PX196 at 0156; PX200 at 0097; PX202 at 0333.

1. The State's Unpaid Volumes Claim

The "unpaid volumes" claim was presented by Saul Solomon, an accountant retained by the State's lawyers. Had Solomon calculated these volumes correctly, they should have equaled, approximately, the volume of gas used by Exxon as fuel gas for the offshore platforms and the OTF, since these were the only volumes on which Exxon did not pay royalties. PX67. His calculation was infected, however, by a fundamental error

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which led him to greatly overestimate the unpaid volumes. As a result, his computation of the royalties allegedly due on those volumes was seriously and unjustifiably inflated.

Solomon's error lay in his failure to appreciate the effect of treatment at the OTF on the heat content of gas per unit of volume. Although gas is physically measured and metered in thousands of cubic feet (mcf), the price of gas depends on heat content, which is measured in millions of British Thermal Units (MMBTU). DX1096; R30/1868:14-15 (Bolin). Treated gas has higher heat content per cubic foot than untreated gas because the treatment process removes both carbon dioxide (which has no heat content) and hydrogen sulfide (which has very little heat content). DX1096 at 5, 44-48; Tab H of PX197, 200 & 203. Removing these components reduces physical volume but leaves a gas that is richer in heat content per cubic foot. DX1096 at 35-48.

Because royalties are based on the *value* of gas, which in turn depends on heat content, Solomon needed to measure the "unpaid volumes" in terms of their heat content, that is, in terms of their content expressed in MMBTU. As his first step in deriving this figure, Solomon computed the MMBTU content of *all* the gas Exxon produced. He made this computation correctly, using heat content measurements made *at the wellhead*. Tabs C, D, & E of PX196, 200 & 202; Tab H of PX197, 200 & 203. He then subtracted what he thought was the MMBTU content of the gas on which Exxon had paid royalties (*i.e.*, the "paid volumes"), taking the difference as his estimate of the MMBTU content of the unpaid volumes. Schedule 2 of PX 196, 200 & 202.

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But Solomon did not correctly compute the MMBTU content of the paid volumes. The volumes Exxon *produced* are untreated gas, and the wellhead measurements of heat content of course reflect that fact. Tab H of PX197, 200 & 203. The paid volumes, however, are *treated* gas – *i.e.*, gas sold to customers at the OTF tailgate or gas used as "co-gen" fuel. Tab I of PX197, 201 & 203. Treated gas has *higher* MMBTU content per mcf than untreated gas. Yet Solomon computed the MMBTU content of *treated* gas using the same *wellhead* heat content measurements he had used to compute the MMBTU content of the *untreated* gas. Tab C of PX196, 200 & 202. This was contrary to the undisputed – and indisputable – physical facts. To do the calculation correctly, Solomon should have computed the MMBTU content of the paid volumes using heat content measurements taken at the OTF tailgate, which reflect, accurately, the richer heat content of the treated gas. PX1096 at 5.

Solomon's error significantly *understated* the MMBTU content of the *paid* volumes, and therefore significantly *overstated* the MMBTU content of the *unpaid* volumes. An example demonstrating this point from Solomon's own work papers is included in the Appendix at Tab 5. Worse, Solomon told the jury that these fictitious "unpaid volumes" could not be accounted for as fuel gas, implying that Exxon had cheated the State by failing to pay royalty on the missing gas. R29/1620:6-22 (Solomon). In fact, no missing volumes existed; they were a mirage created by Solomon's failure to use the right heat content measurements.

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Exxon demonstrated Solomon's error at the post-judgment *Hammond* hearing. HR35/432:1-434:24, 436:2-439:12; HR37/979:20-983:10 (Nicholson). The error inflated the State's $22 million "unpaid volumes" claim by over $13 million.[22] HDX183A, Tab 15. Solomon did not deny that he should have used the (correct) tailgate heat content measurements in performing his analysis, but sought to shift the blame by pretending that Exxon had failed to provide them. HR36/776:24-771:1; HR37/897:1-901:4 (Solomon). This was false, and Solomon must have known it was false. Correct tailgate measurements for most months appear in Solomon's own work papers. PX196 at 0102; PX201 at 0246-63; PX204 at 0029-39. He knew they were there since he used them to carry out a separate calculation he made of the MMBTU content of "co-gen" fuel. PX201 at 0245-46.

2. The State's "Best Price" Claim

Of the State's $33 million (before interest) "paid volumes" claim, Solomon attributed 40% to cost-netting deductions and 60% to what he called the "best price"

[22]Exxon did not detect Solomon's error at trial, since the State did not produce Solomon's work papers in advance of his deposition. One day *afterwards*, on November 9, 2000, the State yielded up nine three-inch-thick notebooks containing approximately 4000 pages of spreadsheets and source documents. Trial began 25 days later. Only after the trial was Exxon able, with the assistance of Warren Nicholson of Ernst & Young, to determine the source of Solomon's errors. As the example given in the Appendix (Tab 5) shows, however, once what Solomon did is known, his mistake may be readily shown from the trial record, which includes the late-produced notebooks. PX196–PX204.

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claim. PX146b; R29/1621:4-1622:14 (Solomon). The "best price" claim was fatally infected by Solomon's calculation errors.

Paragraph 5(a) of the lease, relating to "sold" gas, calculates royalty based on the higher of "the price received [by Exxon] or . . . the best price realizable in the exercise of reasonable diligence." The theory of the "best price" claim was that the price Exxon received for gas it sold was not always the "best price realizable in the exercise of reasonable diligence." Unlike the State's other claims, this claim involved no suggestion that Exxon had misled the State. The issue was a simple factual one: was there a price "realizable in the exercise of reasonable diligence" which Exxon had not obtained?

The State's starting point was testimony from Jeffrey Leitzinger, its retained economist. He gave his opinion about what the "best price realizable in the exercise of reasonable diligence" was for each month for which royalties were due. R29/1504:14-15 (Leitzinger). Solomon then calculated what he called the "gross price received by Exxon," that is, the price before cost-netting deductions that Exxon used as the starting point for computing the royalties it paid each month. Tab L of PX198, 201 & 203. He adjusted this price for certain transportation costs and compared it with Leitzinger's hypothetical "best price realizable," selecting the higher of the two as the price on which the State was entitled to be paid royalties. R29/1622:6-14, 1690:23-1691:8 (Solomon); Schedule 3 of PX196, 200 & 202. The result was the State's "best price" claim for additional royalties. *Id.* Every element of this calculation had serious problems.

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First. Leitzinger's "best price" was always the highest of the three monthly average spot prices quoted on the three independent pipelines connecting to the OTF tailgate. R28/1524:20-1525:3, 1526:1-11 (Leitzinger). If Exxon's average sales price for the month was less than this highest monthly spot price, Leitzinger said that Exxon had not obtained the "best price realizable." R28/1524:20-1536:24 (Leitzinger). But he admitted – and the evidence showed without dispute – that the pipeline with the highest spot price did not have the physical capacity to take all of Exxon's Mobile Bay gas, let alone all the *other* Mobile Bay gas which was competing for the same limited transportation space. R28/1528:8-16, 1531:14-1532:11, 1580:8-12 (Leitzinger); R30/1961:6-1964:5 (Browning). Leitzinger's estimate of the "best price" thus was *not* in fact a price "realizable" by Exxon, either in the "exercise of reasonable diligence," or at all, and cannot possibly have equated to the "best price realizable in the exercise of reasonable diligence," which is the price on the basis of which the lease says Exxon must pay royalties. Leitzinger's calculation was thus fatally deficient.[23]

Second. Solomon's "gross price" calculation involved the same heat content error that has already been discussed. The prices Exxon actually receives for its gas are shown in monthly sales reports that were supplied to the State's auditors. PX199

[23]This is hardly surprising. Exxon is a profit-making company, with every interest in selling its gas for as much as any buyer will pay. Exxon's interests are exactly aligned with those of the State, since Exxon shares revenues with the State in proportion to the State's royalty interest. Exxon has every financial interest in selling its gas at the highest price the market will pay. R30/1973:5-1974:11 (Browning). Common sense thus rejects the entire premise of the State's theory and Leitzinger's testimony – that Exxon would knowingly or negligently fail to achieve the highest price realizable.

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at 1-374. Solomon ignored these and instead attempted to derive his own "gross price received by Exxon" from Exxon's monthly royalty reports to the DCNR. Tab L of PX198, 201 & 203. To calculate this "gross price," Solomon took the volume of royalty-bearing gas reported (in mcf) for each lease, computed what he thought was its MMBTU content, and divided the resulting MMBTU figure into the reported gross value to obtain what he thought was the gross price per MMBTU. *Id.* Had Solomon not blundered, his method would have worked, producing prices exactly matching those shown in Exxon's monthly sales reports.

As before, however, Solomon used the wrong heat content measurements. Instead of measurements made at the tailgate (the only ones appropriate for *treated* gas), he again used measurements of the heat content of untreated gas made at the wellhead. *Id.*; Tab H of PX197, 200 & 203. As a result, his estimates of the MMBTU content of gas volumes reported on the royalty statements were wrong, and the "gross prices" he obtained when he divided those estimates into the gross values reported on the statements did not match the prices Exxon actually received. Indeed, Solomon's computed "gross prices" were *higher* than the actual prices received.[24]

[24]*Compare* Tab L of PX198, 201 & 203 *with* PX199 at 1-374. Solomon also should have seen his error for another reason. When he divided his incorrectly computed MMBTU figures into the gross values shown on the royalty reports, his calculation produced a *different* "gross price" per MMBTU for *each lease*. Tab L of PX198, 201 & 203. When it enters the OTF, however, gas from all leases is commingled in a single stream. DX1096 at 3. Accordingly, while one can sell portions of the commingled tailgate gas stream at different prices to different purchasers, it would be impossible to sell gas from one lease at one price and gas from a different lease at a different price. HR35/444:18-446:14 (Nicholson). Solomon disregarded this anomaly.

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Third. Solomon then compounded his error by mistakenly assuming – presumably because his computed gross prices were too high and he needed a "fudge factor" – that the gross values shown in Exxon's royalty reports had been calculated *before* deduction of post-tailgate transportation costs.[25] R29/1642:8-1643:3 (Solomon). As a final step in his computation, he *subtracted* from his calculated "gross price" an estimate of post-tailgate transportation costs provided by Leitzinger. *Id.*; PX198 at 0011-12; PX 200 at 0146 n.6(b); PX202 at 0060 n.6(b). This was nonsense, because it was undisputed that Exxon was entitled to report gross values *after* deduction of these costs, and there was no evidence that it was not doing so. Subtracting them a *second* time was indefensible.

When Leitzinger and Solomon compared the results of their calculations – now doubly wrong because of Solomon's double errors – with the prices Exxon actually received as shown in its monthly sales records, they found that the "gross prices" they had created were *lower*. Both Solomon and Leitzinger accordingly told the jury that Exxon paid royalties based on gross prices lower than what it was actually receiving. R28/1549:3-1552:10 (Leitzinger); R29/1681:7-1682:20 (Solomon). As before, however, there was no underpayment. There was only a mirage created by Solomon's multiple errors.

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[25]Sometimes the purchaser takes delivery at a location remote from the OTF. In such circumstances Exxon pays the cost of pipeline transportation from the OTF to the delivery point. PX199 at 1-374. When this happens, the State's royalty is based on what the customer pays less the costs of post-tailgate transportation of the gas from the OTF to the purchaser. R30/1985:21-1986:10 (Browning).

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The State told the jury that fully two-thirds of its $30 million (with interest) "best price" claim was attributable to Exxon's failure to pay royalties on the basis of prices actually received. R28/1550:24-1552:10 (Leitzinger); R29/1622:21-1623:21 (Solomon); R32/2256:10-2257:9. But in fact the "failure" was entirely fictitious. If one replicates Solomon's calculations but fixes his errors, using correct heat content measurements and without his erroneous deduction of post-tailgate transportation costs, the alleged underpayment completely disappears: the "gross price" per MMBTU calculated from the royalty reports matches *exactly* the price Exxon actually received as shown in its sales reports. An example demonstrating the point from Solomon's own work papers is given in the Appendix at Tab 6. Exxon also demonstrated this point at the *Hammond* hearing. HR37/1001:25-1005:15 (Borden); HDX265N.

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3. Tract 77A

Solomon's damage calculations attributed $5,249,323 in damages to a lease known as Tract 77A. PX196 at 0189; PX200 at 0103; PX202 at 0006. The record shows that Tract 77A is governed by State Lease No. 348. DX1096; PX196 at 0113; PX203 at 0469. Although the State offered into evidence 22 leases from 1981 and 1984, the State did not offer a copy of this or any other lease governing Tract 77A, and did not attempt to prove its terms though oral testimony. The record is simply silent as to the terms of that lease.

As shown by the lease number, the Tract 77A lease is earlier in time than the 1981 and 1984 leases that govern the other tracts. The 1981 leases start with No. 533; the 1984 leases with No. 611. PX6-27. The State's witnesses testified that pre-1981 leases were more favorable to lessees than the 1981 lease form; indeed Macrory said the purpose of the 1981 lease form was to alter the pre-existing lease terms. R25/829:13-831:23 (Macrory); R24/746:9-749:19 (Weaver); R27/1311:4-1312:8 (Burney). This is confirmed by evidence showing that Tract 77A deductions, unlike all others, include an amortized share of capital expenditures. PX196 at 0122-23. Thus, although the record does not show the exact terms of the Tract 77A lease, it shows plainly that the terms of that lease were different from – and indeed more favorable to Exxon than – the 1981 and 1984 leases which the State put in evidence.[26] *Id.*

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[26]There is no mystery here. Exxon does not believe that the State would dispute that Tract 77A is a corner of the original Mobil Oil Tract 77, which Exxon acquired from Mobil in 1992 and unitized with Exxon's other leases in Bon Secour Bay. It is therefore governed by the original Mobil lease, not the lease form that Macrory drafted in 1981.

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C. "Fraud" Evidence

We come at last to the question most pertinent to the State's $3.42 billion judgment for punitive damages. Did anything in the record show conduct by Exxon that could qualify as "fraud" as the law defines it – the making of a knowingly false representation on which the State relied to its detriment, or the concealment of information which Exxon had a duty to disclose, causing the State to change its position to its detriment?

Such evidence in this record was non-existent. The sole evidence that anyone at the State was ever misled or confused was the testimony of DCNR employees Nancy Cone and Frank Snyder. They said that at various times they had been confused about whether gas volumes reported on Exxon's monthly royalty statements to DCNR included platform and OTF fuel gas (on which Exxon was not paying royalties). But Cone admitted on cross-examination that Exxon disclosed to her in early 1995 that it was paying royalty *only* on fuel gas used to generate electricity sold to Alabama Power (*i.e.*, "co-gen" fuel), and *not* on fuel gas used in OTF or platform operations. R28/1421:14-1422:19 (Cone). Further, her March 1995 memorandum to Lands Division Director Griggs and Assistant Commissioner Macrory states unambiguously that "Exxon is *reporting only co-generation plant fuel* on the statements." PX67 (emphasis added). Thus, by March 1995, Cone understood that the royalty statements did not include royalties on fuel gas other than "co-gen" fuel, and she had conveyed that information, correctly, to senior DCNR officials.

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Snyder, too, admitted that Exxon told him it was not paying royalty on OTF fuel gas or platform fuel gas. R28/1458:13-1459:9 (Snyder). Further, he acknowledged that Exxon had detailed the precise volumes and dispositions of *all* gas produced from Exxon's Mobile Bay fields, including OTF fuel gas and platform fuel gas, in its monthly production reports to AOGB. R28/1472:6-1475:3 (Snyder). As Snyder testified, these reports were "always available" to him and anyone else at DCNR, and in fact he and Kaess "use[d] those figures in the audit." R28/1473:12-1475:3 (Snyder).[27]

Snyder admitted an additional critical fact that all other evidence in this case overwhelmingly supports – namely, that the differences between the State and Exxon in this case turn solely on issues of contract interpretation, not fraud. As Snyder put it, aside from "a couple of small mistakes" on both sides, the parties' dispute turned on a "theoretical question . . . [that] depends . . . upon your interpretation of the lease." R28/1469:25-1470:8 (Snyder). "*[I]f Exxon is correct in their interpretation of the lease, then they don't owe any additional royalty.*" R28/1469:19-21 (Snyder) (emphasis added); *see also* R25/993:1-15 (Macrory).

This is not the stuff of fraud. With witness after witness, the State argued that, when Exxon did not pay in accordance with the State's interpretation of the lease, it not

[27]DCNR indisputably knew about both the existence and the contents of AOGB reports at all relevant times. As set forth in the August 1993 letter from DCNR's Griggs to then-AOGB Chairman Mancini, quoted above, DCNR's in-house petroleum engineer *and its auditor* reviewed and approved Exxon's proposed procedures for metering, allocating and reporting all of its Mobile Bay production. DX1096 at Ex. 9. DCNR's in-house auditor, in other words, signed off on the procedures which established exactly what Exxon would report to AOGB and how Exxon would report it from the moment production began.

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only "underpaid" those royalties, but also "underreported" them. *See, e.g.,* R29/1635:9-23 (Solomon); R30/1815:21-25 (Haynes). To classify such "underreporting" as fraud, however, is false logic. Where, as here, Exxon fully disclosed the lease interpretation underlying its payments and reports, there can be no fraud.

D. Jury Instructions and Verdict

Exxon asked the trial court to instruct the jury that, under applicable law, knowledge of one state agency is imputed to others. R31/2190:22-2191:11; C10/1978. This instruction was important to Exxon's defense of the State's fraud claim because, as previously discussed, the volumes and disposition of Exxon's Mobile Bay production, including the gas used as platform and OTF fuel, were fully disclosed in Exxon's monthly reports to AOGB. The trial court refused to give the instruction. R31/2191:12-13.

The trial judge did so because of her extraordinary policy of refusing to give *any* jury instruction not included in the Alabama Pattern Jury Instructions, if the proposed instruction was objected to. *Id.* As Judge McCooey said:

> THE COURT: Well, let me tell y'all how I do my jury charges anyway. I always give the pattern. I don't mind giving *correct statements of law* as long as the other side isn't objecting. But *if they're objecting, I'm not giving it*.
>
> * * *
>
> All right. If you're objecting, like I said, *I only give correct statements of the law if the parties can agree*. I give pattern only.

R31/2184:17-21, 2191:25-2192:3 (emphasis added).

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Not surprisingly, this statement of the trial court's position prompted the State's counsel to object to all of Exxon's proposed non-pattern instructions, regardless of merit, on the surefire ground that "It's not APJI." R31/2181-2194. Every such objection was sustained. *Id.*

Equally remarkable was the trial court's apparent disdain for the whole idea that a jury should be clearly and carefully instructed on the law, and required to follow its instructions. In the middle of reading the instructions to the jury, the trial court all but instructed the jurors that it would be futile for them even to try and understand what they were hearing:

> THE COURT: *This is so hard*. I know y'all – *I've always thought, I sit here and read this stuff, and I know it's going in one ear and out the other. And I know it's hard to listen to all of these things*. And I will tell y'all at the end of all of this that if you have any questions on the law as I'm giving it to you -- sometimes I just wish I could just give y'all these to take back, but you can't. *And I know it's hard*. And I'll tell you if you have any questions on the law, I can answer those, reinstruct you on something, if you get back there and you need it again. I can't answer questions on the facts, either what a witness said or didn't say, but I can help you on this part. So once you get back there – like I said, *I've always thought to myself, you know, this is like jumbo-mumbo*, and I apologize, but this is how we have to do it. But when you get back there, if y'all have any questions, which you probably will, I'll be able to help you on that. *I know it's a lot to soak in, y'all, and I apologize. Just think, it took us three years to learn this in law school, and y'all are supposed to learn it in five minutes sitting here. It makes no sense, but that's what we're stuck with.*

R32/2391:16-2392:16 (emphasis added); *see also* R32/2404:9-12 ("Like I said, it takes us three years to learn it, and I still don't know it. I often wonder how they expect juries to soak all of this in.").

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So instructed, the jury took precisely two hours to deliberate. It returned with a determination of all liability issues in favor of the State, and the unprecedented $3.5 billion verdict that is now before the Court. C10/1987.

VI. POST-TRIAL PROCEEDINGS

The trial court summarily denied Exxon's motions for JMOL and new trial, refusing to allow Exxon even to brief them. HR33/29:22-35:23. On Exxon's motion, the court did schedule a *Hammond* hearing under *Ala. Code* § 6-11-23 to take additional evidence concerning the size of the punitive award.[28] C10/1997.

Exxon focused its presentation at the hearing on two central elements of post-trial punitive damages review: (1) the degree of reprehensibility of the alleged misconduct; and (2) the reasonableness of the award in relation to the actual or likely harm to the plaintiff. *See BMW of N. Am. v. Gore*, 517 U.S. 559, 575-84 (1996). Exxon called six witnesses.

! Ansel Condray, the senior Exxon executive who approved the company's 1993 decision on how it would interpret the lease and compute royalties, testified that he understood that Exxon had a good faith basis for each of its lease interpretation decisions. HR34/313:15-314:3 (Condray). He confirmed that Exxon expected the State to audit promptly (as the 1993 presentation package says), and expected the parties thereafter to resolve any disputes over Exxon's lease interpretation. HR34/314:4-8,

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[28] *Ala. Code* § 6-11-23(b) codifies the procedures applicable to post-trial *Hammond* hearings on the size of punitive damages, and authorizes the introduction of "[a]ny relevant evidence" on that issue.

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321:1-9, 376:20-23 (Condray). He noted that this approach to resolving lease interpretation issues was normal custom and practice in the industry, especially when dealing with new and untested lease forms like the 1981 form issued by DCNR. HR34/378:22-381:6 (Condray).

! Walter Rosenbusch, the head until this year of the Minerals Management Service of the United States Department of the Interior, the federal agency responsible for administering federal onshore and offshore oil and gas leases, agreed that it was not in any way reprehensible, but normal practice, for both government and industry to take competing positions – even "aggressive" ones – on the interpretation of new and untested royalty provisions. HR33/197:9-19, 34/237:11-239:21 (Rosenbusch). Such positions are resolved by negotiation in the audit process, or by litigation if the parties cannot agree. HR34/237:11-239:21 (Rosenbusch). He added that a company in Exxon's situation had no chance of hiding the way it was calculating royalties. HR34/227:6-234:23 (Rosenbusch). Just like Alabama here, all government lessors audit all major leases; issues like those in dispute in this case – cost-netting and free fuel use – are "Audit 101" issues that no competent auditor would miss and no company would expect to be overlooked. HR34/233:24-234:18 (Rosenbusch).

! Dr. Jonathan Walker, an expert economist, analyzed whether the award of punitive damages in this case could be justified on the basis of a need for deterrence. HR33/110:16-112:10 (Walker). He concluded it could not. HR33/117:10-14 (Walker).

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Drawing on well-recognized economic deterrence principles,[29] Walker explained that a rational profit-maximizing enterprise, like Exxon, will avoid misconduct whose expected costs exceed its expected benefits. HR33/133:25-136:14 (Walker). Punitive damages make sense for deterrence of a rational profit-maximizer *only* if there is a reasonable prospect that particular misconduct will frequently escape detection. HR33/133:25-140:9 (Walker). If underpayment of royalties is certain to be discovered, and if the underpayment must, when discovered, be made up with interest, then the prospect of compensatory damages and interest is alone enough to deter. *Id.*; HR33/152:9-153:10 (Walker). Since Exxon anticipated that it would be audited and its royalty calculations would be challenged, the 12 percent statutory interest penalty was more than sufficient to deter knowing underpayment of royalties. HR33/152:9-153:10 (Walker). Given such a penalty, no rational company would *knowingly* underpay royalties; rather, royalties would be withheld only when a company believed it had a non-frivolous legal argument that the royalties were not due.

! Finally, Dave Borden of the Montgomery accounting firm Aldridge, Borden & Co. presented an analysis demonstrating the gross excessiveness of the punitive damages in relation to the compensatory award. HDX 181; HR35/595:1-5. Borden's analysis was supported by foundational testimony from Warren Nicholson of Ernst &

[29]Despite the extensive economic theory supporting it (*see* note 50 *infra*), the trial court rejected Dr. Walker's testimony out of hand, and called it, on the record, "a bunch of b.s." The official transcript omits this remark, although all Exxon's lawyers heard it, and it was reported in the press the next day. *See* Mike Cason, *Testimony of Exxon's Witness Fails to Impress Circuit Judge*, Montgomery Advertiser, April 18, 2001, at 3C.

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Young LLP, an expert oil and gas auditor, and Ron Platt, a consulting petroleum engineer. HDX59; HDX134; HR36/609:14-22 (Borden). Nicholson showed that Solomon's compensatory damage computations overstated the State's damages by 20 percent even assuming that the State's lease interpretations were correct, primarily because of Solomon's use of incorrect heat content measurements for treated gas. HR35/434:7-439:12, 442:4-447:5 (Nicholson); HDX61, 62 & 63. Platt projected future prices and gas reserves for the Mobile Bay field using accepted industry methods and demonstrated that various "future damages" theories which the State used to justify the award were grossly exaggerated. HR35/504:2-528:8, 528:16-554:4 (Platt); HDX155, 158, 159, 160, 161, 162.

Drawing on these analyses, Borden showed that the already large ratio (39 to 1) of punitive to compensatory damages in this case grossly underestimates the excessiveness of the punitive award. If the compensatory damages are corrected just for Solomon's clear calculation errors, the punitive damages are over 47 times the actual damages awarded to the State. HDX181 at 10 (Chart 6). If the comparison is limited to the much smaller quantum of damages even arguably arising from "fraud" – the only one of the State's claims for which punitive damages are recoverable – then the ratio of the punitive award to compensatory damages is as much as 462 to 1. HDX181 at 12 Table B; *see* pp. 87-89 *infra*.

The State's only response to this evidence was to recall Solomon. His principal task was to present charts and computations depicting the $3.42 billion award as small

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in comparison to Exxon's financial resources. HR37/800:9-835:24 (Solomon). This evidence had minimal relevance, because Exxon had stipulated it could pay the award if ordered to do so, while current case law makes plain that large punitive damages may not be upheld merely on the ground that the defendant can afford to pay them. *See* pp.107-08 infra; *see also* HR36/761:12-763:5.

Solomon also presented a series of "future damages" estimates in an effort to concoct some kind of "harm" that could justify a $3.42 billion award. HR37/836:2-877:8 (Solomon). But these estimates were so discredited by the combined testimony of Borden, Nicholson and Platt that the State did not even bother to mention them in the proposed order it submitted to the trial court after the hearing. HR37/984:16-999:8 (Borden); C14/2759.

The State's lawyers' proposed order denied all relief, and the trial court adopted it essentially verbatim. C14/2759, C19/3762. Judge McCooey refused to reduce the punitive damages award by even a dollar, or to grant a new trial on any issue. *Id.* The order shows plainly enough that she shared the State's fundamentally mistaken premise that a giant award of punitive damages award can be made without any evidence of fraud, but solely on the basis that a large corporation has breached a contract without (in the State's view) a valid reason to do so.[30] *Id.* That notion permeated the

[30]At the *Hammond* hearing, Judge McCooey stated as follows:

> I mean, big companies, they sit there and they figure out, you know, this is how much we can rip you off or this is how much we can't or this is what we can't do, I mean, however you want to term it. But, I mean, that's normal in the business world.

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Hammond hearing, as it permeated the trial and all other proceedings below. But it was fundamentally wrong, and its acceptance by the trial court and the jury requires reversal of this judgment.

SUMMARY OF ARGUMENT

Inflamed by a clearly privileged document that should never have been admitted, the jury awarded $3.42 billion in punitive damages on the theory that Exxon had committed a fraud. But there was no fraud on the State of Alabama or anyone else. This case involves nothing more than a dispute about the meaning of a lease – and the trial court expressly ruled that "there [wa]s nothing clear" about that lease. Exxon brought this case to obtain a judicial declaration of the disputed lease language; and if Exxon's interpretation of the lease was wrong, there was at most a breach of contract. Punitive damages may never be awarded in Alabama for breach of contract, even "knowing" or "intentional" breach. The trial court erred in allowing the jury to award punitive damages on such a theory, and erred again in failing to set the punitive damages judgment aside.

The State's "fraud" contentions are entirely without substance. Exxon did not hide its interpretation of the lease, but disclosed it openly to the State's royalty collectors and auditors. Exxon's royalty reports to DCNR accurately reported the prices Exxon had received for Mobile Bay gas and showed that Exxon was cost-netting. Exxon did not hide or misrepresent its production and disposition of gas or other products from the

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HR33/157:16-21.

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Mobile Bay field, but reported them every month, under oath, to AOGB. Those reports were public documents, available to the State and to DCNR, and in later years actually posted on the Internet. DCNR's officials and auditors had actual knowledge of Exxon's reports to AOGB and used those reports when they audited Exxon.

Under these circumstances, *not one* of the essential elements of fraud is present. Exxon made no misrepresentation to the State and suppressed no material information. There was no evidence that Exxon intended to defraud the State, and no evidence that the State relied on anything in Exxon's royalty reports. Rather, the State always intended to do a complete audit of all Exxon royalty payments. Exxon always knew that it would be audited. It never hid its interpretation of the lease, but on the contrary expected that all disputes about lease interpretation would be fully aired in the audit, and then resolved either judicially or by agreement. This was a business dispute about the meaning of a lease, not a case that involved any kind of fraud. No punitive damages were legally permissible on these facts.

If there had been a colorable claim for fraud, it would have been barred by the statute of limitations. The State's counterclaim was filed more than six years after what the State itself alleges was the first act of "fraud," and more than four years after Exxon's lease interpretation was fully disclosed to the State. The trial court erred in holding that the State's counterclaim could not be barred by the statute of limitations because it was compulsory. This Court's decision in *Romar Development Co. v. Gulf View Management Corp.*, 644 So. 2d 462 (Ala. 1994), on which the trial court relied,

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was wrongly decided, departed from a century of settled Alabama precedent, and ought to be overruled.

In any event, punitive damages may not be awarded in favor of the State. The plain words of *Ala. Code* § 6-11-21(*l*) prevent an award of punitive damages to the State. Such an award is also prohibited by the Due Process Clauses of the U.S. Constitution and the Constitution of Alabama.

If any award of punitive damages were permissible in this case, the grossly excessive award of $3.42 billion would nevertheless have to be set aside or drastically reduced. Alabama statute and this Court's cases cap punitive damages at three times compensatory damages, which would reduce the award to at most $263 million on the jury's award (itself inflated) of $87.7 million; and to no more than $22.2 million if the cap is applied, as it should be, against the much smaller compensatory damages arguably attributable to the "fraud."

Moreover, even a reduced award, let alone the jury's $3.42 billion one, would be grossly excessive under the federal constitutional analysis mandated by the United States Supreme Court in *BMW I*, this Court's similar decisions in *Hammond* and *Green Oil Co. v. Hornsby,* 539 So. 2d 218 (Ala. 1989), and cases implementing the comparable constitutional prohibition against excessive fines. The award far exceeds any amount rationally related to the need for punishment and deterrence, the only purposes of a punitive damages award that are constitutionally permissible. It meets none of the "guideposts" set out in *BMW* for allowing even a substantial punitive damages award,

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much less a gigantic one. Exxon's conduct was not in any way reprehensible; the punitive award bears no reasonable relationship to any harm caused by Exxon's alleged "fraud"; and no Alabama statute imposing fines or penalties for conduct similar to that alleged against Exxon provides a penalty remotely approaching the multibillion dollar sanction assessed here.

Not only the punitive award was excessive. The award of compensatory damages was also much more than what the law permits. Over $5 million was awarded as damages for the breach of an earlier and different lease that was not even in evidence, although a breach of contract claim requires proof of the terms of the contract. Compensatory damages were also greatly inflated by the State's failure to account for the indisputable physical fact that natural gas shrinks in volume (and consequently increases in heat content per cubic foot) when it is treated to remove impurities; and by the jury's award of damages on the theory that Exxon should have realized prices for its gas which the undisputed testimony showed that Exxon could not have obtained because the relevant pipelines lacked the physical capacity to take Exxon's gas.

To the extent that the Court does not reverse and render judgment for Exxon as to any portion of the judgment for fraud and punitive damages, a new trial of that claim will be required because of the trial court's prejudicial refusal to instruct the jury that it should treat information disclosed by Exxon to AOGB as having been disclosed to the

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State. The trial court's sole reason for its refusal to give this instruction – that it had a "policy" of giving only pattern jury instructions – had no legal merit whatsoever.

Finally, a new trial of the entire case will be required, to the extent judgment for Exxon is not ordered, by reason of the trial court's indefensible and highly prejudicial admission of a clearly privileged document. The document was an opinion by an Exxon in-house lawyer, giving his interpretation of the lease in issue, and providing his candid assessment of Exxon's chances in litigation. The letter was by a lawyer, to a client, following a request for legal advice, and was kept confidential within Exxon. It was clearly covered by the attorney-client privilege. There was no legal basis for ordering its production, much less allowing it to be shown to a lay jury which it inflamed into rendering this excessive and indefensible judgment.

ARGUMENT

I. NO AWARD OF PUNITIVE DAMAGES WAS PERMISSIBLE IN THIS CASE, SINCE THERE WAS NO CLEAR AND CONVINCING EVIDENCE OF FRAUD.

The State told the jury again and again that "intentional" breach of contract was "fraudulent" conduct warranting punitive damages. That was the premise of the State's case from voir dire through closing argument.[31] Counsel hammered away at the Broome opinion and the other so-called "fraud documents" – all on the theory that they showed that Exxon "knew" its contract interpretation was "wrong." The strategy won the State an outrageous $3.42 billion from a jury inflamed by inadmissible evidence. But

[31]R22/307:4-13 (voir dire); R23/414:11-15, 423:1-3, 461:15-16, 462:4-14 (opening); R32/2259:10, 2268:9-12, 2366:25-2367:4 (closing).

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its premise was entirely wrong as a matter of law. Punitive damages are *not* available for breach of contract, however knowing or intentional. And in this record there is *no* evidence of fraud, let alone the clear and convincing evidence of "gross" fraud required to support punitive damages. *Ala. Code* § 6-11-20. Accordingly, the jury's fraud verdict, and with it the $3.42 billion in punitive damages, must be set aside.

A. No Punitive Damages May Be Recovered for Breach of Contract.

Like virtually every state, Alabama forbids punitive damages for breach of contract. *Corson v. Universal Door Sys., Inc.*, 596 So. 2d 565, 572 (Ala. 1991); *Nolin v. Dismukes*, 554 So. 2d 1019 (Ala. 1989); *John Deere Ind. Equip. Co. v. Keller*, 431 So. 2d 1155 (Ala. 1983); *Geohagan v. General Motors Corp.*, 279 So. 2d 436 (Ala. 1973); *see also Ala. Code* § 6-11-20(a) ("Punitive damages may not be awarded . . . other than in a tort action. . . . Nothing contained in this article is to be construed as creating any claim for punitive damages which is not now present under the law of the State of Alabama.")

The principle is longstanding. *See Western Union Tel. Co. v. Rowell*, 45 So. 73 (1907) (only possible exception is for breach of promise to marry). And, except in the case of contracts for insurance, even an intentional or "bad faith" breach does not suffice to turn a contractual violation into a tort.[32] *American Cast Iron Pipe Co. v.*

[32]Even in the context of an insurance contract, the State's tort claim would fail because there were questions of liability under the contract sufficient to require determination by the jury. *See, e.g., Acceptance Ins. Co. v. Brown*, 2001 WL 729283 (Ala. June 29, 2001).

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Williams, 591 So. 2d 854, 857 (Ala. 1991) (refusing, as in earlier decisions, to extend tort of bad faith breach beyond insurance context); *Corson*, 596 So. 2d at 571 (former employee who solicited employer's customers in clear violation of nonsolicitation covenant was liable only for breach of contract, and thus not for punitive damages); *Wood v. Citronelle-Mobile Gathering Sys. Co.*, 409 F.2d 367, 369 (5th Cir. 1968) (claim for "'willful, intentional, wrongful, and malicious'" refusal to pay amount owed for crude oil sounded in contract, and thus could not support an award of punitive damages under the law of Alabama).

To be sure, this Court has recognized that fraud in the course of performing a contract may give rise to a separate cause of action in tort. *Deupree v. Butner,* 522 So. 2d 242 (Ala. 1988). To sound in tort, however, the conduct in question must independently satisfy all the elements of fraud under Alabama law. *Id.*; *Braswell v. ConAgra, Inc.*, 936 F.2d 1169, 1174 (11th Cir. 1991). And, to support a claim for punitive damages, the fraud must be "gross" fraud supported by clear and convincing evidence. *Ala. Code* § 6-11-20; *Wholesale Motors, Inc. v. Williams*, 2001 WL 670496 (Ala. 2001). As the next section shows, the record here does not remotely support such a claim.

B. The State Did Not Prove *Any* of the Essential Elements of Fraud.

The trial court sent the case to the jury on theories of both fraudulent misrepresentation and fraudulent suppression. These theories required the State to prove, by clear and convincing evidence, *each* of the following elements: (1) Exxon

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misrepresented a material fact or suppressed a material fact it was under a duty to disclose; (2) Exxon did so knowingly or recklessly; (3) Exxon did so with intent to deceive the State and induce its reliance; (4) the State, without knowledge of the true facts, reasonably relied on the misrepresentation or suppression to its detriment; and (5) the State suffered damages proximately caused by its detrimental reliance. APJI 18.01; 18.10; 18.04; 18.05; *Ala. Code* §§ 6-5-100 through 104; 6-11-20. If sufficient evidence had been introduced to support one of the State's two theories but not the other (*i.e.*, misrepresentation or suppression but not both), Exxon would be entitled, at minimum, to a new trial, since the jury was allowed to (and may have) proceeded on either theory. *Cincinnati Ins. Co. v. Little*, 443 So. 2d 891, 893 (Ala. 1983). But here the evidence fails to support either theory – or indeed any *element* of either theory. Exxon is accordingly entitled to judgment as a matter of law on the State's fraud claim.

1. No Evidence of Material Misrepresentation

The record contains no evidence whatever – much less clear and convincing evidence – that Exxon made any material misrepresentation about the disputed royalties. In its briefs below, the State half-heartedly argued that there was misrepresentation by mischaracterizing a February 1995 memorandum from the State's Nancy Cone as having stated that Exxon's Linda Kraft had told Cone that fuel gas was included in the "residue" column of Exxon's royalty reports to DCNR.[33] DX391. But the

[33]The "residue" column reports gas sold to customers at the OTF tailgate. R31/2066:12-17 (Kaess); HR35/443:15-17 (Nicholson).

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memorandum actually says no more than that Kraft indicated she would "verify" *if* this was so and report back.

> Linda Kraft is to see where plant and lease fuel shows up [on] the royalty statement. Initially, Ms. Kraft believes this falls under the "Residue" category. However, she will verify.

DX391. A month later, when Cone reported to senior DCNR officials Griggs and Macrory, she was able to state correctly and unequivocally that Exxon included *only* co-gen fuel gas in its royalty reports to DCNR.

> Exxon is reporting only co-generation plant fuel on the statements. Exxon was informed that <u>all</u> usage was subject to the royalty provisions. Exxon management made the decision to pay on co-gen fuel only. <u>Exxon is aware this will be an audit contention.</u>

PX67 (underlining in original). If Cone was ever confused, the confusion was cleared up almost immediately.

2. No Evidence of Material Suppression

The record likewise contains no evidence of material suppression. The State claimed throughout the trial that Exxon "fraudulently underreported" gas volumes by not including in its royalty reports to DCNR the gas volumes on which Exxon did not pay royalties, *i.e.*, gas used as plant and platform fuel. But failure to include plant and platform fuel gas in the royalty reports cannot constitute fraudulent suppression where: (1) it was obvious from the format and content of the reports themselves that they reported only gas on which Exxon was paying royalty; (2) Exxon disclosed to DCNR that it was not paying royalty on plant and platform fuel gas; (3) Nancy Cone's March

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1995 memorandum reveals DCNR's knowledge that Exxon was reporting and paying royalty on fuel gas only to the extent used to generate co-gen electricity; and (4) Exxon reported to AOGB, under oath, the production and disposition of *all* its Mobile Bay gas, including plant and platform fuel gas.[34]

The State disingenuously argued to the jury that, from DCNR's perspective, Exxon's reports to AOGB might just as well have been filed with the highway patrol. But AOGB and DCNR are sister agencies jointly charged with maximizing the State's mineral leasing revenues, *see* note 13 *supra*, and thus, as a matter of *law*, each is chargeable with the knowledge of the other. *Restatement (Second) of Agency* §§ 272, 275, 277 (1957); *In re "Agent Orange" Prod. Liab. Litig.*, 597 F. Supp. 740, 796 (E.D.N.Y. 1984) (stating that "knowledge of employees of one agency may be imputed to those of another if there is some relationship between the agencies"), *aff'd*, 818 F.2d 145 (2d Cir. 1987). Further, as a matter of *fact*, DCNR was fully aware of Exxon's reports to AOGB. DCNR's in-house auditor signed off on the initial procedures explaining exactly how Exxon would meter, allocate and report its production to AOGB. When the State audited Exxon, its auditors retrieved and used AOGB reports. In a word, the claim that Exxon defrauded the State by not reporting to DCNR information

[34]For the same reasons, no inference of suppression can arise from Frank Snyder's statement that, in the course of DCNR's audit, he learned that Exxon had internal accounting codes for monthly volumes of *non*-royalty-bearing gas. These accounting codes were not shown on the monthly reports to DCNR because those reports, as their format clearly indicated, included only gas on which Exxon was paying royalty. Exxon reported the volume and disposition of all non-royalty-bearing gas to AOGB. DX599.

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it was already accurately disclosing every month to AOGB – and of which DCNR was *in fact* fully aware – is absurd.[35]

Nor is there anything to the State's suggestion that fraudulent suppression could be found because, for a short period of time after production commenced, Exxon did not provide detailed royalty reports to DCNR. Nothing in the record suggests or supports a reasonable inference (let alone a clear and convincing one) that this initial lapse was *fraudulent.* DCNR had no standard reporting forms, and Exxon's reporting personnel initially believed that the monthly production reports filed with AOGB were sufficient. Once notified of DCNR's desire for information allocating the royalty payments to individual leases, Exxon worked with DCNR's Nancy Cone to develop a royalty reporting format and filed reports for earlier months to the extent feasible.[36] DCNR accepted reports in that format without complaint from March 1995 through the time of trial.

Perhaps most important, Exxon was entirely candid and forthright about its position on the disputed lease interpretation issues from the very outset of its

[35]The same analysis defeats the State's analogous claim that Exxon fraudulently suppressed information regarding production and disposition of sulfur. Exxon's monthly reports to DCNR showed the gross and net values of all sulfur Exxon sold, but not volumes. Exxon's monthly OGB-18 reports to AOGB fully disclosed monthly sulfur production and disposition by volume.

[36]Exxon filed reports for all months from September 1994 forward. Exxon provided DCNR's auditors with internal source documents for the first eleven months of production. *See* PX196 at 0137.

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conversations with DCNR. As reflected in Nancy Cone's March 1995 memorandum and her trial testimony, Exxon's reporting personnel disclosed to her (and she disclosed to her superiors) Exxon's position on each one of those issues. PX67; R28/1421:13-1422:15 (Cone). Exxon always expected that it would be audited and Exxon anticipated that, as in thousands of royalty audits every year, all disputed issues would be fully aired in the audit, and thereafter resolved either by agreement or by litigation. And in fact that happened. Kaess's audit quantified all disputed issues; and when settlement discussions failed, Exxon filed this declaratory judgment action to obtain a judicial determination of the meaning of the lease. The State cannot complain that Exxon concealed its decision on how to pay royalties. Exxon hid nothing.[37]

3. No Evidence of Intent to Defraud or Induce Reliance

The facts just recited also defeat any plausible inference – let alone a clear and convincing inference – of fraudulent intent, the requirement that any mis-representation or suppression was intended to deceive the plaintiff. It would be a very strange royalty fraud indeed where the alleged perpetrator explains to the alleged victim its position on

[37]The State argued, without basis, that Exxon hid the precise nature of the expenses underlying its cost-netting deductions; the State asserts it first learned of these expenses when it took the deposition of Exxon's accountant Robert Bremer. In fact, Exxon provided the State's auditors with a written description of its cost-netting methodology, together with detailed reports identifying all expenses deducted – exactly the same expenses Bremer described in his deposition. PX196 at 0122-23; PX199 at 0375-0428. In any event, issues about *which* costs were deducted could not possibly be material to any disputed matter, since the State's blanket position was that the leases prohibited *any* cost-netting. The State's auditors disallowed the entire difference between the gross and netted gross values shown on Exxon's royalty reports, without regard to which underlying costs Exxon had deducted.

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the disputed issues, works with the victim to develop acceptable reports, provides the victim's auditors with all requested information,[38] and reports the allegedly concealed information to a sister state agency that makes the information available to the victim, to anyone who wants it, and to anyone with access to the Internet. The record of Exxon's conduct shows candor, not fraud, and defeats the State's claim here.

4. No Evidence of Reliance by the State

Detrimental reliance is another essential element of fraud. To meet its burden, the State had to prove that it took some action, to its detriment, that it would not have taken but for Exxon's alleged misrepresentation or suppression. *Liberty Nat'l Life Ins. Co. v. Allen*, 699 So. 2d 138, 141 (Ala. 1997). The evidence proves no such reliance here. On the contrary, the State never intended to rely on royalty reports, but always intended to audit "every single month" of production. *See* note 16 *supra*. It hired an aggressive auditor (Kaess), who received Exxon's full cooperation and had no difficulty obtaining all the information he needed to quantify the State's claims. If there had been any deficiencies or inaccuracies in Exxon's reports to DCNR, they would have made no difference, and in no way impeded the State's ability to pursue its claims.

Put differently, the State knew – because Exxon told it – how Exxon was paying and reporting royalties. The State conducted audits and obtained all additional

[38]Although required by the leases to keep its backup data for only two years, Exxon has preserved this information for the entire period, and at the completion of each of the two audits DCNR expressed the auditors' "appreciation for the cooperation and assistance extended by Exxon personnel during the audit." DX371; DX374.

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information it asked for. The State's own documents and testimony establish that it would have performed the same audits whatever Exxon's royalty reports had said. The State did nothing different from what it would have done if, for example, Exxon had included a section in its monthly royalty reports pointing out, in large red type, the two categories of gas (platform and OTF fuel gas) on which royalties were not paid. Because the State offered absolutely no proof that it did or failed to do anything as a result of any deficiency in Exxon's reporting, it did not meet its burden of proving the reliance element of its fraud claim.

5. No Evidence of Resulting Damage

For similar reasons, the State has failed to prove any damage resulting from any alleged fraudulent misrepresentation or suppression. There is no evidence (and not even an argument) that, but for any misrepresentation or suppression, the State would have discovered any claims it did not, would have made claims higher than it actually made, would have audited or filed suit any sooner than it did, or would have done *anything* different. In these circumstances, the essential element of damage is lacking, and the fraud claim fails. *Cf. Atlantic Richfield Co. v. Farm Credit Bank*, 226 F.3d 1138, 1159-60 (10th Cir. 2000) (no fraud claim for alleged hiding of improper royalty deductions where detrimental reliance consisted solely of delay in bringing suit which caused no injury).

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In the end, the State's fraud claim is not supported by any evidence at all. Rather, this case was an ordinary business dispute where the parties disagreed as to the interpretation of a lease. The evidence the State trumpeted to the jury – the Broome opinion and the other so-called "fraud documents" – does not show that Exxon acted in bad faith or even that Exxon "knew" its interpretation of the lease was "wrong." And in any event no law supports the State's theory that a "knowing" breach of contract could permit punitive damages. This record contains nothing else – nothing that a reasonable factfinder could view as clear and convincing evidence of fraud. Accordingly, Exxon was entitled to judgment as a matter of law on the State's fraud claims, and the award of punitive damages must be set aside.

II. THE STATE'S FRAUD CLAIM IS BARRED BY THE STATUTE OF LIMITATIONS.

The State's fraud cause of action is also barred by the relevant statute of limitations. The statutory limitations period for a fraud claim is two years from discovery. *Ala. Code* §§ 6-2-3, 6-2-38(*l*). The period for filing a fraud claim commences when "the party actually discovered the fraud, or had facts which, upon closer examination, would have led to the discovery of the fraud." *Kelly v. Smith*, 454 So. 2d 1315, 1317 (Ala. 1984); *Foremost Ins. Co. v. Parham*, 693 So. 2d 409, 419 (Ala. 1997) (fraud limitations period commences when party becomes aware of "such facts which ought to excite inquiry and which, if pursued, would lead to knowledge of other facts").

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Under these rules the State's fraud claim is barred. The State alleges that the "fraud" began in December 1993 when Exxon made its first payment. If this "fraud" was in not reporting the royalty details to DCNR, then of course the State knew that when the first payment was made. If the "fraud" was in not paying the royalty claimed by the State as due under the leases, then DCNR knew of that no later than March 1995, by which time Exxon had explained the basis for its royalty payments as well as what was being shown on the royalty reports and what was not. Nancy Cone's March 1995 memorandum shows that fact beyond reasonable dispute. PX67. At that point, either the State was actually aware of what it now calls Exxon's "fraud," or the State had more than enough facts to "excite inquiry." Either way, the two-year statute of limitations commenced no later than March 1995 and there is no arguable basis that any fraud occurred thereafter. The statute accordingly expired long before this action was filed.

The trial court, however, apparently accepted the State's argument that its counterclaim was compulsory and that compulsory counterclaims are *never* barred by the statute of limitations, even where (as here) they seek affirmative recovery in excess of the plaintiff's demand. That argument was predicated solely on this Court's controversial decision in *Romar Development Co. v. Gulf View Management Corp.*, 644 So. 2d 462 (Ala. 1994).

Romar was decided over a strong dissent by Justice Houston. It upset a settled common law rule dating back more than 100 years, and it has been extensively and

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persuasively criticized by Alabama commentators. *E.g.*, 1 Champ Lyons, Jr., *Alabama Rules of Civil Procedure Annotated* 291-92 (3d ed. 1996) ("The Court moved past the Legislature's choice of language"). It rests on a historical fallacy and on a plain misquotation of this Court's prior case law.[39] Exxon submits *Romar* was incorrectly decided, and that it ought to be overruled for all the reasons set forth in Justice Houston's dissent. *Stare decisis* does not prevent this Court's correcting an erroneous decision. *Ex parte State Farm Fire & Cas. Co.*, 764 So. 2d 543, 545-46 (Ala. 2000). Exxon therefore urged the trial court not to follow *Romar*. C14/2568 at 2663 n.7.

If *Romar* is overruled, the relation-back doctrine in Alabama will once again be governed by the rules laid out in *Sharp Electronics Corp. v. Shaw*, 524 So. 2d 586 (Ala. 1987), and by *Ala. Code* § 6-8-84, which provides:

> When the defendant pleads a counterclaim to the plaintiff's demand, to which the plaintiff replies the statute of limitations, the defendant is nevertheless entitled to his counterclaim, *where it was a legal subsisting claim at the time the right of the action accrued* to the plaintiff on the claim in the action.

(emphasis added).

[39]The premise of *Romar* was that in *Conner v. Smith*, 7 So. 150 (Ala. 1890), this Court had said that recoupment on a time-barred counterclaim would "at least" reduce *or cancel* the amount of plaintiff's claim; and that the statement that such recoupment would "*at least* cancel" the claim implied that a positive recovery could be had. 644 So. 2d at 470. But the key words "or cancel" are an invention of the *Romar* court. The passage cited from *Conner* says only that recoupment "may be pleaded in *reduction*, at least, of the demand on the contract." 7 So. at 153 (emphasis added). No reference to *cancellation*, as opposed to reduction, of the demand appears in *Conner*.

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The question then would be whether the State's counterclaim was a "legal subsisting claim" when Exxon's cause of action "accrued." Unless it was, no affirmative relief may be had on the counterclaim. *Sharp*, 524 So. 2d at 591.

The answer to the question is no. Exxon's claim was for declaratory relief. The Alabama Declaratory Judgment Act states that "[a]ny person interested under a . . . written contract . . . may have determined any question of construction or validity arising under the . . . contract . . . and obtain a declaration of rights, status or other legal relations thereunder." *Ala. Code* § 6-6-223. A "contract may be construed [by declaratory judgment] either *before* or after there has been a breach thereof." *Ala. Code* § 6-6-224 (emphasis added). Thus, a party seeking a declaratory judgment is not required to "wait until the events giving rise to liability have occurred before having a determination of [the parties'] rights and obligations." *City of Dothan v. Eighty-Four West, Inc.*, 738 So. 2d 903, 908 (Ala. Civ. App. 1999). The State conceded below that Exxon's cause of action for declaratory judgment accrued under State law as early as 1988 or 1989, when Exxon could have gone to court to obtain a declaration of its contractual royalty obligations. C13/2434 at 2484-85. By contrast, the State's fraud claim did not accrue until much later, no earlier than December 1993, when Exxon made its first royalty payment. The counterclaim itself alleges that the payment was the first act of fraud.

Because the fraud claim accrued only *after* Exxon's declaratory judgment claim accrued, it was not a "legal subsisting claim" within the meaning of *Ala. Code* § 6-8-84

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at the time Exxon's claim accrued. It follows that the State may not obtain affirmative relief on its fraud counterclaim. The State could have used the counterclaim to offset any money judgment in favor of Exxon (if Exxon had sought one), but may not use it to obtain a money judgment *against* Exxon. As this Court has said, under § 6-8-84, "a counterclaim that accrues after the date the plaintiff's action accrues but becomes time-barred before suit is filed cannot be used offensively, that is, to exceed the amount of plaintiff's recovery, if any." *Sharp,* 524 So. 2d at 591.

III. NEITHER THE ALABAMA PUNITIVE DAMAGES STATUTE NOR DUE PROCESS ALLOWS AN AWARD OF PUNITIVE DAMAGES IN FAVOR OF THE STATE.

Even if Exxon's conduct could constitute actionable "fraud" for which a private party might seek punitive damages, both Alabama statute and due process prohibit such an award in this case, where the party seeking such damages is *the State*.

A. The Plain Language of *Ala. Code* § 6-11-21(*l*) Bars the State's Recovery of Punitive Damages.

Any award of punitive damages to the State would violate the plain language of Alabama's punitive damages statute. *Ala. Code* § 6-11-21(*l*) (Supp. 2000).[40]

[40] *Ala. Code* § 6-11-21(*l*) became effective June 6, 1999 and applies to "all actions" filed after August 6, 1999, *see* 1999 Ala. Acts 358, § 4. The State's first counterclaim in this case was filed on August 24, 1999. Under Alabama law, counterclaims, including compulsory counterclaims, are "actions." *Penick v. Cado Sys. of Cent. Ala., Inc.*, 628 So. 2d 598, 599 (Ala. 1993); *Barrett Mobile Home Trans., Inc. v. McGugin*, 530 So. 2d 730, 733-34 (Ala. 1988); *Stringer v. Sheffield*, 451 So. 2d 320 (Ala. Civ. App. 1984); *Ala. Code* § 7-1-201 (1997) ("'Action' . . . includes civil action, *counterclaim*, . . . and any other proceedings in which rights are determined."); *Ala. Code* § 12-19-271 (1995) ("ACTION. Any suit, counterclaim, crossclaim or third party claim filed at law or in equity.").

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That statute flatly prohibits the State from receiving *any* punitive damages award:

> No portion of a punitive damage award shall be allocated to the state or any agency or department of the state.

Ala. Code § 6-11-21(*l*). If *no* portion of an award may be allocated to the State, then *a fortiori* the State cannot be entitled to *all* portions of an award, as happened here.

It is the obligation of all courts to apply the words of a statute as written. *See, e.g., DeKalb County LP Gas Co. v. Suburban Gas, Inc.*, 729 So. 2d 270, 275-76 (Ala. 1998). The State would apparently have the court read the words of this statute as if it said, "No portion of a punitive damage award *made in a case between private parties* shall be allocated to the state . . . .;" or perhaps, "No portion of a punitive damage award shall be allocated to the state . . . *except where the state is the party to whom the award is made*."

Erroneously relying on the "relation back" doctrine of *Ala. R. Civ. P.* 13(c), the trial court refused to apply the statute on the ground that Exxon's declaratory judgment complaint was filed July 29, 1999, before the date the statute applied. C19/3762 at 3780-81. But the law is clear that Rule 13(c) only implements *Ala. Code* § 6-8-84, and that the statute and its implementing Rule 13(c) are solely "procedural rules designed to 'heal' violations of *the statute of limitations*." *City of Birmingham v. Davis*, 613 So. 2d 1222, 1224 (Ala. 1992) (emphasis added). Under this Court's long-settled precedents the "healing provisions" of § 6-8-84 are "confined to the statute of limitations by its express terms, and can not be extended further." *Motley v. Battle*, 368 So. 2d 20, 21 (Ala. 1979) (quoting *Patrick v. Petty*, 3 So. 779, 780 (Ala. 1888)); *see Davis*, 613 So. 2d at 1224. This firmly established rule, confining the relation-back doctrine exclusively to statute of limitations problems, disposes of the State's argument that relation back can alter the *substantive* law applicable to its counterclaim. *See Fox v. Fox*, 659 So. 2d 633, 635 (Ala. Civ. App. 1995) ("The mother's counterclaim . . . was filed after the effective date . . . of the recent changes to Rule 32, Ala. R. Jud. Admin., and is, therefore, governed by those changes.").

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There simply are no such limitations in the text of § 6-11-21(*l*). The statute applies in all civil cases, with *no* exception for cases in which the party seeking punitive damages is the State itself. As written, the statute does not merely protect private punitive damage awards from allocation to the State. It also precludes the State from receiving any amount of punitive damages in *any* case. The Legislature wrote those words. The only task of this Court is to enforce them.

B. Due Process Bars the State's Recovery of Punitive Damages.

If there were doubt about the meaning of the statute, moreover, it would have to be resolved by application of the well-settled principle that all statutes should be construed so as to avoid constitutional infirmities. *See*, *e.g.*, *Alabama State Fed'n of Labor v. McAdory*, 18 So. 2d 810, 815 (Ala. 1944). Allowing the State to recover punitive damages would violate the Due Process Clause of the U.S. Constitution and Article I, § 13 of the Constitution of Alabama of 1901, for two related reasons.

First. A State may not impose punishment without observing the requirements of notice and regularity that govern all proceedings in which the government seeks to exact retribution for wrongful conduct. The most fundamental of those principles is that punishment must be within limits fixed by law, and may not be left to the unrestricted discretion of a judge or jury. As the U.S. Supreme Court recently emphasized in *Apprendi v. New Jersey*, 530 U.S. 466 (2000), a State's imposition of punishment "before and since the American colonies became a nation" has been through the exercise of "discretion . . . *within limits fixed by law.*" *Apprendi*, 530 U.S. at 481

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(quoting *Williams v. New York*, 337 U.S. 241, 246 (1949)); *see id.* ("We have often noted that judges in this country have long exercised discretion . . . in imposing sentence *within statutory limits in the individual case*." (emphasis added)); *id.* at 482 n.9 ("Under the common-law procedure, the court determines in each case what *within the limits of the law* shall be the punishment." (quoting 1 J. Bishop, *Criminal Law* §§ 933-934 (1) (9th ed. 1923)).[41]

Common law crimes are now regarded as unconstitutional in this country. That is because government-imposed punishment is impermissible without action *by the Legislature*, which determines what conduct shall be punished and which fixes the range within which punishment may be imposed. Anything else, as Justice Scalia has pointed out, "partak[es] of the odious nature of an *ex post facto* law" by imposing punishment other than what was prescribed by the Legislature at the time the wrongful conduct occurred. *Rogers v. Tennessee*, 121 S. Ct. 1693, 1708 (2001) (Scalia, J., dissenting) (quoting 2 Z. Swift, *A System of the Laws of the State of Connecticut* 365-66 (1795)). As the award below demonstrates, Alabama's procedures for the imposition of punitive damages when sought by the State meet none of the requirements for

[41]*See also Ex parte United States*, 242 U.S. 27, 42 (1916) (finding it "indisputable . . . that the authority to define and fix the punishment for crime is legislative"); *United States v. Guglielmi*, 929 F.2d 1001, 1008 (4th Cir. 1991) (Wilkinson, J., concurring) ("The severity of a sentence ought not to be purely idiosyncratic but should be pursuant to a legislative mandate."); 5 LaFave, *Criminal Procedure* §26.3(a), at 733 (1999) ("Judicial discretion has always been subject to some statutory limits. . . . In the case of fines, . . . the upper limit on the amount of the fine."); 3 *ABA Standards for Criminal Justice* 18-2.1(a) (2d ed. 1980) ("The legislature should . . . state the maximum fine which can be imposed").

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government-imposed punishment. There are no "limits fixed by the law" within which punishment is permissible; instead, it is imposed simply because a jury thinks that the defendant's conduct warrants it, and the jury's discretion as to the size of an award is essentially unlimited. When it is government that punishes, such procedures are not good enough.

Apprendi illuminates the due process violation that would occur if punitive damages could be awarded in favor of the State:

> [S]tructural democratic constraints exist to discourage legislatures from enacting penal statutes that expose *every* defendant convicted of, for example, weapons possession, to a maximum sentence exceeding that which is, in the legislature's judgment, generally proportional to the crime. This is as it should be. Our rule ensures that a State is obliged "to make its choices concerning the substantive content of its criminal laws with full awareness of the consequences, unable to mask substantive policy choices".. . . *Patterson v. N.Y.*, 432 U.S., at 228-229, n.13 (Powell, J., dissenting). So exposed, "[t]he political check on potentially harsh legislative action is then more likely to operate." *Ibid.*

530 U.S. at 490 n.16. Allowing the State to inflict punishment by a common-law proceeding seeking undefined and unknowable punitive damages would enable the State to impose punishment through the backdoor, without the democratic "political check" that is supposed to constrain *every* State's choices about what punishment shall be imposed.[42]

[42]The State cannot avoid these rules about the imposition of punishment merely because punitive damages are awarded in a proceeding labeled "civil." The Supreme Court has recognized that punitive damages, even if sought by *private* parties, are "quasi-criminal" because their purpose is solely to punish and deter. *Cooper Industries, Inc. v. Leatherman Tool Group, Inc.*, 121 S. Ct. 1678, 1683 (2001). When punitive damages are sought by a State, acting in substance as a prosecutor, they resemble criminal punishment even more closely. In any event, the constitutional limits on punishment

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Second. *The* absence of the usual "structural democratic check" on the imposition of punishment by the State would be compounded, if the State were allowed to seek punitive damages, because the self-interest of jurors resident in the State would always bias them toward awarding the highest punitive damages possible. The due process requirement of disinterested decisionmakers in judicial proceedings was set forth in *Tumey v. Ohio*, 273 U.S. 510 (1927), and *Ward v. Village of Monroeville*, 409 U.S. 57 (1972). In those cases the United States Supreme Court held that a statute authorizing a village mayor, acting as judge, to receive a portion of every fine awarded by his court "certainly violates the Fourteenth Amendment, and deprives a defendant in a criminal case of due process of law." *Tumey*, 273 U.S. at 523.

> [T]he test is whether the mayor's situation is one "which would offer a *possible* temptation to the average man as a judge to forget the burden of proof required to convict the defendant, or which *might* lead him not to hold the balance nice, clear and true between the State and accused."

Ward, 409 U.S. at 60 (emphasis added).

These cases involved judges acting as decisionmakers, but the principle applies with even greater force where jurors – unschooled in the judicial art of disregarding their own self- interest – are the decisionmakers. *See Irvin v. Dowd*, 366 U.S. 717, 722 (1961) (*Tumey* requires "trial by a panel of impartial, 'indifferent' jurors"); *Standard Alaska Prod. Co. v. Schaible*, 874 F.2d 624, 630 (9th Cir. 1989) (noting responsibility of State, in case where every State resident stood to gain money from the outcome, to

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when sought by the State "cut[] across the division between civil and criminal law." *Austin v. United States*, 509 U.S. 602, 610 (1993).

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provide a fair forum, including "unbiased judge and unbiased jurors"); *Montana v. LaMere*, 2 P.3d 204, 216-17 (Mont. 2000) ("right to an impartial adjudicator, be it judge or jury," is "so basic to a fair trial" that its deprivation can never be harmless error (internal quotation marks omitted)); *Gibson v. Berryhill*, 411 U.S. 564, 579 (1973) (due process forbids administrative proceeding where decisionmaker has "possible personal interest" in outcome); *Brown v. Vance*, 637 F.2d 272, 276 (5th Cir. Jan. 1981) (*Tumey/Ward* rule applies to "every civil litigant").

In any case where the State seeks punitive damages in its own courts, the taxpayer-jurors asked to fix the amount of damages have an unavoidable personal interest in an award favoring the State. In this case, the $3.42 billion award below works out to $769 for every Alabama citizen or $3076 for a couple with two children – over 256 times the $12 involved in *Tumey*. HDX181 at 24. No one could say with confidence that in such circumstances jurors will be able to "hold the balance nice, clear, and true between the State and the accused," *Tumey*, 273 U.S. at 532, or that they are in reality "*wholly* free, disinterested, and independent," as Alabama law requires. *Ex parte White*, 300 So. 2d 420, 429 (Ala. Crim. App. 1974) (emphasis added).

The State's attorneys, moreover, made the constitutional problem worse by openly and aggressively emphasizing the jurors' direct financial interest, as citizens, in any potential judgment against Exxon. They told the jurors "there's a lot at stake for the State" in this case, thanked them on behalf of the Governor and the Attorney General

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of Alabama, and described how royalties from the gas leases benefitted Alabama citizens:

> [The money] goes into a trust . . . .
>
> I'm sure all of you remember about Amendment One that we all voted on that was passed in the last election. And that relates to this money, also. All that says is that thirty-five percent of the income stream that is coming into the trust now was – is going to be used to purchase a three hundred and fifty million dollar bond issue that will give the State three hundred and fifty million dollars like this to build roads and bridges and improve agriculture and the State in a number of projects.

R23/400:6, 401:15-402:1; R23/442:13; R32/2211:12-16.

This case is a textbook example of why due process prohibits a State from recovering punitive damages under the procedures used in Alabama. It involved massive punishment, set in the standardless discretion of an inherently self-interested jury, without limits fixed by a Legislature through the democratic process. Applying § 6-11-21(*l*), as written, bars the State from receiving any portion of any punitive damages award, and would make decision of these due process issues unnecessary.

IV. THE AWARD OF $3.42 BILLION IS GROSSLY EXCESSIVE AND MUST BE DRASTICALLY REDUCED.

By any measure the $3.42 billion punitive damages award is grossly excessive. The award is over 200 times the largest award this Court has approved since it first elaborated the Alabama standards for excessive punitive damages awards in *Hammond v. City of Gadsden*, 493 So. 2d 1374 (Ala. 1986), and *Green Oil Co. v. Hornsby*, 539 So. 2d 218 (Ala. 1989); and it is over 1100 times greater than the largest award

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approved since the U.S. Supreme Court specified the due process limitations on such awards in *BMW of North America v. Gore*, 517 U.S. 559 (1996) ("*BMW I*"), *on remand*, 701 So. 2d 507, 509 (Ala. 1997) ("*BMW II*").[43] Indeed, the award exceeds the *total* of *all* punitive damages affirmed by this Court. HDX218. It is also nearly 40 times the total compensatory damages awarded (for breach of contract), and 462 times the damages arguably related to any alleged fraud. HDX181 at 10 (Chart 6), 12 (Table B) ($3.42 billion/$7.4 million).

This Court reviews the size of punitive damage awards under both the federal excessiveness criteria announced in *BMW I* and the preexisting state law criteria established in *Green Oil* and *Hammond*. *See BMW II*, 701 So. 2d at 510 ("We see the [*BMW I*] guideposts as factors to be emphasized in a judicial review of a punitive damages award pursuant to *Hammond*, *Green Oil* and *Ala. Code* 1975 § 6-11-23(b)"). The Court reviews *de novo* the question whether the award complies with due process limits. The Court accords *no* presumption of correctness to the underlying punitive award made by the jury. *Ala. Code* § 6-11-23(a); *Horton Homes, Inc. v. Brooks*, 2001 WL 792730 at *12 (Ala. July 13, 2001) (overruling *Armstrong v. Roger's Outdoor Sports, Inc.*, 581 So. 2d 414 (Ala. 1991)). In addition, the trial court's decision warrants *no* deference. *Horton Homes*, 2001 WL 792730 at *12; *Acceptance Ins. Co. v. Brown*, 2001 WL 729283 (Ala. June 29, 2001) (both following *Cooper Industries*, 121 S. Ct. at 1685-86 (2001)). Review should be even more searching

[43]*See Duck Head Apparel Co. v. Hoots*, 659 So. 2d 897 (Ala. 1995) ($15 million); *Life Ins. Co. of Georgia v. Johnson*, 701 So. 2d 524 (Ala. 1997) ($3 million).

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where, as here, the trial court merely rubber-stamped an order prepared by State's counsel.

As a preliminary matter, Exxon shows that Alabama statutory and case law cap punitive damages at no more than three times the relevant compensatory damages. But even that figure – $263 million if computed on the entire underlying award of $87.7 million, or $22.2 million if computed (as it should be) on the basis of the largest damage amount arguably attributable to "fraud" – is still vastly higher than any punitive award approved by this Court since *Green Oil* and *BMW II*. The constitutional analysis of *BMW* and *Green Oil* accordingly compels remittitur of the award to much less than three times the (proper) level of compensatory damages.

A. Alabama Statutory and Case Law Both Cap Punitive Damage Awards at Three Times Compensatory Damages.

Ala. Code § 6-11-21(a) (Supp. 2000) limits punitive damages in all cases involving only economic damages to three times the amount of compensatory damages awarded. Applied here, this statutory cap would reduce the $3.42 billion in punitive damages to *no more than* $263 million, and to much less if the court excludes compensatory damages clearly unrelated to any "fraud." The statute became effective June 6, 1999, and applies to "all actions" filed after August 6, 1999. Since the State's counterclaim was filed on August 24, 1999, it was subject to the statute. The trial court, however, refused to apply the statute because of its mistaken belief that "relation back"

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could change the *substantive* law applicable to a claim. This was obvious error. *See* note 40 *supra*.

The trial court's ruling was also self-defeating. If, as the trial court mistakenly thought, the law in effect prior to August 6, 1999 governs the State's counterclaim, that law is the previous punitive damages statute, *Ala. Code* § 6-11-21 (1987), which limited punitive damages to $250,000. That statute was declared unconstitutional in *Henderson v. Alabama Power Co.*, 627 So. 2d 878 (Ala. 1993), but until amended in 1999 remained on the books, subject to enforcement should this Court overrule *Henderson*. *See Goodyear Tire & Rubber Co. v. Vinson*, 749 So. 2d 393, 398 (Ala. 1999) (Houston, J., concurring). If this Court were to agree with the trial court that the relation-back doctrine prevents application of the current version of § 6-11-21, the question whether *Henderson* should be overruled would be squarely presented.[44]

In that circumstance, Exxon urges that *Henderson* should be overruled for all the reasons set forth in the opinions criticizing *Henderson* cited in *Goodyear*, 749 So. 2d at 393-400; *see Ex parte Apicella,* 2001 WL 306906 (Ala. March 30, 2001) ("To the extent that [it] held that § 11 [of the Alabama Constitution] restricted the Legislature from removing from the jury unbridled right to punish, *Henderson* . . . [was] wrongly decided."). *Henderson* also should be overruled because its central *premise* (that restrictions on an award of punitive damages could violate the right to a jury trial) has now been authoritatively rejected by the United States Supreme Court. *Cooper*

[44]As required to preserve the issue, Exxon urged the trial court below not to follow *Henderson*. C11/2118 at 2127 n.11; C12/2204 at 2214 n.14.

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Industries, 121 S. Ct. at 1686 (holding that the amount of a punitive damages award is not a "fact tried by the jury").

Even if the statutory cap of § 6-11-21 (Supp. 2000) did not apply of its own force, moreover, the legislative judgment it embodies would be entitled to substantial deference. In its recent decisions, this Court has accorded great weight to the policy declared in § 6-11-21(a). At least in the absence of physical injury or especially outrageous or contemptible conduct, the Court has employed the 3:1 punitive-to-compensatory ratio as a benchmark above which higher punitive awards will be presumed excessive.[45] *See Wal-Mart Stores, Inc. v. Goodman*, 789 So. 2d 166, 182 (Ala. 2000); *Cooper & Co. v. Lester*, 2000 WL 1868433 (Ala. Dec. 22, 2000); *Prudential Ballard Realty Co. v. Weatherly*, 2000 WL 1038167 (Ala. July 28, 2000). The policy of deference to the legislative judgment should be especially strong when, as here, the State itself is plaintiff. To disregard the cap in that situation would in effect permit the State to disavow its own public policy.

It remains only to address the quantum of "compensatory damages" to which the cap must be applied. Obviously the statutory language means the amount can be no *more* than the $87.7 million the jury awarded; the words of the statute are thus sufficient to dispose of the principal justification the trial court (copying the State's lawyers) gave

[45]The Court has not strictly applied this 3:1 benchmark in cases where the compensatory damages are nominal or otherwise too small to cover the costs of litigation, *e.g.*, *Ex parte Liberty Nat'l Life Ins. Co.*, 2001 WL 367609 (Ala. Apr. 13, 2001), but that exception obviously has no application here.

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for an award more than 39 times compensatory damages, namely that it could be based on "potential" harm.[46] The limitation to three times "compensatory damages" also means that those elements of a jury award that are not "compensatory," or that do not constitute damages *arising from the misconduct permitting punitive damages,* must also be excluded. *Cooper Industries*, 121 S. Ct. at 1688-89 (punitive damages must bear a reasonable relationship to harms reasonably attributable *to the tort*).

Here, as shown at the *Hammond* hearing, the $87.7 million awarded by the jury included many millions that clearly cannot qualify as "compensatory damages" for purposes of the cap on punitive damages:

! $27.6 million of the award is interest at 12 percent awarded pursuant to *Ala. Code* § 9-17-33(d), an "interest penalty" imposed as a deterrent to underpayment. Act No. 82-557 (purpose of double rate was to "prescribe interest penalties"); R25/962:12-16, 966:9-15 (Macrory) (State's representative at trial acknowledges the double rate is the statutory "penalty" for underpayment). Perhaps interest at the normal prejudgment rate of 6 percent could be treated as "compensatory," but that would still leave $13.8

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[46]C19/3762 at 3779-85; *see* discussion *infra* at 97-102. Exxon acknowledges that this Court has sometimes said it is appropriate to consider "harm that is likely to occur from the defendant's conduct as well as to the harm that actually has occurred," *Wal-Mart*, 789 So. 2d at 182, but this issue arises only in the context of misconduct that threatens to harm third parties in the same manner as the plaintiff. *E.g., Life Ins. Co. of Georgia v. Johnson*, 701 So. 2d 524, 530 (Ala. 1997) (likely harm factor weighed against reduction of award since "there was a sizeable group of Alabama citizens who were put at risk by the defendant's wrongful conduct"). Here there is no threat of harm to third parties other than the State.

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million in "penalty" interest that would have to be excluded for purposes of the cap. *See* HDX181 at 8.

! The State's "best price" claim, for which the jury awarded over $30 million, C10/1987, was purely a contractual claim, a dispute merely about what prices were "realizable" by Exxon for the sale of its gas. The "best price" claim does not depend in any way on any claim of fraudulent misrepresentation or suppression. Punitive damages cannot be awarded on the "best price" claim; and these damages must therefore be excluded for purposes of the application of the punitive damages cap.

! As previously noted, there was never any fraud, and there were never any damages caused by any fraud. But even giving the State much more than the benefit of the doubt, Exxon's position on disputed royalty issues was fully disclosed to DCNR by March 1995; underpayments from March 1995 forward therefore cannot possibly be the consequence of any "fraud" and must be excluded for purposes of applying the cap. *At most*, only underpayments before March 1995 should be considered, and those damages total only $11.7 million.[47] HDX181 at 9, Table A.

! Finally, if corrections were made *only* for Solomon's indefensible errors in using the wrong conversion factors and including Tract 77A damages (errors which Exxon demonstrated at the *Hammond* hearing, *see* pp. 37-46, 54-55 *supra*), then the total "fraud" underpayments before March 1995 would fall to no more than $7.4 million. HDX181 at 12, Table B. The $3.42 billion award is 462 times this amount.

[47]This figure excludes "best price" damages, but gives the State the benefit of the doubt by including half of the 12 percent statutory interest.

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Correctly applying the cap would thus have resulted in a punitive award no higher than $22.2 million (three times $7.4 million). Any such award would be less outrageous than $3.42 billion, but it would still be vastly higher than any punitive award approved by this Court since *Green Oil* or *BMW II*. As we show in the following sections, the record will not support an award of that magnitude, nor will the Constitution permit it.

B. No Award Here Is Necessary for Punishment or Deterrence, the Only Constitutionally Permitted Purposes of Punitive Damages.

The 3:1 cap discussed in the preceding section, whether statutory or presumptive, is just that: a cap. This Court has acknowledged that in many cases the maximum reasonable punitive-to-compensatory ratio is *lower* than 3:1. *See*, *e.g.*, *Ford Motor Co. v. Sperau*, 708 So. 2d 111, 120 (Ala. 1997) (reducing award in low reprehensibility fraud case to approximately 1:1); *Hillcrest Ctr., Inc. v. Rone*, 711 So. 2d 901, 909-10 (Ala. 1997) (reducing punitive award to 2:1 because verdict, even as reduced by trial court below 3:1, still exceeded amount necessary to punish).

The touchstone of whether a punitive award is proper is whether the amount is reasonably necessary to punish and deter. The rule in Alabama, this Court has said, is that punitive damages "must not exceed an amount that will accomplish society's goals of punishment and deterrence." *Green Oil*, 539 So. 2d at 222. The federal constitutional rule is the same. Punitive damages must be "reasonable in their amount and rational in light of their purpose to punish what has occurred and to deter its repetition." *Pacific*

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Mut. Life Ins. Co. v. Haslip, 499 U.S. 1, 21 (1991); *accord*, *BMW I*, 517 U.S. at 584 (sanction "cannot be justified on the ground that it was necessary to deter future misconduct without considering whether less drastic remedies could be expected to achieve that goal"). On the record here, even an award of three times the highest arguable "fraud" damages of $7.4 million would grossly exceed the amount necessary to accomplish punishment or deterrence.

As for the objective of punishment, no punitive award is necessary, because the $87.7 million compensatory award already includes $27.6 million in "penalty" interest the State Legislature has fixed as the proper punishment. *Ala. Code* § 9-17-33(d). This interest penalty by itself is more than nine times the largest punitive damage award this Court has upheld since *BMW II* in a case not involving wrongful death. *See Life Ins. Co. of Georgia v. Johnson*, 701 So. 2d at 534 ($3 million for fraudulent insurance sales). No greater amount is reasonably necessary to vindicate the State's interest in punishment.

As for deterrence, the interest penalty also is more than sufficient to satisfy any legitimate State interest. Under standard deterrence theory, "[a] higher [punitive-to-compensatory] ratio may . . . be justified in cases in which the injury is hard to detect . . . ." *BMW I*, 517 U.S. at 582; *see also Cooper Industries*, 121 S. Ct. at 1687 (explaining deterrence principles); *BMW I*, 517 U.S. at 592-93 (same) (Breyer, J., concurring). But conversely, as this Court has observed, a high likelihood of detection diminishes the need for punitive damages as deterrence. *Chrysler Corp. v. Schiffer*,

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736 So. 2d 538 (Ala. 1999).[48] Here, the likelihood that the State would not have detected and challenged Exxon's alleged suppression of royalty underpayments was nil.

The State had a policy of auditing *all* gas producers, and it engaged an aggressive outside oil and gas auditor to ensure that nothing was overlooked. Exxon knew the State was auditing Shell, expected the State to audit Exxon aggressively, and advised the State of its lease interpretations before any audit began.[49] PX49; PX182 at 0045770; PX67. Moreover, all of Exxon's underlying production information had been reported to AOGB, where the State's auditors, just as anyone would expect, reviewed it.

Given the certainty of detection, no company could rationally expect to profit by underreporting royalties it knew it owed. If lower royalties were paid temporarily, pending an audit, any such gain would be more than offset by the 12 percent interest penalty on all underpayments. As economist Jonathan Walker testified at the *Hammond* hearing, the interest penalty is more than sufficient to deter *knowing* underpayment of

[48]"'[M]aterial' damage [to purportedly new cars] is generally relatively easy to detect. Thus, it is difficult to understand how the kind of conduct involved in this case could be pervasive in Chrysler's operations and, therefore, particularly profitable to Chrysler. This factor, therefore, also weighs in favor of a reduction in the punitive-damages award." *Id.* at 549.

[49]No auditor would have missed these deductions in any case. As Walter Rosenbusch (the former head of the Minerals Management Service, in charge of all oil and gas royalty payments to the federal government) testified at the *Hammond* hearing, cost-netting and free fuel use are "Audit 101" issues – matters that no competent auditor overlooks. HR34/233:24-234:18 (Rosenbusch).

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royalties by any profit-maximizing company. Underpayment of royalties will occur only when (as here) the company believes it has a reasonable legal position that the royalties are not owed. No rational incentive exists for conduct that achieves nothing but the creation of certain liability for millions of dollars of above-market interest costs.[50] A punitive award is thus no more necessary for deterrence than it is for punishment, and no such award may be justified here. *BMW I,* 517 U.S. at 584; *see also Glynn v. Roy Al Boat Mgmt. Corp.*, 57 F.3d 1495, 1505 (9th Cir. 1995) (punitive damages unnecessary where provision for attorneys' fees supplied adequate deterrent to misconduct).

C. The Award Far Exceeds Federal and State Constitutional Due Process Limits on Punitive Damages.

In *BMW I*, the United States Supreme Court held a $2 million punitive damages award excessive, applying three guideposts: (1) the degree of reprehensibility of the defendant's conduct, (2) the ratio of the punitive damages to the harm inflicted on the plaintiff, and (3) the size of the award in relation to civil or criminal penalties for

[50]Deterrence theory is well developed in the economic literature. Both the Alabama and Harvard Law Reviews have published leading articles applying these principles to punitive damages. *See* Robert D. Cooter, *Punitive Damages for Deterrence: When and How Much?*, 40 Ala. L. Rev. 1143, 1149-66 (1989); A. Mitchell Polinsky & Steven Shavell, *Punitive Damages: An Economic Analysis*, 111 Harv. L. Rev. 869 (1998). But, as the United States Supreme Court recently noted, lay juries typically do not factor these economic considerations into their punitive damages decisions. *Cooper Indus.* , 121 S. Ct. 1678, 1687 (2001) (citing Cass Sunstein et al., *Do People Want Optimal Deterrence?*, 29 J. Legal Stud. 237, 240 (2000)); *see also* W. Kip Viscusi, *The Challenge of Punitive Damages Mathematics*, 30 J. Legal Stud. 313 (2001) (finding that lay juries have difficulty applying principles of economic deterrence even when instructed to do so). This makes the economics of deterrence an especially pertinent consideration for courts reviewing such jury awards *de novo.*

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comparable misconduct. 517 U.S. at 574-85. Meaningful application of these guideposts is necessary to ensure that "a person receive fair notice not only of the conduct that will subject him to punishment, but also of the severity of the penalty that a State may impose." *Id.* at 574. In addition, such application "helps to assure the uniform general treatment of similarly situated persons that is the essence of law itself." *Cooper Industries*, 121 S. Ct. at 1685; *BMW I*, 517 U.S. at 587 (Breyer, J., concurring); *accord Horton Homes*, 2001 WL 792730 at *11.

In its very recent *Cooper Industries* decision, the Supreme Court emphasized again the importance of the *BMW* guideposts as a restraint on excessive punitive damages awards. The Court held that reviewing courts must evaluate *de novo* a trial court's failure to set aside or reduce a punitive damages award. The Supreme Court's broader message is loud and clear: courts reviewing punitive awards must apply the *BMW* guideposts realistically to *restrict* disproportionate awards, not unrealistically to *rationalize* them. The amount of punitive damages is not a "fact" found by the jury; and the day is over when deference to a jury's conclusions is either required or constitutionally permitted. This Court has taken these requirements seriously, as have other appellate courts.[51] The trial court here did not. As a consequence, it is up to this

[51]Applying the *BMW* guideposts on remand, this Court reduced the verdict in *BMW* from $2 million to $50,000. *BMW II*, 701 So. 2d at 515. *See also Foremost Ins. Co. v. Parham*, 693 So. 2d 409 (Ala. 1997) (reducing two punitive awards of $4 million each to $175,000 and $173,000); *Inter Med. Supplies, Ltd. v. EBI Med. Systems, Inc.*, 181 F.3d 446, 465-70 (3d Cir. 1999) ($50 million award reduced to $1 million); *Johansen v. Combustion Eng'g, Inc.*, 170 F.3d 1320 (11th Cir. 1999) ($45 million award for pollution reduced to $4.35 million); *Kimzey v. Wal-Mart Stores, Inc.*, 107 F.3d 568 (8th Cir. 1997) (reducing punitive award to $350,000 after trial court had reduced it from $50

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Court to apply the hard scrutiny that this massive and unprecedented award so obviously requires.

1. This Case Did Not Involve Reprehensible Conduct Warranting an Enormous Punitive Award.

"Perhaps the most important indicium of the reasonableness of a punitive damages award is the degree of reprehensibility of the defendant's conduct." *BMW I*, 517 U.S. at 575; *see also Wal-Mart*, 789 So. 2d at 182 (reprehensibility inquiry under *Hammond-Green Oil* encompasses such factors as "the duration of [the] conduct, the degree of the defendant's awareness of any hazard which [its] conduct has caused or is likely to cause, and any concealment or 'cover-up' of that hazard, and the existence and frequency of similar past conduct."). None of the elements required to support a large award of punitive damages is present here.

To begin with, the finding of reprehensibility in the trial court's *Hammond* order is predicated almost entirely on the breach of the lease, what the trial court termed Exxon's "calculated decision to underpay royalties." C19/3762 at 3775. Whether "calculated" or not, however, breach of contract is not a permissible predicate for punitive damages, because it does not amount to fraud at all. *See supra* at 61-63.

Even under the State's contrary view, moreover, such "fraud" would fall at the lowest end of the reprehensibility scale, for multiple reasons. *See BMW I*, 517 U.S. at 580 ("[t]hat conduct is sufficiently reprehensible to give rise to tort liability, and even a

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million to $5 million).

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modest award of exemplary damages does not establish the high degree of culpability that warrants a substantial punitive damages award"). First, following *BMW I*, this Court has held that conduct causing only economic harm is less reprehensible than conduct causing physical injury or threatening the health and safety of others. *BMW II*, 701 So. 2d at 512; *Wal-Mart*, 789 So. 2d at 181. The trial court improperly disregarded this principle. *See* C19/3762 at 3779.

Second, any "fraud" here was short-lived and of minimal practical impact. As already discussed at length, Exxon disclosed all production information to AOGB, and disclosed its position on the disputed lease terms to DCNR's Nancy Cone in 1995. As both Exxon and the State had always expected, the disputed issues were addressed by audits which quantified all alleged underpayments. And, if there were any underpayments, the State will recover them all with 12 percent interest.

Third, no evidence supports the trial court's statement (again copied from the State's proposed order) that Exxon has a "general practice of disregarding the rights of others for its own financial gain." C19/3762 at 3790. At the *Hammond* hearing, the State introduced, over Exxon's objection, a handful of pleadings from cases involving royalty claims against Exxon. HR37/946:2-954:2. None involved circumstances similar to this case, and none involved any finding that Exxon had committed fraud. Given that Exxon pays $1.4 billion annually to 66,000 different royalty owners, a few isolated disputes prove nothing.[52] HR34/340:22-341:7 (Condray).

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[52]Indeed, this Court's cases make plain that such evidence should not have been admitted at all. *See Robinson v. Kierce*, 513 So. 2d 1005, 1007 (Ala. 1987) ("The idea

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In sum, Exxon's conduct was not reprehensible. The State's inflammatory rhetoric aside, this case concerns only an ordinary contract dispute. What happened here was nothing more than an openly discussed disagreement over a very limited aspect of an ongoing contractual relationship. If that amounts to tortious fraud in Alabama, as the State contends, then it must surely be the least reprehensible fraud in the history of the tort. The first guidepost thus points to a decidedly minimal punitive award, if one is allowed at all.

2. The Award of $3.42 Billion Is Grossly Excessive in Relation to the Harm from the Alleged Fraud.

"A second indicium of either reasonableness or excessiveness of the jury's punitive-damages award is the ratio between the amount of punitive damages awarded and the actual harm to the plaintiff." *Wal-Mart*, 789 So. 2d at 181-82; *BMW I,* 517 U.S. at 580. This guidepost derives from the common law principle that "exemplary damages must bear a 'reasonable relationship' to compensatory damages." *BMW II*, 701 So. 2d at 513; *BMW I*, 517 U.S. at 580. Especially where the defendant's conduct was not reprehensible, a high ratio of punitive to compensatory damages signals excessiveness. *BMW II*, 701 So. 2d at 513. Once again, straightforward application of this guidepost demonstrates the unconstitutionality of the award here.

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that a complaint filed in one action can be introduced in another action to establish the truthfulness of the allegations in the complaint transcends our established rules of evidence"); *Courtesy Ford Sales, Inc. v. Clark*, 425 So. 2d 1075, 1078 (Ala. 1983) ("mere rumor of fraud on the part of the party is not admissible evidence and cannot serve as a basis for finding fraud in a later transaction").

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The trial court's order does not even attempt to defend the punitive damages as reasonable in relation to any *actual* harm. Nor could it have done so. *See* pp. 82-84, 86-89 *supra*. Instead, citing *TXO Production Corp. v. Alliance Resources Corp.*, 509 U.S. 443 (1993), the order purports to find that the award may be upheld as reasonable in relation to "potential harm" from the alleged fraud, again following verbatim the proposed order drafted by the State's lawyers.[53] The court's reliance on *TXO* is misplaced, and its "analysis" of the potential harm question is unsupported in law or fact.

[53]The trial court sought, colorfully but incorrectly, to analogize this case to the facts in *TXO* on the ground that both cases involved attempts to "steal" a "stream of royalties" by filing "frivolous" declaratory judgment actions asserting that documents "did not mean what [they] clearly said and concealing the reliance on that frivolous position." C19/3762 at 3781. Again, the trial court failed to appreciate the difference between a contract dispute and a tort. The defendant's lawsuit in *TXO* – a frivolous quiet title action – was a tortious act in furtherance of a slander of title. Exxon's declaratory judgment action was a perfectly lawful claim seeking adjudication of rights under a contract regarding interpretive positions that Exxon had fully disclosed to the State years earlier. The filing of such an action, which the trial court sent to the jury only after ruling that the disputed contractual language was *not* clear, was not a tort of any variety.

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a. There Is No Legal Basis to Consider "Potential" Harm.

As earlier discussed, this Court has considered unrealized harm in the punitive damages context only where there is likely harm to persons other than the plaintiff. *See* note 46 *supra*. But even those courts that consider unrealized harm to the *plaintiff* do so only where actual damages are minimal and additional deterrence is needed – for example, the gunshot that misses. *See Garnes v. Fleming Landfill, Inc.*, 413 S.E.2d 897 (W.Va. 1991), from which United States Supreme Court plurality in *TXO* drew its potential harm analysis: "[I]n the *narrow exception* ... where the actual harm was minimal but the potential harm was tremendous, a jury may reasonably find punitive damages commensurate with the potential harm." *Id.* at 908 (emphasis added). That is not this case.

More fundamentally, the potential harm argument in *TXO* necessarily rested on the premise that the tortious plan could have succeeded without being detected, a reasonable premise in that case since the misconduct included the procurement of false testimony to support a frivolous quiet title action. *See TXO,* 509 U.S. at 460 (issue is "harm likely to result" from the defendant's conduct); *Haslip*, 499 U.S. at 21. Here, by contrast, no such possibility existed. Exxon always expected an audit, and in an audit any royalty underpayments had zero chance of going undetected. Following the audit, when negotiations with the State broke down, Exxon initiated this action to resolve all issues both as to past amounts and as to the future. The ultimate judicial decision in this

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case will determine how royalties are paid in the future. Accordingly, there is not, and never was, any prospect of *future* underpayments, since any disputes will be resolved during the course of the litigation, and since royalties will be paid as the Court orders. *Cf. Tyson Foods, Inc. v. Stevens*, 783 So. 2d 804, 810 (Ala. 2000) (where problem causing hog farm waste run-off had been cured, there was no possibility of future harm to consider in the *Hammond-Green Oil* analysis).

b. The Trial Court's Estimates of "Potential" Harm Are Unsupported.

Even if there were a legitimate basis for considering some hypothetical future harm, the trial court's cavalier and self-contradictory treatment of this issue resulted in a gross exaggeration of that harm.

Judge McCooey ruled correctly at trial that, since the declaratory judgment action would determine the basis for future royalty payments, no evidence could be presented to the jury concerning the size of projected future underpayments. The court left open only the possibility that such evidence could be considered in a post-trial *Hammond* hearing if the jury awarded punitive damages. R29/1706:22-1714:11; R31/2160:23-2162:3. At the *Hammond* hearing, the State presented estimates of projected "future" royalty underpayments, based on the absurd premise that the underpayments challenged by the State would continue undetected into the future, ranging from $650 million to $12 *billion*. Exxon showed that all these estimates were grotesquely inflated and unsupported. *See* pp. 54-55 *supra*.[54]

[54]Exxon also showed that reasonably prepared estimates of future royalty savings based

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Faced with this record, the State's lawyers changed their tack. They submitted a proposed order denying remittitur that ignored the *Hammond* evidence and asserted that *trial* evidence which Exxon had failed to "challenge" supported an estimate of future royalty underpayments in the range of $1.8 to $3 billion. The trial court adopted verbatim this portion of the State's order, thus basing a decision against Exxon on Exxon's failure to rebut trial evidence that the trial court *itself* had ruled the State could not present. C19/3762 at 3782 n.13. Worse, the trial record in fact contained *no* evidence about future royalty underpayments. The State's claims instead rested only on the argument of its own counsel.

Over Exxon's objection, the State's lawyer told the jury in closing argument that Solomon had testified that, at "today's gas prices" of $8 per MMBTU, the State would lose $60 million per year in royalty underpayments over the remaining 30-year life of the Mobile Bay field. R32/2266:3-2267:23. In fact, Solomon did not opine that "$60 million per year" was a valid damages estimate. Nor did he say that multiplying compensatory damages by an increase in gas prices was a sensible way to estimate future damages. He did no more than acquiesce in a series of mathematical computations which the State's counsel put to him.[55]

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on the best available current information would produce a figure in the range of $88.8 million, orders of magnitude lower than the State's inflated and speculative estimates. HR35/528:16-537:16, 553:17-554:2, 564:4-16, 566:19-22, 576:23-579:7 (Platt); HR36/663:15-702:5 (Borden); HDX179; HDX181 at 17-24; HDX212; HDX265L.

[55]The entirety of Solomon's trial testimony on this point was as follows:

Q. All right. I'd like to see if you can help me with my math this

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In its recent *Cooper Industries* decision, the United States Supreme Court warned that reviewing courts should not rationalize large punitive damage awards on the basis of "potential harm" not realistically connected to the alleged tort. 121 S. Ct. at

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> morning. Mr. Solomon, you understand the State's position that Exxon has underpaid royalties, according to your calculations, by eighty-seven plus million dollars; is that correct?
>
> A. Yes, that's correct.
>
> Q. All right. If I were to take that eighty-seven million dollars and divided it by six, would I get essentially fourteen and a half million per year?
>
> ***
>
> A. Yes, exactly fourteen and a half.
>
> Q. All right. Now, you understand – or tell me what your understanding is about the price of gas over the last six years?
>
> A. Well, the price of gas has gone up generally over the last six years. In fact, as of Monday of this week, it was almost nine dollars and fifty cents per MCF [sic] which is substantially higher than it has been, particularly during the last six-year period.
>
> Q. What I'd like to do to make this calculation a little bit simpler is just use eight dollars, if I may. So if I were using eight dollars, that would be four times two dollars; would that be correct?
>
> A. Yes. Two dollars being the average price of gas over the last six-year period of time, that's right.
>
> Q. So it's four times as high now as it's averaged over the last six years?
>
> A. Yes, that's correct.
>
> Q. So, if we were to take that fourteen and a half and – and let me use fifteen million per year since were using – since we're using eight dollars instead of nine. And if we multiply that by four, would we get sixty million a year?
>
> A. Yes.

R29/1651:3-1652:18 (Solomon).

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1688-89. The State's potential harm estimates cannot be taken seriously; they completely lack integrity.[56] They should be dismissed out of hand as any basis for justifying a substantial punitive award.

3. The $3.42 Billion Award Is Grossly Excessive in Relation to Applicable Sanctions for Comparable Conduct.

The final *BMW* guidepost requires the Court to compare the punitive damages to civil or criminal sanctions that could be imposed for comparable misconduct. *BMW II,* 701 So. 2d at 514; *BMW I*, 517 U.S. at 583. This guidepost promotes appropriate deference to legislative judgments about the magnitude of permissible punishment, *id.*, and also helps ensure that defendants receive "fair notice" of the size of any punishments they may face. *BMW I*, 517 U.S. at 584. This guidepost also compels dramatic reduction of the $3.42 billion award.

The most relevant state-law sanction is obviously *Ala. Code* § 9-17-33(d), which imposes a 12 percent interest penalty (double the normal prejudgment rate of six

[56] Even if Solomon had given an opinion about the future harm (which he did not), no estimate consistent with the State's lawyers' calculations is remotely defensible since: (1) it assumes that underpayments would rise proportionally to the price of gas, even though the amount of the State's claims for cost-netting, best price, sulfur, slop oil, and electricity should not rise with a rise in gas prices; (2) it rests on a 12-year-old gas price forecast that was wildly high historically and is inflated in terms of current market prices and projections; (3) it assumes a constant level of gas production for 30 years, although in fact production declines over time; (4) it projects future underpayments from a compensatory "damages" base of which 25% represents not royalties but statutory interest; and (5) it fails to discount future cash flows to present value as Alabama law requires. *HealthSouth Rehab. Corp. v. Falcon Mgmt. Co.,* 2001 WL 410470 at *7 (Ala. April 20, 2001) ("our caselaw has consistently required that future damages be reduced to present value"); HR37/984:16-999:8 (Borden); HDX176; HDX179; HDX265K; HDX212A; HDX265L.

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percent) for failure to pay royalties when due (*see* pp. 37, 53-54 *supra*). The Alabama Legislature judged this specific sanction sufficient to assure that producers would not intentionally underpay royalties. An above-market interest rate removes the profit from underpayments, and more than makes the State whole. Greater sanctions would only increase contracting costs without any offsetting benefit; they would reduce the size of the bids Alabama could expect to receive on future contracts. The judgment of the Alabama Legislature as to the proper level of sanctions required merits this Court's deference, both in general and under *BMW*. The $3.42 billion punitive damages award eviscerates the Legislature's judgment.

The foundation of *BMW*, moreover, is that defendants receive "fair notice" of the size of any punishments they may face. *BMW I,* 517 U.S. at 584. Exxon's documents show that it understood that the underpayment penalty in Alabama was 12 percent interest, and it assessed its legal risks accordingly. Nothing else in Alabama law gave Exxon or other companies notice that royalty underpayments could give rise to massive sanctions in addition to the interest penalty that the Legislature prescribed. Even Alabama's statutes addressed to deceptive trade practices, or to criminal theft and fraud – all involving misconduct much more reprehensible than anything here – limit the civil recovery to "three times any actual damages" and the criminal fine to "double the pecuniary gain to the defendant or loss to the victim."[57] *See Ford Motor Co. v.*

[57]*Ala. Code* §§ 8-19-10(a)(2) (deceptive trade practices); 13A-5-11(a)(4) (fines for felonies); 13A-5-12(a)(4) (fines for misdemeanors); 13A-8-3(a), 13A-9-41(a), 13A-9-51(a) (offenses involving theft or misappropriation of property).

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Sperau, 708 So. 2d 111, 121-24 (Ala. 1997). Consistent with *BMW*, Alabama may not now impose punishment dozens or hundreds of times more severe than what its statutes provide.

Unable to cite a single Alabama statute that would support a penalty greater than two times the actual harm (and once again taking its cues verbatim from the State's proposed order), the trial court purported to justify the $3.42 billion award in light of multibillion dollar fines supposedly available for comparable conduct under the Federal Oil and Gas Royalty Management Act (FOGRMA).[58] This argument goes nowhere. From the standpoint of fair notice, it is self-evident that fines payable to the federal government under FOGRMA do not provide notice of sanctions potentially payable to the State of Alabama. Exxon's underpayment of royalties to Alabama is not punishable under FOGRMA, and no reasonable person would look to that statute to determine the likely consequences of such an underpayment.

Second, it is unreasonable to assume that the federal government would ever apply FOGRMA in the oppressive manner the trial court and the State postulate.[59] No

[58]Citing FOGRMA provisions authorizing a $10,000 per day fine for knowing and willful failure to make royalty payments and a $25,000 per day fine for knowing and willful preparation, maintenance or submittal of false or misleading reports, 30 U.S.C. §§1719(c)(1) and 1719(d)(1), the trial court asserted that the cumulative daily fines under these provision applied to each of Exxon's monthly underpayments since 1993 would now exceed $3.7 billion. To get to this massive figure, the trial court had to assume that *each* alleged monthly underpayment over the six-year damage period, regardless of its size, would inaugurate a *separate* $35,000 *per day* "penalty stream" which would continue through to the end of period.

[59]Indeed, there is nothing but the trial court's unsupported say-so to establish that any

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reported decision supports such application and, at the *Hammond* hearing, Walter Rosenbusch, the former Director of the Mineral Management Service who only a few months earlier had been responsible for administering FOGRMA, testified unequivocally that he did not know of a single instance in which the agency had applied the statute as the State urged. HR34/268:23-270:16 (Rosenbusch).

The cases do not allow a plaintiff merely to identify a statutory sanction and then compare the size of the punitive award to the maximum theoretical sanction. In *Johansen v. Combustion Engineering, Inc.*, 170 F.3d 1320 (11th Cir. 1999), for example, the court rejected such an approach, noting that the "adequate notice" aspect of the third *BMW* guidepost necessarily requires inquiry into how the statute is actually implemented in comparable cases:

> If a statute provides for a range of penalties depending on the severity of the violation, however, it cannot be presumed that the defendant had notice that the state's interest in the *specific* conduct at issue in the case is represented by the maximum fine provided by the statute. . . . *[C]onstitutionally adequate notice of potential punitive damage liability in a particular case depends upon whether this defendant had reason to believe that his specific conduct could result in a particular damage award.*

Johansen, 170 F.3d at 1337 (footnote and citations omitted, emphasis added).

Finally, application of the federal statute in the draconian manner hypothesized by the trial court would raise serious constitutional questions in its own right. A

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conduct here alleged against Exxon would even qualify as a violation of FOGRMA. It is not at all clear, for example, that the provision penalizing knowing and willful nonpayment would apply to underpayment pursuant to a disputed lease interpretation. Likewise, the trial court identifies no false or misleading Exxon reports that would give rise to liability under the provision penalizing the use of such reports.

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multibillion dollar FOGRMA penalty as postulated by the trial court would appear on its face to be "grossly disproportionate" to the gravity of the underlying offense, and therefore would itself be unconstitutional in violation of the Eighth Amendment's Excessive Fines Clause. *See United States v. Mackby*, 2001 WL 921177, at *7-8 (9th Cir. Aug. 16, 2001) (vacating and remanding $729,000 civil penalty under False Claims Act for determination of whether fine violates Eighth Amendment where defendant submitted false Medicare claims).

D. The Award Far Exceeds the Limit for Punitive Damages Under This Court's *Hammond* and *Green Oil* Decisions.

Hammond-Green Oil review requires analysis of the punitive damage award with reference to: (1) the actual or likely harm from the defendant's conduct; (2) the degree of reprehensibility of the defendant's conduct; (3) the defendant's profit from the wrongful conduct; (4) the financial position of the defendant; (5) the plaintiff's litigation costs; and (6) any civil or criminal punishment imposed on the defendant for the same misconduct. *Green Oil*, 539 So. 2d at 223-24. Review of these factors confirms that the award here – even after applying the 3:1 cap – is grossly excessive.

Relationship to Likely Harm. This factor, fully discussed above, calls for substantial reduction of the punitive award. *See* pp. 96-101 *supra.*

Reprehensibility. This factor, also fully discussed above, calls for substantial reduction of the award as well. *See* pp. 94-96 *supra.*

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Removal of Profit. The trial court did not discuss this factor. But the $3.42 billion award has no relationship to any profit Exxon realized. As already discussed, compensatory damages plus the statutory interest penalty are by themselves more than sufficient to remove any such profit. *See Cooper & Co., Inc. v. Lester*, 2000 WL 1868433 at *15-16 (Ala. Dec. 22, 2000) (modest profit weighs against imposition of substantial punitive damages); *Life Ins. Co. v. Parker*, 726 So. 2d 619, 624 (Ala. 1998).

Exxon's Financial Position. The trial court sought to justify the award on the ground that is "only" 4.9 percent of Exxon's $70 billion net worth at December 2000 and "only" 62 days' worth of its 2000 profit. C19/3762 at 3787-88. This Court's decisions make clear that the financial strength to pay a large punitive award is *not* a sufficient basis to uphold the award if it is otherwise unreasonable. *See BMW II*, 701 So. 2d at 514 ("[W]here a defendant has not committed an act that would warrant a large punitive damages award, such an award should not be upheld upon judicial review merely because the defendant has the ability to pay it"); *Sperau*, 708 So. 2d at 123-24 (Ala. 1997) (noting that $6 million punitive award was a tiny fraction of Ford's net worth, but that Ford's conduct was not reprehensible, and an award should not be upheld merely because the defendant has the ability to pay it); *American Pioneer Life Ins. Co. v. Williamson*, 704 So. 2d 1361, 1366 (Ala. 1997) (defendant's "ability to pay a large award should not . . . result in an affirmance of an unjustified award 'simply because the defendant has the ability to pay it.'").

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Applying this principle, the Court has substantially reduced awards considerably *more* affordable to the defendant than the $3.42 billion award is to Exxon here. In *Wal-Mart*, for example, the Court reduced a $3 million punitive damages award against Wal-Mart to $600,000 notwithstanding that the defendant (a $29 billion company) could readily have absorbed the $3 million judgment. 789 So. 2d at 183.

Costs of Litigation. At the *Hammond* hearing, the State represented that its litigation costs were approximately $2.26 million. HPX35. These litigation costs are a tiny fraction of the compensatory damages awarded by the jury, and a small fraction even of the $27.6 million in statutory interest included in the award. This penalty provides ample incentive to litigate underpayment claims. No further incentive is needed.

Other Sanctions Imposed. Other criminal or civil sanctions imposed against the defendant for the same conduct weigh in mitigation of punitive damages. *Green Oil*, 539 So. 2d at 224. Here the statutory 12 percent interest penalty is a substantial civil sanction. Not only is it more than sufficient to remove any gain Exxon would otherwise have received, it approaches, standing alone, twice the largest punitive damages award ever approved by the Court. *See Duck Head Apparel Co., Inc. v. Hoots*, 659 So. 2d 897 (Ala. 1995). Accordingly this factor weighs strongly against the imposition of additional punitive sums.

E. The Award Far Exceeds Federal and State Constitutional Limits for Excessive Fines.

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Since punitive damages are "quasi-criminal" punishment, *Cooper Industries*, 121 S. Ct. at 1683, their award to the State implicates not only due process but also the Excessive Fines Clauses of the Eighth Amendment of the U.S. Constitution and Article I, § 15 of the Alabama Constitution. Although these clauses do not apply to punitive damages sought by private parties, *Browning-Ferris Ind. of Vermont, Inc. v. Kelco Disposal, Inc.*, 492 U.S. 257, 259 (1989), they apply fully to punitive damages sought by the government as plaintiff. *See Austin v. United States*, 509 U.S. 602, 609-610 (1993); *Cooper Industries*, 121 S. Ct at 1685; *Mackby*, 2001 WL 921177, at *7.[60]

A fine is excessive if it is "grossly disproportional to the gravity of a defendant's offense." *United States v. Bajakajian*, 524 U.S. 321, 334 (1998); *Ex parte Kelley*, 766 So. 2d 837, 839 (Ala. 1999). Courts must consider whether the amount of punishment exceeds the amount "required to achieve the desired deterrence." *Mackby*, 2001 WL 921177, at *8. Legislative determinations of appropriate punishment deserve deference. *Bajakajian,* 524 U.S. at 336; *see Kelley*, 766 So. 2d at 839.

[60]In *Browning-Ferris*, the Supreme Court carefully limited its holding to punitive damages sought by private parties. *See* 492 U.S. at 275 n.21 (distinguishing case in which "the *Government* was exacting punishment in a civil action, whereas here the damages were awarded to a private party"); *id.* at 298-99 (O'Connor, J., dissenting in part) (observing that majority relies "so heavily on the distinction between governmental involvement and purely private suits, [that] the Court suggests . . . that the Excessive Fines Clause will place some limits on awards of punitive damages that are recovered by a governmental entity").

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For all the reasons set forth above in connection with the *BMW* guideposts, the $3.42 million punitive damages award violates the Eighth Amendment of the United States Constitution and Article I, § 15 of the Alabama Constitution.

V. THE AWARD OF COMPENSATORY DAMAGES FOR BREACH OF CONTRACT WAS EXCESSIVE.

The punitive damages must be reversed, and judgment rendered for Exxon. But Exxon is also entitled to a new trial on compensatory damages, which were themselves overstated by many millions of dollars.

A. The Damages for Tract 77A Must Be Set Aside.

As shown in the Statement of Facts (p. 46), the verdict included $5.25 million in compensatory damages for Tract 77A, even though the State did not introduce the lease that governs Tract 77A. The record provides no basis for an inference that the terms of the lease governing Tract 77A are the same as the other leases; quite the contrary. This is a complete failure of proof that requires reversal of the judgment insofar as it awarded Tract 77A damages.

Alabama law has long required that "absent an admission by the defendant of the existence, execution, and content of the written agreement, a written contract sued on must be put into evidence." *Alabama Life & Disability Ins. Guar. Ass'n v. Trentham*, 543 So. 2d 195, 196 (Ala. 1989); *Bell v. Washington*, 373 So. 2d 865, 867 (Ala. Civ. App. 1979). The application of that rule here is straightforward. The State

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had the burden of proof. Since it failed to put the Tract 77A lease into evidence, it cannot recover damages for breach of that lease.

B. Exxon is Entitled to a New Trial on the Damages Awarded for the Unpaid Volumes Claim.

The law in Alabama, as elsewhere, is that "[w]hen an expert opinion is not supported by sufficient facts to validate it in the eyes of the law, or when indisputable record facts contradict or otherwise render the opinion unreasonable, it cannot support a jury's verdict." *Brooke Group, Ltd. v. Brown & Williamson Tobacco Corp.*, 509 U.S. 209, 242 (1993). The jury's damage award on the State's unpaid volumes claim depended entirely on Solomon's quantification of that claim. Solomon's computation, however, ignored the indisputable physical fact that treated gas has higher heat content than untreated gas, and this led him to grossly overstate the claim.

At the *Hammond* hearing, Exxon showed that Solomon's error inflated the "unpaid volumes" claim by over 100 percent, and that the true claim (before interest) should have been about $8.6 million rather than $22 million. The court need not rely on this post-trial evidence, however, to conclude that a new trial is required. As shown above (pp. 37-40) and in the Appendix at Tab 5, the trial record alone shows that Solomon's "unpaid volumes" computation was fundamentally unsound. Exxon moved for a new trial on the ground that the compensatory damages were excessive; the trial court summarily denied the motion without allowing briefing. The refusal to grant a new trial was error that this Court should correct.

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C. Exxon is Entitled to a New Trial on the Damages Awarded for the Best Price Claim.

Leitzinger's and Solomon's cascading errors also require reversal or new trial of the damages awarded on the State's $30 million "best price" claim. As discussed in the Statement of Facts (pp. 41-45), that claim depended on an estimate by Leitzinger of the "best price realizable," and a "gross price" calculated by Solomon. For each month, Solomon chose the higher of the two prices and computed royalties based on that higher price; damages claimed were the difference between royalties so computed and the amount Exxon had paid.

Leitzinger's opinion about the "best price realizable in the exercise of reasonable diligence" was wrong as a matter of law. For each month, he calculated a "best price realizable" based on the highest average spot price reported each month; and he treated *all* gas sold that month for less than the spot price as having been sold for less than the "best price realizable." But Leitzinger admitted that much of Exxon's gas could not in fact be sold at the spot prices, since the pipeline with the high price frequently, if not always, lacked the physical capacity to take all of Exxon's gas. R28/1531:14-1532:11, 1580:8-12 (Leitzinger). A price cannot be "realizable" for all of Exxon's gas if Exxon lacked the ability to "realize" that price for all of its gas. This error fatally infects Leitzinger's calculation of the amount of the "best price realizable." And since Solomon's damage calculation rested on Leitzinger's estimate of "best price," Leitzinger's error requires reversal of the jury's entire award of "best price" damages.

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Further, Solomon's quantification of the best price damages was riddled with errors. As shown above and in the Appendix at Tab 6, his calculations rested on two undeniably false assumptions: (a) that treated gas has the same heat content as untreated gas; and (b) that the "gross values" shown on Exxon's royalty reports were *before* deduction of post-tailgate transportation costs. Without redoing Solomon's entire calculation using correct assumptions, no one can be sure whether the erroneous "gross prices" he calculated are higher or lower than the prices he would have calculated using correct assumptions. Therefore one cannot be sure whether correctly calculated prices would have been higher or lower than Leitzinger's estimate of the "best price," even assuming that Leitzinger's estimate were itself defensible. And, without knowing whether the calculated "gross price" or the "best price" is higher, one cannot know if there are any "best price" damages at all. It follows that the jury's award of such damages must be set aside.

Finally, as discussed above, the State told the jury that fully two-thirds of its $30 million "best price" claim was attributable to Exxon's supposed computation of royalties on the basis of gross prices lower than the prices it actually received. As shown above and in the Appendix at Tab 6, this charge was untrue: the trial record shows that, properly computed, the two prices match *exactly*. Accordingly, the "best price" damages must be set aside for this reason as well.

VI. THE TRIAL COURT UNREASONABLY REFUSED TO INSTRUCT THE JURY ABOUT CONSTRUCTIVE KNOWLEDGE.

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The trial judge followed a bizarre "policy" of refusing to give instructions to which either side objected, whether or not the instructions were legally correct, unless they were Alabama pattern jury instructions. *See* pp. 49-50 *supra.* This deprived Exxon of an important instruction on the relationship between the two State agencies to whom Exxon reported information. The trial court's arbitrary ruling, standing alone, requires a new trial of the State's fraud claim.

The essence of the State's fraud claim was that Exxon fraudulently underreported production information to DCNR. That was untrue; DCNR fully understood Exxon's royalty position. But even assuming *arguendo* that DCNR lacked some data about the disposition of Exxon's Mobile Bay gas, complete information about the disposition of every cubic foot of that gas was disclosed to AOGB. That information was public, was posted on the Internet, and was available both in theory and in fact to DCNR and its auditors. The State's fraud theory in this case asked the jury to ignore all of the information Exxon reported to AOGB, to ignore the statutory duty of the two agencies to cooperate in jointly administering the State's Mobile Bay gas reserves, *Ala. Code* § 9-5-3, and to conclude that if DCNR was not directly told of certain facts by Exxon, then those facts were necessarily concealed from the State.

No law justifies such a cramped view of the State's knowledge. Exxon therefore requested an instruction (Number 23) regarding imputed knowledge:

> If you find from the evidence that any agency of the State of Alabama had knowledge of the true facts which the State claims to be false or suppressed, then in that event there can be no suppression or false

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> statement. Knowledge of any state agency is knowledge to all state agencies.

C10/1978. This instruction was consistent with Alabama statutory law, federal case law, and other authority.[61] Indeed, the trial court never suggested that the instruction did not correctly state the law. Rather, it refused to give the instruction solely because it was "not APJI" and because the State objected to it. R31/2190:22-2191:17. "Well, I'm not going to give it. There's an objection." R31/2191:12-13.

In so ruling, the trial court ignored a cardinal principle of Alabama trial practice: "a party is entitled to have his theory of the case, made by the pleadings and issues, presented to the jury by the proper instructions, . . . and the court's failure to give those instructions is reversible error." *Alabama Farm Bureau Mut. Ins. Serv., Inc. v. Jericho Plantation, Inc.*, 481 So. 2d 343, 344 (Ala. 1985). The trial court's policy is particularly hard to justify in view of the fact that the Alabama Pattern Jury Instructions explicitly caution judges and lawyers that the pattern instructions do not occupy the entire field of legally permissible or required instructions.[62] As it happens, there is no

[61]*Ala. Code* § 8-2-8 ("As against a principal, both principal and agent are deemed to have notice of whatever either has notice of and ought in good faith and the exercise of ordinary care and diligence to communicate to the other."); *In re "Agent Orange" Prod. Liab. Litig.*, 597 F. Supp. at 796 (citing *Restatement (Second) of Agency* §§ 272, 275, 277), *aff'd*, 818 F.2d 145.

[62]*See* Committee Report, *Alabama Pattern Jury Instructions Civil* (2d ed. 1993) p. xviii ("The Committee does not pretend to represent that the work done by it is in anywise complete as to the subjects included or includes all subjects that will be useful."); Order of the Supreme Court of Alabama approving use of Alabama Pattern Jury Instructions, *Alabama Pattern Jury Instructions Civil*, pp. xix-xx ("while these instructions appear to be accurate and appropriate *to the subjects to which they relate*,

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Alabama pattern jury instruction on imputed knowledge or on imputed knowledge from one governmental agency to another. Nevertheless, "it is the duty of the trial court to instruct the jurors fully and correctly on the applicable law of the case and to guide, direct, and assist them toward an intelligent understanding of the legal and factual issues involved in their search for truth" – even if some of the instructions required are not found in the pattern books. *See American Cast Iron Pipe Co. v. Williams,* 591 So. 2d 854, 856 (Ala. 1991).

The trial court's refusal to give Exxon's requested instruction was erroneous and prejudicial; and the trial court's reason – that its "policy" was to sustain any objection to a non-pattern instruction, whether or not the requested instruction correctly stated the law – must be rejected as a matter of law.

VII. THE TRIAL COURT COMMITTED REVERSIBLE ERROR BY IGNORING THE ATTORNEY - CLIENT PRIVILEGE.

There is no mystery about why the jury reached the excessive verdict it did. It was inflamed by the State's repeated distortions of materials that were clearly protected by the attorney-client privilege, but which the trial court ordered produced, allowed as documentary evidence, and permitted to be the subject of extensive trial testimony. Privileged documents are kept from juries, among other reasons, because juries cannot be expected to evaluate them fairly. That is exactly what happened here, and the result of the trial is proof of the magnitude of the trial court's error. This error infected not

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they are to be considered as patterns only and *should be altered or changed as circumstances indicate*") (emphasis added).

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only the fraud and punitive damages verdicts, but also the verdict on the contract claim. It will thus require a new trial on any issues not fully resolved in Exxon's favor in this appeal.

As previously discussed, in-house Exxon lawyer Charles Broome was asked in 1993 for his legal opinion about how to construe paragraph 5 of the Alabama lease form. His opinion (PX49) is reproduced at Tab 3 of the Appendix. He noted that the State had one interpretation, and that Shell Oil Company, another lessee, appeared to have a second, different interpretation. Broome's opinion was that yet a third interpretation of paragraph 5 was "plausible," one which "harmoniz[ed] [paragraphs] 5(a) and 5(b)."

The content of Broome's analysis is set out in detail in the Statement of Facts (pp. 15-18), and will not be repeated here. It is sufficient to say that the letter is a classic example of what careful lawyers advising clients are supposed to do. Faced with a complex post-production process, a complicated lease, two conflicting interpretations advocated by others, and no case law directly on point, Broome tried to arrive at a "plausible interpretation" based on the standard contract interpretation principles of harmonizing apparently conflicting provisions and giving meaning to every word in the contract.

To be sure, the interpretation he chose favored his client to some extent (though, it bears emphasis, he *rejected* an even more favorable interpretation). But private lawyers are not supposed to be judges and juries in their clients' affairs. Consulted on a question of the interpretation of potentially disputed language, a lawyer's duty is to take

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precisely the approach Broome did: to determine whether a plausible interpretation exists that is consistent with the client's interest, and to advise the client candidly as to the likelihood that such an interpretation will prevail.[63]

The State's counsel, however, twisted this perfectly ordinary piece of attorney's advice almost beyond recognition. They told the court that Broome's letter was not just a "smoking gun," it was "the equivalent of a crystal clear video with sound of the assailant plunging a bloody knife into the victim's chest." C7/1279 at 1281. They highlighted it in opening statement [R23/420:17-423:15, 426:5-11]; they told the jury it was "infamous" [R32/2245:20]; they used it with witness after witness, most of whom had no connection whatever with Broome or with Exxon [*see* R26/1035:21-24 (Macrory); R26/1143:10-11 (Bremer); R27/1315:25-1316:1 (Burney)], and they played for the jury a videotaped deposition of Broome where he was interrogated about the opinion and his thought process in writing it. R26/1153:2-R27/1235:20 (Broome). And their thrust was always the same: because Exxon had paid royalties in accordance with Broome's advice, and because Broome told his client candidly that the chances of his interpretation "prevailing in court" were "less than 50%," that meant that Exxon had deliberately not paid royalties that it "knew" it owed. R32/2217:20-24, 2245:19-2249:3.

This is nonsense. When a lawyer says, "My position may not prevail in court," that does not mean that the lawyer believes (much less knows) that the position is

[63]*See* Preamble, *Alabama Rules of Professional Conduct* ("As advisor, a lawyer provides a client with an informed understanding of the client's legal rights and obligations and explains their practical implications. As advocate, the lawyer zealously asserts the client's position under the rules of the adversary system.").

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wrong; and it certainly does not mean his client believes that. Instead, it means only that the lawyer has a healthy respect for the risks of litigation. Any lawyer with any experience knows that litigation often does not turn out as lawyers believe it should. Broome cannot be faulted for telling his client that the risks of royalty litigation before an Alabama jury, with the State of Alabama as the plaintiff, were very substantial for Exxon – and indeed events have proved how right he was. But that does not remotely show that Broome's opinion was wrong, let alone frivolous, or that he was insincere in giving it. Any lawyer who has ever tried to help a client through a complicated legal problem knows what Broome's letter reflects – an honest assessment of a substantial legal issue. Lawyers and judges know this, but a lay jury would not know it, and could not be expected to understand Broome's role.

The trial court thus put a lay jury in the position of having to evaluate a legal opinion, which the jury was not competent to do; the State then compounded the problem by doing everything in its power to assure that the jury got the answer wrong.[64] That was tremendously prejudicial to Exxon, just as the State intended it would be. But the law contains a safeguard against just this kind of prejudice, which is the attorney-client

[64] An egregious example was their persistently misleading treatment of the "more extreme construction" of paragraph 5(b), which Broome rejected because he concluded it would "have little chance of being upheld." R32/2247:21-2248:6. Although the State's counsel reminded the jury repeatedly of this provision of Broome's opinion, they never told the jury that Exxon followed Broome's advice and did *not* adopt this construction of the lease. R32/2247:21-2248:6. Broome's interpretation of the lease was projected, when Exxon adopted it in late 1993, to save about $3 million per year in royalties; the construction of paragraph 5(b) which Broome (and Exxon) rejected would have saved Exxon an additional $16.4 million.

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privilege. *Ala. R. Evid.* 502. The privilege means that juries should not see – much less be forced to evaluate – legal opinions, and that litigants should not be subjected to the distortion and prejudice that overwhelmed Exxon in this trial. But the trial court laid waste to the privilege, over Exxon's *repeated* objections.

Exxon listed the Broome opinion on its privilege log during discovery, and asserted the attorney-client privilege in response to the State's ensuing motion to compel. C1/45; C1/118; C3/536, 585; C* (Exxon's 9/20/00 Brief Regarding Materials Submitted for *In Camera* Inspection). Nevertheless, the trial court ordered the letter produced. *See* C7/1318. Over Exxon's continuing objection, the State then took Broome's deposition; and filed a motion seeking production of yet more privileged documents, which the trial court also granted. *Id.* Exxon filed a motion to reconsider the ruling on the Broome opinion, again asserting the privilege, but the trial court denied it. C7/1321; R21/153:21-154:1. Exxon next filed a motion in limine to preclude the State's use of the opinion at trial, but the trial court denied that too. C9/1775; R22/218:7-9. Exxon was granted a continuing objection both to the use of the letter at trial and to the use of the Broome deposition. R22/218:7-221:2; R26/1148:18-1150:3. Exxon's privilege could not have been more carefully preserved; it was raised four times, and four times the trial court expressly overruled it.

Rule 502 of the Alabama Rules of Evidence is the current Alabama embodiment of the historic attorney-client privilege. It provides:

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> A client has a privilege to refuse to disclose and to prevent any other person from disclosing a confidential communication made for the purpose of facilitating the rendition of professional legal services to the client (1) between the client or a representative of the client and the client's attorney or a representative of an attorney . . . .

The Broome opinion met each of the requirements of Rule 502:

! It was a communication to a "client" – Exxon. Under Alabama law a corporation clearly is a client entitled to the benefit of the attorney-client privilege. Advisory Committee Comments to Rule 502; *Ex parte Great American Surplus Lines Ins. Co.*, 540 So. 2d 1357 (Ala. 1989); *Jay v. Sears, Roebuck & Co.*, 340 So. 2d 456 (Ala. Civ. App. 1976).

! It was a communication from the "client's attorney" – that is, from Broome, an in-house lawyer for Exxon. *Upjohn Co. v. United States*, 449 U.S. 383 (1981); *see Ex parte Alfa Mut. Ins. Co.*, 631 So. 2d 858, 859-60 (Ala. 1993).

! It was a communication to the "client's representatives." The opinion was requested by R.J. Mertz, Exxon's accounting manager for the Mobile Bay Project, was addressed to R.J. Kartzke, Exxon's Mobile Bay Project Manager, and was copied to Mertz and to R.G. Bremer, Exxon's operations accountant for the Mobile Bay Project. PX49; C7/1357 at 1363:2-13, 1365:9-17.

! It was a confidential communication. No one outside Exxon received a copy; no one not involved with the Mobile Bay Project received a copy; and the Exxon personnel who received it at all times treated it as confidential. C*(Capobianco Affidavit at ¶ 3, attached to Exxon's 11/6/00 Notice of Filing of Documents *In Camera*).

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! It was for the purposes of facilitating the rendition of legal services. Mertz testified that he was seeking a legal opinion; and Broome testified that that was what he was providing. C7/1357 at 1363:2-13, 1365:9-17; R26/1181:22-24 (Broome).

Alabama case law has long made plain that legal opinions on the merits of disputed issues are privileged attorney-client communications that may *not* be revealed to juries. In *Ex parte Great American Surplus Lines*, 540 So. 2d at 1358, an insurance company had commissioned an opinion as to its liability on a reinsurance policy. The trial court ordered the opinion produced because the company had told its adversary that it was denying coverage on the basis of the lawyer's "coverage letter." But this Court reversed, and held that the "coverage letter" was protected by the attorney-client privilege. *Id.* at 1361.

Similarly, in *Melco System v. Receivers of Trans-America Ins. Co.*, 105 So. 2d 43 (Ala. 1958), a lawyer had reviewed a series of case files, and made evaluations of the insurer's potential liability. In an action by the insurer's receivers to compromise their claim against a reinsurer, the lawyer was asked what values he had placed on the various claims. This Court upheld the trial court's ruling that the opinion was privileged:

> If he were required to give testimony as to the value of any of those cases, and if he assessed any value above nuisance value, that would be an admission of liability, and that testimony, if later used in the trial of that case, would be highly prejudicial and injurious to the rights of the receivers. It is obvious that reason and common sense support the ruling of the trial court. . . .

Melco System, 105 So. 2d at 52.

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Those words exactly describe the situation here. Plaintiffs' counsel treated Broome's opinion, because it was honest and candid and attempted to make a prediction about what would happen in litigation, as if it were an admission of liability by Exxon. That was highly prejudicial, and that is why *Melco System*, like countless cases from other jurisdictions, holds that such legal opinions are privileged, and that it is prejudicial to reveal them to a jury.[65]

[65]*E.g., Diaz v. Delchamps, Inc.*, 1997 WL 680602 (E.D. La. 1997) (communication from attorney to client for purpose of giving advice or opinion concerning potential exposure to liability of a retail store owner for auto accident caused by shopping cart in middle of road was privileged); *Fox v. Massey-Ferguson, Inc.*, 172 F.R.D. 653, 669-70 (E.D. Mich. 1995) (litigation risk analysis recommending legal strategies for anticipated litigation was "clear[ly] and undisputed[ly]" privileged); *Florentia Contracting Corp. v. Resolution Trust Corp.*, 1993 WL 127187 (S.D.N.Y. 1993) (finding legal opinion letter analyzing issues relating to settlement agreement privileged, and noting that "the legal opinion letter may be the quintessential confidential communication that is encompassed within the privilege"); *Shriver v. Baskin-Robbins Ice Cream Co.*, 145 F.R.D. 112 (D. Colo. 1992) (memorandum from corporation's director of operations relaying attorney's opinion that there was a risk of losing litigation that might ensue from not renewing a lease was privileged); *McNulty v. Bally's Park Place, Inc.*, 120 F.R.D. 27, 31 (E.D. Pa. 1988) (legal advice from counsel regarding defendant's legal obligation to maintain its premises was privileged); *In re RFD, Inc.*, 211 B.R. 403, 406 (Bankr. D. Kansas 1997) (noting that there was "no dispute" that an opinion letter relating to a client's business were confidential communications within the scope of the attorney client privilege); *Palmer v. Farmers Ins. Exch.*, 861 P.2d 895 (Mont. 1993) (attorney's reports to client containing advice relating to insurance litigation including witness and trial evaluations, defense and trial strategy, and prospects for success were privileged); *National Utility Service, Inc. v. Sunshine Biscuits, Inc.*, 694 A.2d 319 (N.J. App. Div. 1997) (memorandum from lawyer to corporate client discussing basis for contract claims against it, and recommending corporate action, was privileged and not discoverable); *Manufacturers & Traders Trust Co. v. Servotronics, Inc.*, 132 A.D.2d 392, 395-96, (N.Y. App. Div. 1987) (memoranda from attorneys containing legal advice regarding application of securities laws to preferred stock were protected by the attorney-client privilege); *Seattle Northwest Sec. Corp. v. SDG Holding Co.*, 812 P.2d 488 (Wash. Ct. App. 1991) (opinions from lawyer to client regarding probability of success in defending or resisting claims in lawsuit were privileged); *State ex rel. U. S. Fidelity & Guar. Co. v. Canady*, 460 S.E.2d 677, 688-89 (W.Va. 1995) (letter containing legal

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It remains only to discuss the mystifying comments the trial court made on November 7, 2000, which constitute the entire record of her grounds for rejecting Exxon's claim of privilege. They are as follows:

> As I told y'all yesterday -- and I still have a problem with it -- is whether or not that letter is confidential in the meaning of confidential under the rules. I don't think that it is. The reason I say this is this Broome letter, what he was writing up, he had obviously Mr. Caretta's opinion, his own review, and then competitor information. What he's doing in this letter is he's summarizing the different things that are going on with the royalties. But the one thing that he states in here is if I need to go beyond a safe approach, you know, he'll come up with more. In other words, I don't think that there's anything confidential about this. This is an information letter going out to people. To be honest with you, this letter probably went out to other companies as well.

R21/125:19-126:11.

To the extent this discussion is pertinent to any issue under Rule 502 – and most of it has nothing to do with confidentiality in any ordinary sense – the trial court seems to have confused: (1) the question of whether the *sources* for a legal opinion are confidential (which they mostly were not here, since Broome was interpreting a lease that was not itself confidential) with (2) the question of whether the opinion itself was intended by its author and recipients to be confidential, which is the test under Rule 502. Advisory Committee Notes to Rule 502(a)(5). Here, Broome and every other Exxon employee who received his opinion intended it to be confidential, and there is nothing in the record to the contrary. Nor is there a scrap of support in the record for the trial court's speculation that the letter "probably went out to other companies as well."

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opinions with respect to coverage of insurance claim was privileged).

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Had the trial court actually considered the controlling issue – whether the Broome opinion was intended to be and was confidential – she would have had to conclude that it was. Her ruling to the contrary, based on no evidence, was enormously prejudicial. It not only fueled the State's false argument that breach of contract is "fraud," but also eliminated any chance that the jury would get the contract interpretation issues right. After all, what juror would adopt an interpretation which Exxon's own lawyer had said had less than a 50 percent chance of prevailing in court? And how could Exxon possibly explain the truth to a jury – namely, that a lawyer's estimate of whether a legal position will prevail in court reflects (as much as anything else) the lawyer's estimate of the likelihood of jury error?

The interpretation of the leases was not a simple matter for a lay jury. Given the difficulty of their task, the jury's decision on the lease interpretation issues had to be greatly affected by the trial court's admission of the Broome letter – the more so since the State did everything in its power to emphasize the importance of the letter and to increase the prejudice to Exxon. The lease interpretation issues were at the heart of this case, so the erroneous admission of the Broome letter infected every aspect of what the jury did – not only its verdict on fraud and punitive damages, but also its decisions about what the lease meant and what royalties were owed. Exxon has previously shown that the State's fraud and punitive damages claims should be dismissed outright. But all other issues will need to be retried because of the admission of the Broome letter. Only in a new trial can Exxon be granted the declaratory judgment that it brought this action to

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obtain – a determination, by a judge or jury not infected by inadmissible and prejudicial evidence, of what the language of the leases means.

Finally, there are broader interests at stake here. The possibility of harm if the trial court's ruling is not reversed extends far beyond this case. Clients need to be free to ask lawyers for candid assessments of their legal position, without fear that the resulting opinion, because it identifies the weaknesses as well as the strengths of the client's position, will be used against it in court. If opposing parties are free to use attorney-client opinions in litigation, clients will be reluctant to seek legal advice, and lawyers will be reluctant to express opinions contrary to their clients' positions. That would be a loss for all lawyers, and all clients, in Alabama.

CONCLUSION

For the reasons stated, this judgment should be reversed. Judgment should be rendered in Exxon's favor on the fraud and punitive damages claims. On all issues on which judgment is not rendered in Exxon's favor, the case should be remanded for a new trial. Should this Court not invalidate the entire punitive damages award and not order a new trial, it should nevertheless order an appropriate remittitur of the punitive damages.

Respectfully submitted this 24th day of September, 2001.

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STATEMENT REGARDING ORAL ARGUMENT

Exxon respectfully requests oral argument. In the trial court, this case produced the largest jury verdict ever returned in Alabama and one of the largest in the history of the United States. Here, this appeal involves not only a complex set of facts, but also a number of significant legal issues, all of which can be illuminated by oral argument. Exxon believes that oral argument will significantly aid the Court's decisional process.

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CERTIFICATE OF SERVICE

I hereby certify that I have served a copy of the foregoing brief upon the parties listed below by placing a copy thereof in the United States Mail, postage prepaid, and properly addressed to them on this the 24th day of September, 2001.

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Punitive Damages: How Real and Big Is the Threat?

Potential Pitfalls in Punitive Damages Cases

Discovery and document production

Problems arising during discovery can affect a jury's perception of the parties, and play a role in awarding punitive damages. Juries generally expect corporations to be able to locate and produce every single document requested in litigation. The inability or failure to produce all documents properly requested may reinforce a jury's skepticism about a company's candor, particularly in the current environment of news reports about widespread document shredding in some of the corporate scandals. A plaintiff's argument that a corporate defendant is guilty of a "cover up" can be powerful and damaging, and thus should be anticipated regardless of its plausibility or factual support.

The best antidote to this problem of juror perception obviously is full compliance with all legitimate discovery requests. However, even a good faith effort to retrieve everything pertinent may not uncover every document sought by an adversary, particularly if some requested documents never existed in the first place. Counsel should prepare to deal in advance with any attempt by a plaintiff to claim the company is withholding documents.

- Be certain the search for documents is truly exhaustive. Remember to contact former employees who might have information about the location of possibly responsive documents.
- Carefully track and document all efforts to collect discovery materials. Prepare a spreadsheet listing all persons contacted, including the dates of the contacts as well as the results.
- Solicit suggestions all along the way about the identity of other personnel or locations that should be included in the search.
- Track all documents retrieved, including their source.

E-mails

Emails are a fertile ground for plaintiff's lawyers, just as they have proven to be for congressional, attorney general, and regulatory investigators. Employees are often almost conversational in email communications. Statements that will appear flippant, or worse, to jurors frequently appear in emails. These statements are sure to be found at trial on large graphic exhibits presented to the jury.

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The ease with which emails are circulated poses a potential problem at trial. The issue of "who knew what and when" can be important in a punitive damages case. Because emails are routinely sent to long lists of recipients, and then forwarded on to many others, someone who receives dozens daily may read them only cursorily or not at all. Despite this reality of corporate life, plaintiff's lawyers are able to argue forcefully that everyone who received an email is fully aware of everything in it, and perhaps related facts and circumstances as well.

Corporate counsel should consider advising their company's employees on ways to prevent unintended damaging consequences from email communication. Two suggestions may help:

- Put nothing in an email that you would not want to appear on the front page of the newspaper.
- Forward or copy emails only to colleagues who need, and will read, the contents of the message.

Witness preparation

As Dr.Speckart points out in his materials for this presentation, witness performance is one of the most critical elements in a jury's determination of whether to award punitive damages. Please refer to the portions of his materials addressing the importance of witness preparation.

Video depositions require special attention. If a video witness's testimony has any weaknesses the deposition will often be shown to the jury. The video is likely to be heavily edited to include only the portions the plaintiff views as damaging. As the judge is absent during the deposition, the opposing lawyer may pose questions that would result in sustained objections in the courtroom, especially irrelevant, repetitive, or argumentative ones. While a motion in limine may prevent the use of edited video, and may result in the striking of improper questions, counsel should not count on this result.

Standard deposition preparation may school a witness to answer questions truthfully but succinctly, and not to volunteer information. However, the witness who follows these rules in a video deposition may well appear evasive or worse to a jury watching the tape in the courtroom. Preparing a witness for a video deposition may take much longer than for a standard discovery deposition. This could pose serious problems when the deponent is a very busy senior executive or a former employee. However, these are precisely the types of witnesses the jury may consider most important.

Consider preparing witnesses for video depositions differently from the standard transcribed discovery deposition.

- The witness should be prepared to answer questions in such a manner that he or she does not appear evasive. This may require volunteering

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information rather than forcing the questioner to drag out of the witness answers that will ultimately be disclosed anyway.

- Use video in the preparation. Tape the mock cross examination, and show it to the witness. Focus on mannerisms and body language that may lead a juror to dislike or disbelieve the witness.
- If time and budget permit, consider showing the preparation session video to a focus group, and share the results with the witness.

David vs. Goliath and other emotional appeals

While attempts to appeal to possible passion or prejudice are improper, they are effective, and therefore should be anticipated. Plaintiff's lawyers know that a powerful way to sway a jury to award punitive damages is to characterize their client as the victimized "little guy" fighting long odds against a corporate bully. Do not be surprised if opposing counsel literally makes a "David vs. Goliath" argument, or engages in inflammatory name calling. If the trial court fails to remedy such improper arguments, the appellate courts might do so. *See, e.g. Pioneer Commercial Funding Corp. v. American Financial MortgageCorp.*,797 A.2d 269, 289 n.12 (Pa. Super. 2002) (copy attached). A motion in limine may be called for to prevent plaintiff's counsel from introducing irrelevant evidence of flights on corporate jets, meetings in executive dining rooms, and similar everyday business occurrences that jurors may view negatively.

The Trial Team

Any case with a viable punitive damages claim is dangerous, and should be a candidate for special staffing. Such staffing will result in additional expense over a company's routine litigation. One of the most important decisions corporate counsel will make is the selection of local counsel. The leadership of the trial team must include a respected local lawyer with a reputation for regularly and effectively trying jury cases. This lawyer's knowledge of the community and reputation with the judiciary are indispensable in everything from discovery disputes to jury selection and argument.

Corporate counsel should carefully consider several pretrial expenditures not normally incurred. Focus groups and mock jury trials can help identify effective trial themes and improve the performance of less effective witnesses. A troublesome witness's testimony can be presented to the mock jury either live or on video, and the jury's videotaped reaction can then be played for the witness. Seeing and hearing the reactions of a group reflective of the potential jury pool can be a powerful learning experience the witness and the trial team. While focus groups and mock juries are not necessarily predictive of the outcome of a trial, they can provide a realistic view of the range of potential results. This information

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may be particularly useful in advising management of the risks presented by the case.

The selection of the jury may be the most outcome determinative time in the trial of a punitive damages case. As the time for jury selection approaches the trial team should seek approval of the court to use a jury questionnaire. The results of the questionnaire will provide insights into the thinking and inclinations of prospective jurors seldom revealed in *voir dire*. In the hands of a skilled jury lawyer, aided by the professional judgment of an experienced jury consultant, the completed questionnaires may provide the information needed to select as good a jury as possible under the circumstances.

When budgeting litigation expense for a punitive damages case seriously consider the need to:

- Retain a strong jury trial lawyer as local counsel
- Add a jury consultant to the team to
  - Conduct mock jury trials and focus groups
  - Suggest effective trial themes
  - Prepare the jury questionnaire and assist in jury selection

Because the risks in punitive damages litigation can be enormous, the additional expense should be considered a necessity rather than a luxury.

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Appendix

Superior Court of Pennsylvania.

PIONEER COMMERCIAL FUNDING CORP. and Bank One, Texas, N.A.
v.
AMERICAN FINANCIAL MORTGAGE CORP., Thomas F. Flatley, Northwest Funding, Inc. and **CoreStates** Bank, N.A.
Appeal Of: **CoreStates** Bank, N.A.

Argued Nov. 29, 2001.
Filed March 18, 2002.
Reargument Denied May 21, 2002.

797 A.2d 269, 289-90, 291

¶ 44 *Punitive Damages.* Throughout its brief, the Bank repeatedly maintains that Pioneer's counsel was permitted to make inflammatory arguments and allegations that ultimately resulted in a verdict based on passion and prejudice. [FN12] *290 **We agree with the Bank only with respect to the jury's award of punitive damages.**

FN12. Counsel for Pioneer in his closing arguments suggested that the Bank committed crimes, repeatedly called the Bank's witnesses "liars," compared the Bank to a "thug" and a "gangster" that would "knowingly steal to allow a customer to engage in kiting, to milk it for fees, and then the last second ... shut it down and just say I'm going to take anybody's money I can." R.R. 2328a-2329a.
In addition, Pioneer's counsel baited the jury by implying that CoreStates was a Goliath and Pioneer a philanthropic David, asking: "How could you not care about the people at RNG? How could you not care at all about all of those families?" and stating without foundation: "[W]e had the government loans, the first time home buyers, the veterans. Those are the people that we lent our money to. They don't have one shred of remorse, one bit of humanity about just how many lives got turned upside down." R. 2849a. Counsel claimed that one witness had fabricated his testimony because by the time of trial he had been hired by First Union (R. 2833a) and that C.B. Cook and Walter Weir were not "people dealing with integrity" and "were caught conspiring and stealing money." For other examples, *see* R. 2837a-2838a, R. 2298a ("this deal that was working until CoreStates came in and decided to steal money"), R. 2300a ("corrupt practice, practices in racketeering, mail fraud, bank fraud, a whole host of both civil and criminal acts which they were allowing and milking for fees. We'll get to the fees that Mr. Weir milked it for as well"), R. 2308a ("the seven court orders I got *** [are] part of the let's stone wall them to death, let's hide what we've been doing *** because what they did is despicable. What they did is unethical. It was outrageous. And, they were hiding among every front they could. And, they got a lot to hide about"), R. 2322a- 2323a ("They put on Walter Weir. How many lies did we catch him in? *** Those are boldface lies, and he knows it. But then again, they're running for cover"), R. 2326a ("There is no limit to how despicable and outrageous their behavior is. They'll go to any lengths, because what they did in allowing this kite, in milking it for fees, both the bank and then the lawyer"), R. 2329a ("What they did was vicious, and they knew it. And to cover it up and to lie about it, and to behave the way they have, I don't know if it's criminal, but I know it's

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> outrageous"), R. 2337a-2338a ("They let a check kiting scheme go on at CoreStates for all of 1997"), R. 2341a ("think about why it's so despicable, that not only did a bank do something that it knew was a violation of federal law and permit its customer to engage in conduct which it calls criminal, but when it steals Pioneer's money to get it back"), R. 2834a (reference to witness: "The guy was lying *** He was lying to protect his new employer, because they know they've got live risk"), R. 2835a ("Their own customer, the crook who had every reason in the world to say it's my money because it's going to pay down his debt"), R. 2842a ("it's more of this approach that they have to litigation and drag it all out and trial by ambush"), R. 2848a-2849a ("this is a vicious greed machine, drag it out as long as they possibly can. No heart"), R. 2852a ("what they did was diabolical ... that kind of vicious little agenda"), R. 2858a ("When does a bank steal? Steal. That's what they did. That's what conversion is"), R. 2867a-2868a ("as I've told you: They don't have personal integrity").

Bank's Brief, at 45 n. 19.

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¶ 45 The Bank has carefully listed the instances in which Pioneer's counsel made allegations of criminal conduct, alleged cover-up, and made other inflammatory statements. *See* footnote 10. [sic] We find these instances too numerous to be harmless and we find these allegations to be unduly prejudicial. Further, we find that the trial court's grant of a remittitur in the amount of $40.5 million did not adequately remedy the harm caused. Accordingly, we will vacate the award of punitive damages and remand this matter for a new trial on the issue of punitive damages alone.

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Putting the Brakes on the Runaway Jury: Causes of Excessive Damage Awards and Tactics for Containment

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In 1984, the Agent Orange settlement of $180 million was the largest in the history of litigation at the time. In 1999, a North Texas jury gave $296 million in compensatory damages to the father of a teenage girl killed in a pipeline explosion. By 2000, a Florida jury had awarded $144 billion in a class action lawsuit against cigarette manufacturers. Dozens of other recent juries have awarded hundreds of millions, and even billions of dollars, many of them in cases involving actual damages amounting to only tiny fractions of these awards. Since the 1980's, an inflationary trend has occurred in civil jury damage awards that cannot be explained solely by economic factors.

To be sure, there are sociological trends at work in the last two decades that have undoubtedly served to inflate damage awards by juries. Population changes in inner city venues; indignation over CEO salaries; frustration with a stagnant minimum wage; and other events linked to historical, demographic and socioeconomic factors have very likely contributed to the sentiments of jurors as expressed in their damage awards. Additional trends may have been set in motion by the Enron, WorldCom, and other corporate scandals.

However, extrinsic forces arising from social and historical events cannot be controlled by trial teams. What can defense litigators do to mitigate tendencies by juries to render increasingly enormous damage awards? While defense trial teams cannot counteract sociological forces, there are tactical measures that can be taken to manage risk, minimize a defendant's exposure, and suppress damages in most cases. This article is focused on factors that impinge directly on the litigation scenario, and that, for the most part, are within the defense counsel's realm of influence.

Within the litigation arena, identifying the origins of excessive damage awards can enable the detection of a potentially dangerous case in its early stages and assist in steering it to a resolution of minimal cost. Knowledge of the explicit conditions that lead to a runaway jury may also be used to formulate a checklist of "red flags," or indicators of excessive risk, to guide the litigation team as discovery unfolds. Awareness of such indicators can be instrumental in shaping the litigation team's conceptualization of effective strategy and ensuring ultimate preparedness for trial or settlement. In order to maximize such

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knowledge and awareness, this article outlines the conditions that lead to excessive damages awards generally, with an emphasis on punitive damages in particular.

The causes of inflated damage awards are presently considered not from a legal point of view, but rather from the vantage point of jury psychology and overall trial preparation. Specifically, the present discussion is oriented toward illuminating the *non-legal* antecedents of excessive damage awards as a guide for defense litigators. In particular, it is concerned with the simple question, "Why do excessive jury awards occur?" and provides practical suggestions to ameliorate perception problems that are often found in runaway juries.

As we shall see, excessive damage awards are not always punitive awards in a legal sense, since juries may include "punitive" damages within inflated compensatory damages awards. As occurred in the $296 million North Texas verdict in 1999, when jurors are not given the chance to award punitive damages, some juries will increase the amounts of compensatory damages using punitive motives. From a psychological or non-legal perspective, therefore, it is difficult to disentangle compensatory and punitive damages, since they both may become inflated for the same reasons. Thus, the focus will be on "excessive damages" as a reference to awards that appear to be unreasonably high, and that are certainly unjustifiable from a purely economic point of view.

The primary causes of excessive damage awards considered in this article are as follows: I) The Problematic Witness; II) Actual Damages; III) Attorney Performance; IV) The Punitive Juror; and, V) Trial Venues.

I. The Problematic Witness

Studying jurors over a wide variety of cases, there appears to be a readily identifiable "cognitive map" that jurors utilize in order to determine verdict and damages. This "cognitive map" is essentially a step-wise progression that jurors follow in problem-solving a case. It is a progression that is virtually universal, that is, applicable across all types of cases for all types of venues.

Generally, the "map" is characterized by a "trail" that begins with two decisions: First, jurors formulate an impression of who the litigants are (*Who are these guys?*): What kind of people are they? Are they responsible, trustworthy, and likeable? What are their characteristics? What are their values and motives? Second, jurors come to a conclusion about their duties and responsibilities: What were these people supposed

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to do? What were they morally or ethically obligated to do? How does this compare with their actual conduct?

The manner in which these two decisions are made by jurors tilts the psychological playing field for the entire trial. When these two questions are answered by jurors in a manner detrimental to the defense, a substantial damage award is a virtual certainty. The very first question – *Who are these guys?* – is answered by the witnesses, not by the defense attorney, nor by the corporate representative present during trial.

More than any other cause, the poor performance of witnesses appears to be a pivotal factor in producing inflated damage awards. There are two subsections within the general topic of problematic witness performance that warrant consideration: a) Inadequate preparation; and, b) the incompetent witness.

Inadequate preparation: Many witnesses enter a deposition, and take the witness stand, without the skills needed to testify effectively. Inadequate preparation for depositions is perhaps the most ubiquitous problem encountered in litigation. Although insufficient preparation for both deposition and actual trial testimony represent tandem concerns, for the purposes of this section, we will concentrate on the problem of deposition training, since vulnerabilities in this area extend all the way through to trial in a more insidious manner.

Many deponents are never trained from the standpoint that their testimony can, and likely will, be used at trial. They are often instructed to give minimal information, but are not guided as to how to accomplish this in a manner that still appears to be cooperative and accommodating. The resulting deposition testimony, when reproduced at trial, may as a result appear to be arrogant, or at the very least, evasive.

In addition, deponents are seldom given a full range of tools required to detect and avoid common traps set up by skilled interrogators. Even when such teaching is given, however, witnesses are rarely subjected to the rigorous practice and role-playing, using videotape and subsequent critiques, necessary to ensure that the teaching "sticks." Most witnesses absorb information during coaching and training, but then revert back to old habits under the pressure of the interrogation environment. Role-playing using videotape is essential to let a witness see his own mistakes as an observer, and to enable subsequent discussion of more appropriate response options or demeanor among the trial team members before the actual deposition takes place.

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Most importantly, it is suggested that a witness is not prepared to testify unless he can articulate the *objectives* of his testimony in his own words. These objectives are directly connected with cornerstone themes that can serve as "buoys" defining a "safe harbor" for him. Such themes may be seen as a limited set of "silver bullet" points that serve as psychological organizers for the witness, keeping him within the boundaries of a seamless picture that has been formulated by the defense in advance.

The development of effective objectives for a given witness requires careful orchestration of the full range of defense themes among all of the witnesses that is 1) tailored to their unique backgrounds, knowledge and expertise; and 2) organized in a manner that reinforces consistency and credibility for the team as a whole. Trial teams rarely implement explicit objectives for witness testimony in this fashion when depositions are taken. As a result, a given witness may not know where the boundaries are between safe and unsafe testimony; may not be equipped to competently challenge hidden premises in "loaded" questions; and may contradict documents, other testimony, or other aspects of the evidence in his, or other depositions.

There are three types of consistency for testifying witnesses:

- *Consistency between himself at Time A and himself at Time B.* Witnesses who contradict their own prior testimony, or who appear to be a "different person" under direct versus cross, lose their credibility almost instantly.

- *Consistency between himself and other witnesses.* Although inconsistency in this area can sometimes be explained by different backgrounds or experiences, it still represents dead weight on the defense team's progress.

- *Consistency between himself and "hard evidence" (e.g., documents).* Problems in this area are extremely difficult to defuse, for obvious reasons. Jurors tend to conclude that anything in black-and-white is more likely to represent "truth" than what is said by a witness under the pressure of litigation.

Achieving consistency in these three areas cannot be accomplished by simply briefing the witness. Failure to achieve consistency in these areas is a hallmark of the problematic witness in high-damage cases. The inevitable conclusions to this scenario range from, at best, a compromised defense theory of the case, to, at worst, severe damage to the credibility of the entire defense team.

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When witness objectives are not clearly established early in discovery, a trial team frequently is forced to deal with trial testimony that is suddenly and unexpectedly at odds with the strategic position of the defense team once it hits the courtroom floor. At the hands of a skilled cross examiner, the witness is subject to being forced to recant or explain discrepant content from a deposition, diminishing his credibility, and causing the jury start the "cognitive map" on the wrong trail. Once the jury sets off on the wrong trail in this map, it is extremely difficult to rein them in again.

The Incompetent Witness: Many litigators have a list of the "worst" witnesses that they have ever had on their teams, and indeed, the high-damage verdict is nearly always characterized by the presence of one or more especially poor witness(es) for the defense. It is tempting to conclude that some witnesses are constitutionally incapable of performing effectively on the witness stand. Some "freeze up" out of fear, and, as a result, appear to be hiding something; some have problems with anger; some have distracting mannerisms; and some are simply too acquiescent, agreeing to virtually anything that a cross-examiner suggests. Many witnesses forget who they are while testifying, and either try to answer too many questions, speculate, or simply travel outside of their "safe harbor" without knowing that they have crossed the line. Others sit on their hands and give non-informative answers, or obstruct the line of questioning, causing the jury to judge them harshly in the process.

Problem witnesses can, and should, be tested in a courtroom environment repeatedly before going to trial. In this regard, it is worth noting that a "problem witness" is not necessarily an unsuccessful or incompetent person. From the standpoint of acceptance by the jury, some of the worst witnesses come from the ranks of CEO's, engineers, and even attorneys. Unfortunately, these successful individuals are often the least likely to be willing to give the trial team the time needed to adequately prepare them for the courtroom. Experts may also resist training for various reasons (Speckart, 2000a). Moreover, the time demands placed on the trial team itself often limit the amount of work that is typically done to prepare a witness thoroughly.

In the final analysis, the distinction between "inadequate preparation" and the "incompetent witness" can become blurred. Witnesses who seem to be constitutionally incapable of effective performance are apt to be found in connection with trial teams that are rushed, and which simply do not have the time to go over and over the type of repetitive, painstaking witness training that is typically required. In rare instances, however, we have seen witnesses who do in fact seem to be hiding something and who seem unusually unresponsive to

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training. In such instances, substantively different forms of intervention (e.g., from the management level of the defendant corporation) may be required.

II. Actual Damages

This section considers how jury awards become inflated in cases that involve serious actual damages. Such cases could range from more famous cases, such as the *Exxon Valdez* matter, to lesser-known trials, such as the $296 million pipeline explosion verdict mentioned in the introduction, in which a teenage girl was killed. The common feature underlying these cases is that severe harm to property, or to one or more persons, has occurred. In order to fully appreciate the factors that lead to excessive damages in such cases, it is helpful to consider some fundamental principles of jury psychology that illustrate how jurors construe evidence and testimony in the courtroom.

One psychological principle that gives rise to inflated awards in serious actual damages cases is often referred to as *hindsight bias*. In jury trials, hindsight bias causes behaviors resulting in disastrous consequences to be more harshly judged than the same behaviors that lead to more harmless outcomes. Generally, the term refers to judging conduct by its putative results, rather than by looking at the conduct itself. For example, in criminal cases, studies have shown that police are less likely to be blamed for illegal search and seizure if hundreds of kilos of cocaine are recovered, compared to situations involving the same practices by police when nothing is recovered.

Hindsight bias is a virulent juror perception problem that is extremely difficult to ameliorate when severe harm or injury (actual damages) have occurred. As a litigation example, if a pharmaceutical corporation falsifies testing data submitted to the FDA, this conduct will be viewed much more severely if the result is a series of patient deaths than if it simply leads to a few cases of skin allergy. Punitive damages for such a case would in theory be directed toward only the conduct itself, but psychologically, a jury would determine the amount of such damages as a result of *what comes after* the conduct. The *Exxon Valdez* case is perhaps the quintessential hindsight bias case, since it is extremely doubtful that $5 billion in punitive damages would have been awarded had the amount of oil spilled amounted to only a few hundred barrels. Myriad other examples are available demonstrating that hindsight bias causes corporate defendants to be viewed in a more negative manner when actual damages are severe, leading to inflated jury awards.

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Two additional jury psychology principles tend to operate in conjunction with hindsight bias to create excessive damages awards against corporate defendants:

- Corporate Omniscience: Jurors tend to think that large corporations and their executives are, for all practical purposes, omniscient. That is, the more highly elevated a manager's position in the corporate hierarchy, the more he or she is presumed to know about everything that is going on in the company.

- Corporate Omnipotence: The larger the corporation, the more it is seen as having ready and immediate access to a complete solution for any sort of technological, personnel, or management problem. Intellectual property, know-how, and abilities to implement improvements are seen as virtually unlimited.

Aside from the formidable challenges that these two distortions create in preparing corporate witnesses for testimony, they combine with hindsight bias to produce harsh judgments of corporate defendants in the context of the serious damages case. For example, even when the evidence appears to point clearly to the existence of an accident, jurors seem to frequently infer the presence of motives by corporate representatives that are at best grossly negligent, and at worst, sinister or malevolent. While such judgments by jurors may stem from witness performance problems, they also arise from perceptual distortions that lead jurors to expect corporate defendants, their conduct, and their products and services to be, for all practical purposes, virtually perfect.

To illustrate with an example, in a product liability case arising from the crash of a small private plane, a manufacturer was sued because its part had failed before the accident. The audiotapes of the last minute interactions between the pilot and the control tower were bone-chilling. Four tragic deaths were involved, including children. Despite the fact that there is no technology for replacing this part with one that is immune from wearing out and failing, jurors 1) assumed that management knew that these types of accidents could and would occur, despite salient warnings to routinely replace the part (corporate omniscience); 2) presumed that the corporate defendant could have devised a different type of part that would never wear out (corporate omnipotence); and 3) awarded punitive damages of a hundred million dollars against the manufacturer defendant, even though it was not clear that its conduct had contributed to the accident (hindsight bias).

The perceptual tendencies of jurors considered up to this point represent persistent hazards for defense litigators. These perceptual tendencies typically interact with "bad facts" of the case in a synergistic

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fashion, creating damage awards that greatly exceed actual damages. Ironically, such "bad facts" are usually events that are only indirectly connected to the accident, transgression, or other seminal harm-producing event that precipitated the lawsuit in the first place.

The "bad facts" characterizing high damages cases are apt to be a result of preventable management conduct that occurs before or after the damaging event that gave rise to the litigation. One essential strategy for damages suppression, therefore, is to minimize the number and potency of these "bad facts" surrounding the incident that actually caused the injury. This strategy requires proactive corporate management decisions that are made with jury psychology and the overall public image of the company in mind. Such tactics for damages containment can and must be made at the corporate management level, even before discovery in a case is conducted.

Analyses of recent high damage verdicts reveals commonalities in "bad facts" that significantly increase the risk of catastrophic damage awards. Such commonalities include corporate behavior that suggests to jurors a breach of trust and fairness; lack of timeliness and responsiveness; indifference and callousness; and/or a failure to follow perceived protocols or standard of care. The following represent just a few examples from actual cases in which "bad facts" increased the exposure of a defendant to levels substantially higher than they would have been as a result of the injury-producing event alone:

- In a railroad case in which a boxcar slipped loose and rolled down a hill, killing the father of three young children, the railroad company believed that it was not at fault, since it had reason to conclude that a third party had irresponsibly loosened the brake. A corporate representative visited the grieving widow at her home the next day and told her, "We would be willing to pay for the funeral if the cost is reasonable."

- In a downtown metropolitan area, a large corporation was having a dispute with a contractor over how the office windows had been installed. Instead of having the windows adjusted properly, the company spent its efforts in obtaining reimbursement from the contractor. During this period of time, a window became detached in a windstorm and fatally lacerated a pedestrian. Naturally, in trial the plaintiff attorney was able to paint a picture of a corporation that was more interested in profits than public safety.

- After a serious injury, a manager from the defendant corporation called the hospital claiming to be a witness to the accident, and

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stated that he wanted to find out how the victim was doing. He subsequently wrote an internal memo describing his surreptitious scheme to investigate the condition of the plaintiff, which was ultimately produced during discovery and shown to the jury.

- During a trial, a key defense witness who happened to the CEO of the company was able to give a compelling account of his side of the case during the defense case-in-chief. At the end of the day, however, he was observed by jurors in the parking lot of the courthouse, where he was yelling at his assistant. He was trying to induce her to walk faster, while she carried two boxes and he carried one. In post-trial juror interviews, jurors stated that they believed they saw the "real" CEO in the parking lot, and awarded punitive damages.

Similar examples from innumerable additional cases include self-serving or incriminating communications, both internal and external; deceptive measures taken to attempt to undermine the plaintiff's case; lack of training, or resistance to training, by key witnesses; inappropriate conduct during trial that is visible to jurors; or any conduct that is seen as arrogant, callous, or acting "above the law."

Generally, the "bad facts" that increase damage awards can be divided into the categories of "pre-incident" and "post-incident" conduct. "Post-incident" conduct is referenced in all but the second example, and indeed, it is at this point in time when the most egregious conduct seems to occur. However, both categories have in common the fact that training and awareness of sensitivities to litigation-related issues at the management level can decrease the likelihood of their occurrence, and the resulting exposure to corporate defendants.

Research indicates that jurors examine the conduct of both plaintiffs and defendants in making assessments as to whether the parties met their duties and responsibilities for appropriate conduct, but they are comparatively more forgiving of plaintiffs' mistakes. Jurors recognize that accidents happen; however, hindsight bias and the additional perceptual problems mentioned previously result in particularly close scrutiny of the conduct of corporate defendants. Ultimately, the result of these assessments by jurors influences the character impressions of the parties formed by the jurors. When breaches in pre-incident or post-incident conduct by a defendant have occurred, these character impressions then drive damage award levels to magnitudes that may far exceed those mandated by the facts surrounding the specific events producing the actual damages.

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In many severe damages cases, trial teams have tested themes designed to mitigate damages by attempting to induce jurors to see the events from a more "corporate" view. For example, themes such as the following have been tested in mock jury settings to attempt to minimize punitive damages:

- The subsidiary that is responsible for the accident is a different entity than the parent corporation ("corporate veil" defense);
- Only shareholders would be hurt by a large damages award;
- A large punitive award would result in lost jobs at the company; and,
- A large punitive award would force the company to pull out of the region, creating overall economic losses for the community.

These themes are not only invariably ineffective, but they tend to create a backlash against the defendant (*Is this some kind of a threat?*) and raise the specter of an *increased* punitive damages award. Pre-trial research conducted on serious actual damages cases suggests that the following guidelines are more generally useful for minimizing the amounts of money awarded by jurors:

- Jurors want lawyers to "get real" with them. They do not want to hear ingenious arguments. Instead, they want the lawyers, and the corporate representatives, to look them in the eye, tell them they are sorry, and really mean it.
- Jurors need to know that other players in the industry, and perhaps even other industries, have "received the message" already -- not just the defendant in the trial at hand. In some cases, jurors may want to be assured that the whole country has "received the message."
- The "corporate face" of the defendant plays a substantial role in the determination of damages awards. As a minimum requirement for suppressing damages, it is essential that the corporate defendant has done everything possible to assist and compensate any victims well before the lawsuit takes place – preferably, as soon as possible after the offending incident. (Forcing victims to sign waivers is another example of egregious post-incident conduct, as discussed previously).
- Building a favorable corporate image is a process that requires long and painstaking efforts. While a corporate defendant cannot

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build a concert hall in every county across the United States, it can contribute to visible charities, schools, and other community efforts in cost-effective but conspicuous manners.

- Many arguments that seem useful ("only the shareholders will be hurt") may be more clever than helpful. Indeed, some may increase the anger of the jury. Pre-trial simulations are essential to separate out those that work from those that do not.

The obstacles posed by the "actual damages" case, in which the true damages are indeed horrendous, represent some of the most severe challenges to the suppression of punitive damages awards that a defense litigator is likely to face. These challenges are rivaled, however, by the conditions noted in the final Section V ("Trial Venues") as perhaps the most problematic situations to be encountered in the quest to mitigate excessive damages awards. Additional tactical suggestions offered in Section V at the conclusion of this report augment the recommendations provided here as a means to contain damages awards in cases that are the "worst of the worst," that is, when there is no chance of settlement, and defense counsel is faced with the most daunting of trial circumstances.

III. Attorney Performance

The topic of attorney performance is a broad one that encompasses many areas, including preparation issues. In addition to the deposition problems mentioned in the first section of this report, many other preparedness issues related to discovery; production of creative graphics and visual exhibits; development of juror profiles and a Supplemental Juror Questionnaire; and a seemingly limitless number of others can affect the outcome of a trial.

However, from the standpoint of the topic under review, one specific aspect of attorney performance has particular relevance: Plaintiff attorneys have recently become more and more creative at stretching courtroom boundaries and artfully "crossing the line" on the courtroom floor to win the hearts and minds of the jury. They have also become more adept at exploiting jurors' inability to comprehend numbers like a "billion," and have innocuous ways to characterize such numbers as suitable punitive damages awards by portraying them as "just a week's pay for this corporation." In addition, plaintiff attorneys appear to understand the implications of research demonstrating that the more they ask for, the more they will get (Sunstein, Hastie, Payne, Schkade and Viscusi, 2002), and they readily capitalize on this phenomenon.

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At this point, we note that the vantage point of this discussion is strictly confined to the courtroom floor. Its scope is limited to actual jury trial outcomes, and the inflated damages that have recently been associated with them. Appellate issues are not considered here. With these restrictions in place, a distinct impression emerges that plaintiff attorneys are more likely to bend the rules in their zeal to sway the jury, compared to defense attorneys. The result has been a number of memorable jury verdicts in which plaintiff attorneys have forced their way toward enormous damage awards.

Observation of plaintiff and defense litigators reveals distinct differences in how they assess and manage risk. Plaintiff attorneys are not trying to protect a client relationship. They are simply trying to win. They know that after the case, their client will be gone. In addition, plaintiff attorneys may be more interested in achieving fame (or, perhaps more appropriately, notoriety) and may not be as concerned as to whether an award will "stick." As a result, on the courtroom floor, they seem to continuously push the envelope by encapsulating their closing arguments in opening statements, speaking objections, and cross-examination questions of witnesses. By the time actual closing arguments are presented, plaintiff attorneys need merely expand and reinforce the arguments that jurors have already heard for weeks throughout the trial.

There seems to be a greater conservatism among defense attorneys, with a concomitant focus on protecting the record for appeal, and a comparatively lesser emphasis on winning the approval of the jury at any cost. In addition, they may be encumbered by a myriad of political situations and extraneous considerations, including competition among the firm members, or other law firms; relationships with corporate counsel; and, especially, the continued extension of the corporate client's loyalty to the firm. While it is *not* suggested that these considerations are trivial, it *is* suggested that they can compromise the ability to fight effectively against more nimble and aggressive opposing counsel in the courtroom jungle.

In contrast to plaintiff litigators (and again, it is acknowledged that exceptions can readily be found), many defense litigators save their argumentative material for the end of trial, during "actual" closing arguments; however, at this juncture, jurors have already made up their minds. In many cases, defense counsel may overestimate the size of their "window of opportunity" for persuasion, thinking that, if closing arguments are sufficiently compelling, they can wrest the case from the jaws of disaster at the end of trial. Research clearly demonstrates, however, that jurors almost never change their minds at this juncture.

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In fairness, it should be acknowledged that defense attorneys may frequently be more focused on winning over the long haul. Thus, while plaintiff attorneys may try to win "here and now," defense attorneys may be focused on the "win for all purposes." Furthermore, it is, of course, acknowledged that the court can rule on motions, render directed verdicts, and the like. It is also acknowledged that some cases cannot be won except at the appellate level. However, there is also a level of conservatism among many defense teams that extends beyond long-term strategic considerations and that severely compromises efforts to persuade a jury in the heat of battle.

Some specific examples are noteworthy in this regard:

- In a fraud and breach of contract case, pre-trial research had indicated a strong antipathy in the venue between many African American women and key defense witnesses. As a result, the defense team was advised during jury selection to use peremptory challenges on two particularly vociferous African American women. Defense counsel declined, citing concern over a Batson challenge and political "correctness" (the judge was also Hispanic). No African Americans were stricken by the defense in this case. During deliberations, these two women led the charge against the defendant, in which hundreds of millions of dollars were awarded by the jury.

- In a trade secrets and misappropriation case, a corporate plaintiff was suing two individuals. In this trial, the roles of the attorneys were reversed: The plaintiff corporation was represented by attorneys who normally handled defense litigation, while the individual defendants were represented by lawyers who otherwise handled only plaintiff cases.

  The corporation's lawyers were advised to provide a lengthy opening statement (well in excess of two hours) at the outset of trial. Lead trial counsel responded to this suggestion by declaring, "I can't do that – the judge won't let me." His subsequent opening lasted about one hundred minutes. Opposing counsel (normally plaintiff attorneys) subsequently gave an opening statement in rebuttal that lasted for two *days*. The judge simply watched while the corporation's case was buried in the avalanche. During the remainder of the seven-week trial, the corporation's attorneys (again, normally defense litigators) were never able to gain control of the trial, and ultimately lost the case.

- In a toxic case involving a gas processing plant, the defense team was advised to acquire photographic evidence in the locale

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surrounding the plaintiffs' homes in order to show the jury the considerable distance between the homes and the plant. The defense team said, "We can't do that – Ms. Wilkinson (one of the plaintiffs) is a maniac. She will see us because she's out there everyday checking on who comes around." The defense team expressed concern that she would report to the media and others that "people from the gas company" were out there "snooping around." As a result, the actual jury never saw pictures showing how far the homes were from the plant.

What happened in these cases? In the first example, defense counsel indicated concern at the time over a potential Batson challenge and whether they would appear to be "politically incorrect." Instead of focusing on the jury – who they are, what they are going to think – the defense team focused on legal issues and the appearance of propriety. Even if the Batson challenge had been won by the plaintiffs (an unlikely outcome when a Juror Questionnaire is used, as in this case), the result would have simply been a re-seating of the stricken juror(s).

In the second instance, the corporation's attorneys attempted to comply with what they anticipated to be the court's reaction to a lengthy opening. They thought they knew where the line was, but didn't – because they never crossed it. The defense (again, normally plaintiff lawyers) decided to push the envelope and take whatever they could. The difference in these two approaches determined the entire complexion of the trial, and drove the ultimate jury verdict in favor of the team that was willing to take risks.

In the third case involving the gas plant, the real jury was never able to appreciate the considerable distances between the plaintiffs' homes and the gas plant, ultimately because of the trial team's fears that one of the plaintiffs would contact the media if photographs were taken near their homes. Yet, the defendant was perfectly justified in obtaining this documentary evidence – after all, it had been sued, and the distance between the homes and the plant was a pivotal issue in the case. From a verdict analysis perspective, the risk-reward or cost-benefit considerations clearly point to the conclusion that there would have been more benefit for the jury to see the photographic evidence than harm arising from the local newspaper reporting that someone in the area was taking pictures.

These three actual case scenarios were purposefully chosen to illustrate the principle that defense attorneys often "carry their conservatism with them" into areas that are unlikely to affect an appellate review of the case. Every jury trial is like a chess game or a sport, where the best defense is very frequently a good offense. There are

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many other examples that could be cited here, but the key point is that a conservative mindset can create a handicap when it comes to persuasion of the jury. As Wayne Gretzky stated, "You miss one hundred percent of the shots you don't take." Opportunities for persuasion are routinely left on the table by defense attorneys – opportunities that plaintiff attorneys are typically less likely to overlook.

In a jury trial, on the courtroom floor, you cannot serve two masters. Risks in strategic decisions will either be assessed primarily on the basis of their effects on the jurors, or on legal bases. When legal ramifications dictate procedural or substantive decisions made by litigators in front of a jury, the result can render a trial team unable to navigate effectively and strike decisively in the courtroom jungle. More effective criteria for strategic decisions would be, "Will this influence the jury in a favorable manner?" and, "Can I get away with it without creating any permanent damage?"

Again, it is acknowledged that appellate issues can and should control in some instances. Nonetheless, from the vantage point of the courtroom floor, after watching courtroom dramas for the last twenty years in dozens of venues across the United States, a consistent trend becomes apparent: The counsel team that is willing to bend the rules and cross the line is more likely to win the jury verdict. The team that is the most cautious, operating from a more legalistic mental framework, operates at a tactical disadvantage from the standpoint of jury persuasion.

Many defense litigators approach a jury trial well armed for a legal battle, fully stocked with case law, briefs, motions, documents, and exhibits. However, once a case reaches the courtroom floor, the trial attorney is often faced with a situation that has more in common with a knife fight. The trial lawyer who is better prepared for this reality is likely to be the last man standing when the jury renders its decision.

IV. The Punitive Juror

The amount of pre-trial effort, preparation and thought that litigators devote to jury selection typically pales in comparison to the amount devoted to other trial preparation activities. Yet the importance of having the right – or avoiding the wrong – people in the jury box is difficult to overestimate. One or two intractable jurors who are adversely predisposed can persuade a jury to award catastrophic damage awards.

Research on punitive damages shows that, instead of moderating the amounts awarded, the jury deliberation process produces a striking

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"severity shift" toward ever-higher awards (Sunstein, Hastie, Payne, Schkade and Viscusi, 2002). This "severity shift" is frequently instigated by a small number of extreme jurors in the group. The purpose of this section is to investigate the psychological make-up of this special class of jurors, and to provide some basic methods for identifying them so that they can be eliminated during jury selection.

Perhaps the most dangerous juror is the "stealth" juror, that is, the venire member who professes neutrality while concealing bias (Bodaken and Speckart, 1996). The stealth juror is most commonly found in high-profile cases, or cases that are well-publicized through considerable grass-roots involvement in a community. These jurors have an explicit agenda, generated prior to the trial itself, that includes punitive motives against the defendant.

Stealth jurors are usually revealed by discrepancies between in-court questioning during oral *voir dire* and prior Supplemental Juror Questionnaire responses. These individuals are usually taken by surprise as a result of a lengthy and detailed Juror Questionnaire, and have not typically planned their "assault" carefully enough to avoid tripping up on some of the details. In short, stealth jurors make mistakes in the consistency of their responses that can be detected by the trained observer, *if* the completed Juror Questionnaire is in place.

With regard to the more "garden variety" punitive juror, repeated observations from mock trials and actual jury panels reveal commonalities in psychological characteristics among such individuals that are robust and persist across case types and venues throughout the country (Speckart, 2000b). Identification of these general traits and commonalities can assist defense counsel in revealing the presence of such risky jurors during selection in many, if not most, types of civil cases. Once again, however, detection of these individuals is greatly enhanced by the use of an appropriately designed Juror Questionnaire – something that rarely is given priority during trial preparation (Speckart and McLennan, 1999).

At the most fundamental level, the search for the marker characteristics of the punitive juror may be targeted at the level of basic personality dimensions that differentiate this juror from others. Reviews of databases for mock trials and actual post-trial interviews have implicated the following personality constructs or traits as "markers" for the punitive juror:

- Cynicism – A generalized tendency to view the world as sinister, oppressive, or malevolent.

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- Vulnerability – A characteristic associated with heightened sensitivity, for example, sensitivity to rejection.

- Arousability – A predisposition toward nervousness, distractibility, jitters, hysteria, mania, and other excessively aroused states.

- Depression – This trait may manifest as ranging from mild dysphoria ("the blues") to clinical depression. In the general population, it is usually observed as a sluggish, withdrawn, or sullen demeanor.

These personality traits are often intercorrelated, and indeed may present as a syndrome of interrelated psychological characteristics. Obviously, for example, a correlation between cynicism and depression would appear to be self-evident in many individuals. For purposes of brevity, the present analysis concentrates chiefly on the traits of *cynicism* and *arousability*, although others are considered where appropriate.

Research demonstrating the relationship between cynicism and high damage awards provides results that are intuitively obvious, since cynical individuals already believe that corporations are inherently predatory. Of course, it would not be surprising to find that individuals characterized by this temperament dimension would favor substantial damages in cases alleging fraud, unfair competition, tortious interference, misappropriation, unjust enrichment, sexual harassment, or even product liability in which corporate misconduct is alleged. Results from mock trials and real trials demonstrate repeatedly that increased cynicism is positively correlated with excessive damages awards.

Another noteworthy characteristic of punitive jurors is connected with the psychological trait of *arousability*. In the courtroom, a high degree of arousability is often linked to a cognitive or information–processing style in which large amounts of evidence are stored during the plaintiff's case-in-chief, with less and less information being assimilated later when the defendant has a chance to put on evidence. In essence, this juror becomes excessively "heated up" (aroused) by the plaintiff's case to the point where the juror's cognitive (information-storing) facilities "melt down." Post-trial interviews of such jurors reveal that they have retained only traces of evidence from the defense, later in the case, although their recall of information from early in the case is quite vivid, thorough, and accurate. In short, highly arousable jurors get angry quickly, undergo "cognitive meltdown," and stop listening midway through trial – precisely when the defense needs their attention the most.

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A good example of this type of juror can be identified from the antitrust case of *ETSI v. Burlington Northern et al.*, in which the plaintiffs were suing various railroad companies for preventing the construction of a coal slurry pipeline. The defendants sought to demonstrate that there was no causation between their actions and the failure to construct the pipeline, since ETSI (Energy Transportation Systems, Inc.) had not even obtained approval for the project from the Interstate Commerce Commission. The former head of the ICC was the last witness in the trial, and spent the entire day on the stand. Notably, however, a handful of jurors - - all comparatively energetic and arousable individuals - - could not even describe, during the post-trial interviews, what the ICC was. By contrast, these jurors recalled, with great clarity, the videotaped depositions of railroad executives that the plaintiffs had presented during their case-in-chief, weeks earlier.

Research establishing correlates of arousability has revealed that:

- There is a significant relationship between arousability and "emotional empathic tendency" – the predisposition to empathize on an emotional level with another person. More arousable people are more likely to react in kind to an emotional appeal.

- Highly arousable individuals are more likely to *store in memory* and *recall* only the emotional portion of a message or communication. As a result, it is clear that the plaintiff message will stand out in the memory of an arousable juror not only as a result of "cognitive meltdown," but also because of a generalized bias toward emotional messages.

- Positive correlations exist between arousability and distractibility, which is in turn positively correlated with neurotic tendencies.

- High levels of arousability have also been linked to impulsivity, lack of endurance, anxiety, mood disturbance, and sensitivity.

Traits such as neuroticism, anxiety, mood disturbance, impulsivity, and the tendency to be emotionally empathic are not the types of characteristics that a defense lawyer typically hopes to find in a panel of jurors. Research demonstrating that these traits are intercorrelated helps explain why punitive jurors frequently do not even recall evidence from the defense. This research is strongly consistent with anecdotal observations from mock trial and real trials which suggest that punitive jurors are often more unstable, emotional, sensitive, and selective in their memories than their more defense-oriented counterparts.

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The traits that have been considered presently tend to surface in behaviors that are identifiable and detectable during *voir dire* and selection, particularly when a Supplemental Juror Questionnaire is utilized. For example, with regard to the construct of arousability, there is scientific research indicating a clear association between high levels of this trait and various stress-related illnesses, including cardiovascular disease and myocardial infarction. More broadly, arousability is associated with a variety of physical, psychosomatic, and psychological illnesses and symptoms. This trait has also been associated with an increased prevalence of accidents. Illnesses and accidents are certainly events that are detectable during *voir dire*, and research with mock jurors has demonstrated clearly that reports of poor health and/or frequent accidents are generally predictive of a punitive orientation.

How deeply one can "dig" in *voir dire* is always a sensitive issue, and depends on many factors, including the judge; whether one is in state versus federal court; and one's own comfort level and skill in phrasing questions and producing a non-threatening, unobtrusive context. However, the use of a Supplemental Juror Questionnaire to reveal subtleties in jurors' personalities yields substantial tactical advantages, particularly when one side takes the initiative and formats tactful but revealing questions with response options that are designed to expose only the most risky jurors for one's side.

V. Trial Venues

The seasoned defense attorney knows that there are some venues – perhaps an increasing number in recent years – that are notorious as "bad" (i.e., high damage) venues. It is implausible to suppose that these venues just happen to be areas in which most of the population has inordinately high levels of the personality traits mentioned in the previous section. These areas of the country are instead awarding runaway verdicts for some other reason(s) that appear to be somewhat location-specific. That is, there is some other characteristic, or set of characteristics, prevalent in these venues, that precipitates excessive damages.

Litigators with varying experiences may point to different venues as problematic, with some emphasizing specific areas in southern states (parts of Mississippi; Louisiana; Alabama or Texas) and others emphasizing inner-city state court venues. However, difficult venues – labeled by the American Tort Reform Association as "judicial hellholes" -- can be found in various regions and diverse pockets scattered throughout the country.

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Federal venues centered in urban areas may often be recognized as reasonably "good," whereas some of the state courts centered in the same urban regions may have frequent high-damage verdicts associated with them. For example, anyone who has tried a case in both Atlanta-area state and federal courts, or both Houston-area state and federal courts, can verify that the different panels within the same urban regions are vastly different in terms of the degree of risk involved for the defendant.

This distinction between the state and federal court venire members provides relevant insight into the characteristics associated with the observed differences in risk. Jurors from federal venires tend to come from outlying areas that are more suburban or rural; more affluent; and have greater proportions of Caucasians and Republicans. Jurors from contiguous state court venues are typically more urban; have comparatively lower socioeconomic status overall; and consist of a greater number of minorities and Democrats.

There are both legal and non-legal reasons that defense attorneys usually prefer to be in federal courts. The demographic profile differences between the state versus federal venues are clearly part of the non-legal reasons, as most litigators realize that jurors from state court rosters tend to have comparatively more "high-damage" characteristics (e.g., minority, liberal or Democratic political stance, and lower socioeconomic status).

One distinct impression that emerges from experiences with high-damages verdicts in "bad" venues is that jurors are motivated to simply redistribute wealth (the so-called Robin Hood mentality), and have little interest in the specific factual nuances of the case. In fact, our research has demonstrated that one of the most valid predictors of a high-damage award is prior agreement with the phrase, "Taxes for large corporations should be increased." The interest in simply redistributing wealth causes jurors to have a lack of motivation for assimilating the fact patterns of the case, resulting in poorer recall of the evidence – especially the evidence in the defense case.

It is important to note that this lack of retention is not for the reasons discussed earlier in conjunction of the highly aroused juror who undergoes "cognitive meltdown." Instead, "bad venue" jurors simply *do not care* about the defendant's case, and may fail to process information because they do not have the motives, or the capabilities, to do so. Their motives are often limited to voyeuristic curiosity that is satiated during the plaintiff's case, with an underlying goal is to simply funnel cash from corporations to the trial venue or a "needy" plaintiff.

These types of juror thought patterns represent some of the most daunting obstacles facing a defense team trying to suppress damages in

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a problematic case. There are instances, however, in which comparatively reasonable damages have been obtained in such venues. Generally, these successes utilize many of the recommendations described in preceding sections, combined with the following:

- *Make liberal use of creative illustrations, graphics, animations and demonstrative exhibits.* There is no better weapon against sluggish information processing than to attack the problem visually. Jurors are typically visual learners, and the less sophisticated their problem-solving capabilities are, the more urgent the need for compelling visual aids (Babcock and Bloom, 2001). Graphics development is another area in which thorough trial preparation becomes of paramount importance. Painstaking formulation of creative and effective visual aids is time-consuming and requires labor-intensive efforts long before the trial date. Orchestrating these visual aids into an electronic presentation system is a vital component of such efforts and extends further the amount of preparation time necessary.

- *Meet the jury where they are.* Jurors in difficult venues are apt to focus on different issues than the trial team, and often "invent" unexpected issues that need to be addressed. Many such issues will not be on the trial team's radar screen unless and until field research is conducted *within the venue*. Moreover, issues that are more arcane, complex, or specialized must be articulated in plain language that jurors can easily understand. It is not enough to simply make an effort to simplify concepts as fully as possible. Trial attorneys must "get a feel" for the jurors by recruiting panels for trial simulations in the venue, repeatedly trying new approaches, discarding what does not work and retaining what does, until a maximally effective message is forged. Such efforts may entail multiple projects such as mock trials or focus groups until the optimum tactical position has been formulated.

- *"Out-fair" the other side*. Regardless of the socioeconomic backgrounds of jurors, they are still apt to have a basic notion of fairness. The commonsense notions of fairness that are instilled in people when they are young can transcend political and demographic differences if they are summoned and resurrected in a compelling manner. Concessions that *some* damages may be appropriate are usually involved in such messages. Jurors need to know that the plaintiffs will be fully compensated; that they will be treated well; and that the defendant cares about their well-being.

- *Provide alternative damages numbers*. Too often, defense litigators do not provide jurors with a complete and realistic map of how to

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interpret the numbers that are at stake, or simply deny the plaintiff's damages theory without presenting a valid and believable alternative. Clarification of the damages that are being requested by the plaintiffs, and what such numbers actually mean, can help to mitigate damages. Annuities and other economic formulas can be portrayed in a convincing manner to suppress damages awards and reinforce the notion of fairness and taking care of the plaintiff.

- *Focus on credibility.* In order to prevail in a bad venue, the defense attorney must be the most credible person in the room. He must have the most complete command of the facts, and must be communicative in a way that is superior to, and transcends that of his opponent. He must deliver everything that he has promised in his opening statement, and must do so convincingly through expert and fact witnesses who are fully trained to connect the dots in a lucid manner throughout the case. Integration of the visual exhibits with witness preparation plays a vital role in enhancing credibility.

- *Use local counsel, private investigators and other research techniques to find out who the jurors are.* In smaller venues, many prospective jurors know each other, and/or know the plaintiffs and their family members. In many cases, these jurors do not reveal such information during *voir dire*, and there may exist good reasons for getting them off for cause at this juncture. Photographs of residences, internet search mechanisms, and other types of investigations can also be used to identify the worst jurors.

- *Accept the burden of proof.* Relying on the notion that the plaintiff must meet his burden of proof in order to win is a tactical error. Jurors from "bad venues" typically assume that the defendant must have done something wrong, or else they would not be in court. Defendants must take the initiative and assume that the jury needs proof that the plaintiff's case is fallacious.

Conclusions. This paper is oriented chiefly toward assisting defense trial teams and corporate counsel with cases that are, for want of a better term, the "worst of the worst" – that is, cases for which damage control is the only realistic goal. It goes without saying that settlement for a reasonable amount is always the preferable endpoint for such cases. In this regard, it is important to note that some cases that could be settled early sometimes end up going to trial because missed opportunities for settlement are lost.

Some cases can, and should be settled quickly. When a case is filed, the defendant may know more about the fact scenario than the

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plaintiff. With competent risk assessment in place, the identification of the high-damages case can be made on a reasonably prompt basis after filing, once the case facts and venue are considered. Faced with the prospect of years – maybe even a decade – before being able to recover any money at all, many plaintiffs may be happy to get a much lesser amount quickly. In short, the time surrounding the filing of a case may be the best time to get a problematic case out of the way cheaply. Numerous cases have been observed in which a corporate defendant had a chance early in discovery to dispense with a case for only a few million dollars, when instead the ultimate jury award turned out to be hundreds of millions.

For jury trials, if all that a jury really wants to do is redistribute wealth, or if key witnesses are intent on lying, there may be little that can be done in some instances. Like a case of melanoma, they only treatment may be "excision," which in judicial terms would be comparable to an appeal. Nonetheless, the guidelines suggested in this paper represent a fair summary of that which can be accomplished at the level of the jury trial to minimize the probability of a disastrous outcome -- if adequate preparation is carried out ahead of time.

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