

surrendered its valuable gas to Exxon on the erroneous understanding that Exxon was honestly fulfilling its side of the exchange. See *supra* at 27-33. Therefore, the State did not demand the payment it was due when Exxon underpaid.

The record also contains ample evidence that the State suffered detriment because it refrained from auditing Exxon earlier, and thereby did not uncover Exxon's fraud until years later.⁶¹ And once the State did audit, it suffered a further detriment because it had to hire expensive outside experts and conduct a more extensive audit than it would otherwise have conducted, in an effort to discover and determine the extent of Exxon's fraud. See R2104-05 (Snyder); R2367-71 (Solomon). Furthermore, Exxon's fraud deprived the State for years of its ability to bring a legal action for breach of contract.⁶² See,

⁶¹ See R1814 (Macrory) (stating that if someone had told him that Exxon was taking deductions from gross proceeds, his recommendation to the Commission would have been "I would have said we need to audit Exxon now."); R2267 (Cone) (if Exxon had disclosed the nature of its deductions, it would have raised a "red flag" and she would have "brought [it] to the attention of the appropriate people in the DCNR legal department."); R2079 (Snyder) (if Exxon had disclosed its underreporting of royalties, "I'm sure Mr. King, who was in charge at the time, would have ... pushed for -- even more urgently to start an audit.").

⁶² Although the Court in *Hunt* was correct that "**compelling** [a party] to bring [a] legal action" cannot amount to reliance, *Hunt*, 2004 Ala. LEXIS 106 at *21 n.7 (emphasis added), it is no less true that **depriving** a party of its ability to bring a legal action, by misrepresenting and suppressing the facts that would

e.g., R2267 (Cone); R2079 (Snyder).

The jury was certainly entitled to credit all of this evidence. Perhaps more importantly, the jury was entitled to find that the State relied because it did precisely what Exxon hoped and expected it would do as a result of its fraud: The State accepted the payments and reports as true and honest statements of what Exxon had agreed to pay the State; it deposited payments; and it continued to abide fully with its end of the bargain. Exxon thus got from its fraudulent underpayments exactly what it was counting on, to the tune of tens of millions of dollars. Surely the law does not demand that the victim of the fraud do more than precisely what the defrauder wants it to do in reasonable reliance on the representation at issue.

Exxon argues that any reliance was not "reasonable" because the State knew that Exxon was interpreting the lease contrary to its plain language. But, as discussed previously, *supra* at 27-40, the record clearly belies this argument. Moreover, even Condray testified that the State had every reason to believe Exxon was telling the truth. R968-70, 1048 (Condray). See also R2010 (Macrory); R2045 (Snyder). The State's reliance on

ground that party's suit, **can** amount to reliance - otherwise, the mere fact that the fraud was detected and legal action brought would necessarily preclude redress.

Exxon's representations was entirely reasonable, and modern commerce would not be possible were the presumption otherwise.

2. Exxon's Reading of Hunt Would Eviscerate the Law of Fraud.

Exxon reads *Hunt* as preventing any contractual party with a right and intent to audit from establishing reliance, thereby allowing the counterparty to lie and cheat with impunity. Exxon also reads *Hunt* as foreclosing reliance because the "State declared no forfeitures, made no election to take gas in kind, returned no reports, and reversed no wire transfers." Br. 60. *Hunt*, however, did not purport to establish such perverse rules, as evidenced by the fact that *Hunt* never even mentions the great body of authority that uniformly holds, for sound public policy reasons, to the contrary.

a. Exxon's Proposed Rule That, As A Matter of Law, A Right To Audit Precludes Reliance Is Against Public Policy and Well-Reasoned Authority.

It is settled that a contracting party has the right to rely on the truthfulness of his counterparty's representations.

This Court stated long ago that:

Fraud, in the nature of it, implies that the party has been misled and that, by the wrong of another, he is accepting and resting in a false sense of security. A party thus situated is not required to presume fraud or suspect it, until something comes to him leading a just person to suspect and make inquiry.... If [plaintiff] chose to trust and did trust the defendants ...

as having better knowledge of the condition of their company, it is not for them to say: "You should not have believed our report."

Williams v. Bedenbaugh, 110 So. 286, 289-90 (Ala. 1926).⁶³ This pragmatic rule of conduct is at the heart of millions of commercial transactions conducted daily in this nation.

As a corollary, a contracting party does not have the burden to verify its counterparty's representations.⁶⁴ Exxon's proposed rule, however, would improperly shift the burden from companies such as Exxon to conduct themselves uprightly to the State to undertake extensive audits to confirm that its contracting partners are living up to their end of the bargain.⁶⁵

⁶³ See also *Johnson v. Shenandoah Life Ins. Co.*, 281 So.2d 636, 642 (Ala. 1973) (quoting *Bedenbaugh*); *Earle, McMillan & Niemeyer, Inc. v. Dekle*, 418 So.2d 97, 100 (Ala. 1982) (same) (quoting *Bedenbaugh*); RESTATEMENT (SECOND) OF TORTS § 541A cmt. a.

⁶⁴ See, e.g., *King v. Livingston Mfg. Co.*, 60 So. 143, 145-46 (Ala. 1912) ("If the false statement is made by one who may be fairly assumed to know what he is talking about, it may be accepted as true, without question and without inquiry, although the means of correct information are easily within reach."); RESTATEMENT (SECOND) OF TORTS § 540 ("The recipient of a fraudulent misrepresentation of fact is justified in relying upon its truth, although he might have ascertained the falsity of the representation had he made an investigation.").

⁶⁵ In fact, Exxon's rule would effectively impose a defense of contributory negligence in cases of intentional fraud by denying recovery to a plaintiff for failing to discover the defendant's fraud on his own. But this is in contravention of longstanding precedent. *King*, 60 So. at 145; see also *Bank of Loretto v. Bobo*, 67 So.2d 77, 86 (Ala. Ct. App. 1953); RESTATEMENT (SECOND) OF TORTS § 545A.

Exxon's proposed rule would make Alabama a safe haven for cheaters whenever the victim has a right to audit.

[T]he practical import of such a rule would be to punish those parties to a transaction who were conscientious in investigating the veracity of another party's representations (even if their investigation was unsuccessful in identifying deception), while rewarding those who failed to undertake such investigation. Such a rule would encourage parties to a commercial transaction to wear blinders, and would yield inequitable outcomes.

Thomas v. Henderson, 297 F. Supp. 2d 1311, 1318 (S.D. Ala. 2003). The ability to audit is simply no substitute for relying on a counterparty's honesty and good-faith. Even with unlimited resources, audits are not designed to, and as a practical matter simply cannot, ferret out all instances of contractual nonperformance, especially when the other party has made fraudulent misrepresentations in an effort to conceal its nonperformance. See, e.g., R3260 (Griggs) ("audits don't catch everything"); R2052 (Snyder) ("Worldcom and Enron are ... great example[s]" of failed audits); R2384-85 (Solomon).

In addition, the rule Exxon advocates could not be conscientiously applied where, as here, the evidence reveals that any ensuing audit would, as a practical matter, be unlikely to detect the fraud. As the record conclusively demonstrates, the State had very limited resources to conduct an audit. See *supra*

at 42-44. The jury found that Exxon counted on the fact that the State had "inexperienced" "regulatory staff and processes" in deciding to pursue its fraudulent course. Nevertheless, Exxon asks this Court to nullify that finding and to adopt the perfect addition to greedy companies' arsenal of fraud: If the mere fact that the State has some audit processes, no matter how "inexperienced," and some theoretical ability to audit, no matter how illusory, could suffice to defeat a showing of reliance, then any defrauding party that thinks it might be able to outwit the State's auditing capabilities would be free to take a stab at fraud without fear of a downside.

Unsurprisingly, other courts have rejected the rule Exxon seeks to divine from *Hunt*. In the case of royalty payments under mineral leases, for example, courts have held that a lessor's contractual right to audit does not preclude reliance. See *Johns Hopkins Hosp. v. Peabody Coal Co.*, 920 F. Supp. 738, 743 (W.D. Ky. 1996); *Reis*, 997 S.W.2d at 66-67.

Similarly, in *Morrill*, 747 F.2d. at 1223, the plaintiff had been suspicious of the defendant's royalty payments from the outset: plaintiff "questioned [defendant] about the completeness and accuracy of ... royalty statements," but his "repeated requests for additional information were inadequately answered,

and ... his ability to detect improper reporting of the 1% royalty was hindered by [defendant's] reporting methods." The court nevertheless held that "[t]he opportunity for investigation will not of itself preclude the right of reliance. [Defendant's] argument at best establishes that there was conflicting evidence on [plaintiff's] right to rely. The evaluation of this evidence was for the jury." *Id.* at 1223-24 (internal citations omitted).

And in *Gregory*, 38 F. Supp. 2d at 601-02 n.2, the district court, applying Alabama law, upheld a fraud claim where the defendant secretly paid royalties on a smaller category of revenues than had been agreed to by the parties. Neither party intended that the royalty figures generated by the defendant would be conclusive, *id.* at 606, and the contract gave the plaintiff the right to audit the defendant. *Id.* at 612. The court nevertheless held that plaintiffs "relied on the false statements in the revenue summaries and royalty checks." *Id.* at 611-12.⁶⁶

Tellingly, the Sixth Circuit has recently rejected an argument similar to Exxon's in the context of an action under the False Claims Act, 31 U.S.C. §§ 3729 et seq, which prohibits the

⁶⁶ See also *L.C.L. Theatres, Inc. v. Columbia Pictures Indus.*, 421 F. Supp. 1090, 1092, 1100 (N.D. Tex. 1976), *aff'd in rele-*

filing of materially false statements to the federal government. In *United States ex rel. A+ Homecare, Inc. v. Medshares Mgmt. Group, Inc.*, 400 F.3d 428 (6th Cir. 2005), the defendants submitted fraudulent expenses on Medicare cost reporting forms in order to reduce their obligation to Medicare, *id.* at 433-38, and argued that those expenses were included in order to induce the government to perform an audit and not to reduce its obligation. *Id.* at 447. The Sixth Circuit found this argument "wholly unpersuasive," holding that a "party cannot file a knowingly false claim on the assumption that the [government] will correctly calculate the value in the review process." *Id.*

In short, a rule that a contractual party's right to audit precludes reliance simply cannot be justified in light of the strong policy considerations and case law to the contrary.⁶⁷

vant part, 566 F.2d 494 (5th Cir. 1978); *MGM, Inc. v. Antioch Theatre Co.*, 367 N.E.2d 247, 250, 255-56 (Ill. App. Ct. 1977).

⁶⁷ The only authority on reliance relied upon in *Hunt* was *Smith v. J.H. Berry Realty*, 528 So.2d 314 (Ala. 1988). *Hunt*, 2004 Ala. LEXIS 106, at *17. In *J.H. Berry*, the plaintiff alleged that a misrepresentation regarding the applicable zoning regulations induced him to enter into a contract to purchase a house, even though he had undertaken his own prior investigation. 528 So.2d at 314-16. The Court made an express finding based on deposition testimony that "it is clear that Mr. Smith was unwilling to accept the statement of the defendant's [real estate] agent regarding the applicable zoning regulations." *Id.* at 316. The critical fact was not that the plaintiff undertook an independent investigation prior to entering into the contract, but that the evidence taken as a whole showed that he did not be-

b. **Exxon's Proposed Rule That, As A Matter of Law, A Plaintiff Must Stop Accepting Its Counterparty's Performance Upon Discovery of Fraud Is Against Public Policy and Well-Reasoned Authority.**

Exxon also asks the Court to divine from *Hunt* a rule that a plaintiff cannot establish reliance unless he immediately stops accepting his counterparty's performance after discovering fraud. Br. 58-64. If this were correct, a claim for fraud could never be sustained where a defrauded party suffers injury but decides it is nonetheless in his best interest to continue performing under the contract, even while he pursues legal recourse. But there are many instances in which a governmental entity may decide to continue funding or otherwise performing a contract despite discovering a fraud, such as where it would be impractical for the government entity to terminate the contact and start over. Indeed, the rule advocated by Exxon would en-

lieve the agent's statement to be true or otherwise rely on it in making his decision to purchase the house. Thus, as in *Hunt*, the Court found based on the totality of the evidence that there was insufficient evidence of reliance. *J.H. Berry* is inapposite in this case, where the totality of the evidence overwhelmingly establishes the State's reliance on Exxon's misrepresentations and concealments. Moreover, *J.H. Berry* involved fraudulent **inducement** to contract and not, as here, fraud in the **performance** of a contract. Where there is an existing contractual relationship, a contracting party has the right to rely on the honesty and truthfulness of representations made by his counterparty. In fact, "an obligation of good faith and fair dealing is implied in all contracts." *Mutual Sav. Life Ins. Co. v. James River Corp.*, 716 So.2d 1172, 1179 (Ala. 1998).

courage fraud because a contractual cheater could make misrepresentations and not be subject to liability, so long as it was in the midst of performance that would make the victim's decision to stop performing a contract untenable.

Moreover, the Court must affirm the jury's finding of reliance if the record contains clear and convincing evidence that Exxon's misrepresentations or concealments induced the State to take any action, or refrain from taking any action. See, e.g., *International Rehab. Assoc.*, 613 So.2d at 1215; *Fidelity & Cas. Co.*, 13 So.2d at 671. Clearly, whether a party continues to accept his counterparty's contractual performance does not itself indicate that the fraud did not induce it to take or to refrain from taking any action.

Thus, courts "have consistently held that the reliance element of actionable fraud is satisfied when a plaintiff accepts payments in reliance upon representations which intentionally understate the amount due." *Reis*, 997 S.W.2d at 66-67 (internal citations omitted).⁶⁸ This Court has held likewise. See *Bos-*

⁶⁸ See *Braswell*, 936 F.2d at 1173-74; *L.C.L. Theatres*, 421 F. Supp. at 1100, *aff'd in relevant part*, 566 F.2d 494 (5th Cir. 1978); *MGM, Inc. v. Antioch Theatre Co.*, 367 N.E.2d at 256. The State notes that this Court suggested in *Hunt* that the reliance discussion in *Braswell* may not accurately reflect Alabama law. *Hunt*, 2004 Ala. LEXIS at *24 n.8. While the State's reliance case is in no way dependent on the validity of the reliance

well v. Liberty Nat'l Life Ins. Co., 643 So.2d 580, 581-82 (Ala. 1994); *Old Southern Life Ins. Co. v. Woodall*, 326 So.2d 726, 731 (Ala. 1976); cf. *Gregory*, 38 F. Supp. 2d at 612. Thus, as a matter of law, the State relied because it accepted royalty payments which intentionally understated the amount due.

IV. THE STATE OF ALABAMA AS A WRONGED PARTY IS ENTITLED TO PUNITIVE DAMAGES.

The State suffers no less harm when it is defrauded than does any other plaintiff. But Exxon urges a rule by which defrauders could cheat the State without fear of punitive damages simply because they cheat **the State**. That rule is as bereft of support in law as it is in reason.

A. ALA. CODE § 6-11-21(1) Does Not Bar An Award Of Punitive Damages To The State.

Exxon maintains that the "plain language" of ALA. CODE § 6-11-21(1) bars a direct award of punitive damages to the State. Br. 100. Far from supporting Exxon's argument, however, the plain language of § 6-11-21(1) defeats it. It states that "[n]o

analysis in *Braswell*, we nevertheless are compelled to submit, respectfully, that the *Braswell* analysis was indeed consistent with the universal law of reliance. We note in this regard that the opinion in *Braswell* was authored by Judge Frank M. Johnson and was joined by Judge Emmett Ripley Cox; moreover, the district court opinion in that case was authored by Judge Myron H. Thompson. Judges Johnson, Cox, and Thompson, all preeminent Alabama jurists, have participated over the course of decades of distinguished judicial service in literally hundreds of correct interpretations and applications of Alabama law.

portion of a punitive damage award shall be allocated to the state or any agency or department of the state." What the statute plainly forbids is "the **allocation** of some **portion** of an award of punitive damages once such an award has been made." C2312. Far from limiting whether, or to whom, punitive damages can be awarded in the first place, the provision clearly contemplates that "a punitive damage award" has been made to a **private litigant**, and it simply prohibits any judicial allocation of a "portion" of the award to the State. As the trial court recognized, "[i]f the Legislature had meant to work the startling result that Exxon seeks ... surely it would have spoken to the **award** of punitive damages, for instance by providing that 'no punitive damage award shall be made to the state or any agency or department of the state.'" C2312.

As the trial court also noted, C2312, the Legislature has specifically provided otherwise: "The state may commence an action in its own name and is entitled to all remedies provided for the enforcement of rights between individuals." ALA. CODE § 6-5-1. Exxon's argument means that section 6-11-21(1) impliedly repealed that statute as it relates to the State's ability to obtain punitive damages. There is simply no support for that proposition.

In fact the Legislature had no such design. The provision in question was passed against the backdrop of this Court's decisions in the *Johnson* cases. In *Life Insurance Co. of Georgia v. Johnson*, 684 So.2d 685, 698-99 (Ala. 1996), the Court held, in a section of its opinion entitled "Allocation," that a portion of all punitive damages awarded to a private plaintiff would be specially paid to the State, only later to overrule its holding "requiring an allocation of punitive damages." *Life Ins. Co. of Georgia v. Johnson*, 701 So.2d 524, 532 (Ala. 1997). The Legislature expressly ratified that overruling with section 6-11-21(1). Applying the statute to invalidate this direct award of punitive damages to the State as a plaintiff for a wrong it has suffered would pervert the Legislature's intent.

In any event, subsection (1) of section 6-11-21 cannot prohibit the award of punitive damages to the State for the same reason subsection (a) of that provision cannot cap the State's punitive damages. As demonstrated below, *infra* at 117-18, section 6-11-21 applies only to "actions commenced" after August 6, 1999, and the State's compulsory counterclaim for fraud "commenced" on July 28, 1999.

B. The Due Process Clause Does Not Bar An Award Of Punitive Damages To The State.

Claiming that "[i]n 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," Exxon argues that due process prohibits the State from recovering punitive damages. Br. 101-05. Stripped of its hand-wringing rhetoric, this argument amounts to a thinly-veiled and unsupportable attempt to derive special advantage from the fact that Exxon chose to defraud a public rather than a private entity.

As an initial matter, Exxon waived this argument. Despite having made a similar argument in its prior appeal in this case, at no time before or during the second trial did Exxon suggest that any member of the jury, or the jury as a whole, was disabled from deciding this case because of any alleged or perceived derivative interest, as citizens and/or taxpayers, in any judgment awarded to the State. C2311.

The more fundamental problem with Exxon's "biased decision-maker" argument is that it is meritless. The leading cases in this area are *Tumey v. Ohio*, 273 U.S. 510 (1927), and *Ward v. Village of Monroeville*, 409 U.S. 57 (1972). *Tumey* held that it violated due process for a mayor to try criminal cases when both his personal finances and the village's finances (for which the mayor was responsible) **directly** benefited from any fines he as-

sessed. *Tumey*, 273 U.S. at 523. See also *id.* at 533-34.

In *Ward*, the Court invalidated a similar arrangement, emphasizing "the mayor's executive responsibilities for village finances." *Ward*, 409 U.S. at 60. Significantly, the *Ward* Court took great pains to distinguish a prior case, *Dugan v. Ohio*, 277 U.S. 61 (1928), on the ground that in *Dugan*, "the Mayor's relationship to the finances and financial policy of the city was too remote to warrant a presumption of bias toward conviction and prosecutions before him as judge." *Ward*, 409 U.S. at 60-61.

Exxon cannot claim that the jury in this case had a "direct, personal, substantial, pecuniary interest" in finding against Exxon. *Tumey*, 273 U.S. at 523. Exxon nonetheless emphasizes that the jury's punitive damages award "work[ed] out" to \$2,500 for every Alabama citizen. Br. 104. But even assuming, despite the lack of any evidence, that the jurors were aware that the punitive damages award "worked out" to \$2,500 per citizen, and even granting that the Due Process Clause is often concerned with the appearance of bias as well as actual bias, Exxon's mathematical exercise fails to raise even the specter of a due process violation given that no juror stood to gain any

"direct" and "personal" benefit whatsoever.⁶⁹

Finally, the logic of Exxon's due process challenge cannot be limited to a State's claim for punitive damages. If Exxon is correct here, juries are constitutionally disqualified from sitting in any case, civil or criminal, in which it is possible for the State to recover a significant sum of money in the form of compensatory or punitive damages, fines, or forfeitures. Indeed, given the general taxability of punitive damages awards, Exxon's due process argument logically extends even beyond cases in which the State is a plaintiff; after all, Alabama's "taxpayer-jurors" would have the same incentive to award large sums of punitive damages that are then taxed by the State.⁷⁰

⁶⁹ Cf. *Aetna Life Ins. Co. v. Lavoie*, 475 U.S. 813, 825-27 (1986) (that Supreme Court justices were putative members of class of all Alabama state employees did not require the disqualification of such justices; "while these justices might conceivably have had a slight pecuniary interest, we find it impossible to characterize that interest as 'direct, personal, substantial, [and] pecuniary' ") (footnote and internal citation omitted); *In re New Mexico Natural Gas Antitrust Litig.*, 620 F.2d 794 (10th Cir. 1980); *In re Virginia Elec. & Power Co.*, 539 F.2d 357 (4th Cir. 1976).

⁷⁰ Exxon claims that the facts that (1) the trial court allowed school teachers to serve on the jury and (2) the State's counsel sent letters to Montgomery County residents commenting on the importance of the case, somehow "made the constitutional problem worse." Br. 104. Exxon's complaints about the composition of the jury and the letter are wholly without merit, and were properly rejected by the trial court. C2278-81. More to the point for present purposes, even if these contentions did have merit, they would at best support only the grant of a new trial --

V. THE PUNITIVE DAMAGES AWARD IS NOT SUBJECT TO A STATUTORY CAP.

A. No Statutory Cap On Punitive Damages Applies To This Case.

Alabama's claim is not subject to the statutory cap on punitive damages. Section 6-11-21(a) does not apply to actions commenced on or before August 6, 1999, as Exxon acknowledges. Br. 100 n.43. Exxon filed its declaratory judgment action on July 28, 1999. Unaware of Exxon's filing, the State filed its breach of contract and fraud claims on the next day, July 29. Recognizing that its claims were compulsory counterclaims to Exxon's action, the State dismissed its claims and refiled them on August 24 as compulsory counterclaims in Exxon's action, as required by law. Br. 4, 100.

As the trial court correctly held, C2313-14, the State's compulsory counterclaim against Exxon, relating to the same transaction, was deemed to have been filed on the same day, July 28, that Exxon's declaratory judgment action was filed. See *Ex parte Breman Lake View Resort*, 729 So.2d 849, 851 (Ala. 1999) (compulsory counterclaim rule makes "the defendant with a compulsory counterclaim in the first action a 'plaintiff' in that action (for purposes of § 6-5-440) as of the time of its com-

which Exxon does not seek -- and not the outright rejection of the State's claim for punitive damages.

mencement").⁷¹ Because the State's compulsory counterclaim was therefore an "action commenced" as of July 28, the day that Exxon filed suit, section 6-11-21 does not apply to this case.

This result makes perfect sense. The separate action commenced by the State on July 29 was destined for dismissal **precisely because** it was a compulsory counterclaim deemed to have been commenced concurrently with Exxon's action. According to Exxon's reasoning, however, the State's compulsory counterclaim should be deemed filed on July 28 for purposes of precluding the State's July 29 suit, but should not be considered filed until August 24 for purposes of applying the statutory punitive damages cap. That reasoning is as unfair as it is tortured. Competing claims arising from the same transaction obviously should

⁷¹ Exxon argues that the State's fraud claim was its own "action," commenced after August 6, 1999. Br. 120 n.43. Regardless of whether the State's compulsory counterclaim is its own "action," it was inextricably tied to Exxon's declaratory judgment action and necessarily deemed commenced on the same date. In *Penick v. Cado Sys. of Cent. Ala., Inc.*, 628 So.2d 598 (Ala. 1993), the Court hewed to that very rule. The rule barred Penick, after he was sued, from filing a separate suit making the same claim against the plaintiff that he later made as a compulsory counterclaim in the original suit. Penick could not be "a plaintiff in two separate actions 'for the same cause and against the same party,' " and therefore his separate suit was "due to be dismissed." *Id.* at 600 (citation omitted). Though Penick formally filed his compulsory counterclaim **after** filing his suit, the compulsory counterclaim nonetheless predated Penick's suit because it was "a necessary part of the original action." *Id.*

be governed by the same substantive law.⁷²

B. No "Policy" Rationale Justifies Capping The Punitive Damages Award.

Exxon next argues that even if the statutory cap does not apply, this Court should nevertheless defer to the "legislative judgment" that punitive damages should be subject to a three-to-one cap. Br. 107. But the statutory cap does not apply here precisely because the Legislature made an express "legislative judgment" that it would not apply to actions filed before August 7, 1999. Exxon is simply asking the Court to ignore the legislative judgment that the Legislature **did** make and defer to a legislative judgment that the Legislature **did not** make.

While this Court has on occasion ordered remittiturs of pu-

⁷² This Court has not decided whether the relation back doctrine, cf. ALA. R. Civ. P. 13(c), extends to other contexts apart from the statute of limitations. Other courts, however, hold overwhelmingly that it does, see generally *State Sav. & Loan Ass'n v. Rendon*, 712 P.2d 1360, 1363-64 (N.M. 1986) (and cases cited therein), including for purposes of determining what substantive law governs a particular case when there is an intervening statutory change. See generally, e.g., *Theodorou v. Burling*, 438 So.2d 400, 402-03 (Fla. Dist. Ct. App. 1983). Although this Court has commented in dicta that the relation back doctrine is " 'confined to the statute of limitations,' " this comment was made in the unusual context of explaining the doctrine's inapplicability to a nonclaim statute. *City of Birmingham v. Davis*, 613 So.2d 1222, 1224 (Ala. 1992) (quoting *Motley v. Battle*, 368 So.2d 20, 21 (Ala. 1979)). Because of the special status of a nonclaim statute - the whole point of which is to serve as an **absolute** bar - this dicta should not bear upon when the State's compulsory counterclaim commenced for purposes

nitive damages to a level consistent with a three-to-one aggregate ratio, none of these cases purport to be implementing the "public policy" of the Legislature, and none of them adopt a three-to-one ratio as a bright-line, mathematical limit. In fact, this Court made clear in *Harrelson v. R.J.*, 882 So.2d 317, 324 (Ala. 2003), that it "has refused to apply a rigid formula to or set an upper limit on the ratio of punitive damages to compensatory damages."⁷³ Accordingly, the awards in the cases cited by Exxon were ultimately based upon this Court's examination of the facts of each case.

Exxon argues that the jury's compensatory damages award includes many millions that cannot qualify as compensatory damages for purposes of the statutory punitive damages cap and this Court's cases supposedly applying such a cap as a matter of policy. Br. 108-10. Because neither the statutory cap nor a "public policy" cap applies to this action, the Court need not reach this argument. In any event, Exxon's arguments for why the compensatory damages award must be carved up into smaller pieces for purposes of the punitive damages analysis are meritless. Thus, Exxon is simply incorrect when it claims that the State's

of § 6-11-21.

"payout" claim was purely a contractual claim. Br. 109. See *supra* at 33-36. Similarly, Exxon's claim that any underpayments from March 1995 forward cannot constitute fraud, Br. 109, is inconsistent with the evidence presented at trial and the facts found below. See *supra* at 27-40.

VI. THE PUNITIVE DAMAGES AWARD IS NOT EXCESSIVE.

When viewed against the backdrop of the evidentiary record in this case, it is clear that the \$3.5 billion punitive damages award – every penny of it – is a just, proportionate, and necessary response to the coldly calculated fraud that Exxon carefully planned and executed against the people of Alabama.⁷⁴

A. The BMW Guideposts Support The Award.

The Supreme Court has identified three "guideposts" governing whether a punitive damages award is unconstitutionally ex-

⁷³ See also *Orkin Exterminating Co. v. Jeter*, 832 So.2d 25, 40 (Ala. 2001). *Wal-Mart Stores, Inc. v. Goodman*, 789 So.2d 166, 181 (Ala. 2000).

⁷⁴ This Court has held that a trial court's determination on the excessiveness issue is subject to *de novo* review. See *Horton Homes, Inc. v. Brooks*, 832 So.2d 44, 57 (Ala. 2001); *Orkin*, 832 So.2d at 39. Nothing in *Horton Homes*, however, disturbs the long-standing principle that the factual findings of the trial court are reviewed under the "clearly erroneous" standard. *Odom v. Hull*, 658 So.2d 442, 444 (Ala. 1995); *Gaston v. Ames*, 514 So.2d 877, 878 (Ala. 1987). See *Cooper Indus. v. Leatherman Tool Group*, 532 U.S. 424, 440 n.14 (2001); *id.* at 1687 n.12; *United States v. Bajakajian*, 524 U.S. 321, 336-37 n.10 (1998); *Johansen v. Combustion Eng'g, Inc.*, 170 F.3d 1320, 1334 (11th Cir.), cert. denied, 528 U.S. 931 (1999).

cessive: (1) the degree of reprehensibility of the defendant's conduct; (2) the ratio of the punitive damages award to both the actual harm that resulted from the defendant's conduct and the potential harm that would have resulted if the defendant's conduct had gone undetected; and (3) a comparison of the award to the civil or criminal penalties that could be imposed for comparable misconduct. *BMW v. Gore*, 517 U.S. 559, 575-85 (1996). In *State Farm Mut. Automobile Ins. Co. v. Campbell*, 538 U.S. 408, 430-31 (2003), the Supreme Court elaborated on the *BMW* guideposts, but did not change the basic nature of the due process "excessiveness" inquiry.⁷⁵

1. Reprehensibility.

The *BMW* Court stressed that "'trickery and deceit' ... are more reprehensible than negligence," *BMW*, 517 U.S. at 576 (quoting *TXO Prod. Corp. v. Alliance Res. Corp.*, 509 U.S. 443, 462 (1993)), and that evidence of bad faith is relevant to reprehensibility. *BMW*, 517 U.S. at 579. While conduct that causes "purely economic" injury is ordinarily less reprehensible than conduct that causes noneconomic injury, *BMW* made clear that "infliction of economic injury, especially when done intentionally

⁷⁵ See, e.g., *In re Exxon Valdez*, 296 F.Supp.2d 1071, 1076 (D. Alaska 2004); *American Trim v. Oracle Corp.*, 383 F.3d 462, 477 (6th Cir. 2004).

through affirmative acts of misconduct ... can warrant a substantial penalty." *Id.* at 576 (internal citation omitted; emphasis added). Moreover, "evidence that a defendant has repeatedly engaged in prohibited conduct while knowing or suspecting that it was unlawful would provide relevant support for an argument that strong medicine is required to cure the defendant's disrespect for the law." *Id.* at 576-77.

Much of the *BMW* Court's discussion about the reprehensibility inquiry was drawn from its decision in *TXO*, a case whose facts are quite similar to the facts here. *TXO* involved an oil and gas lease transaction in which *TXO* agreed to pay the landowner, Alliance, royalties. Shortly after the lease agreement was signed, however, *TXO* initiated a scheme to reduce its agreed-upon royalty by asserting that an earlier deed created a cloud on Alliance's title. *TXO*, 509 U.S. at 448 (plurality opinion). *TXO* "knowingly and intentionally brought a frivolous declaratory judgment action when its real intent was to reduce the royalty payments under [the] oil and gas lease." *Id.* at 449 (citations and internal quotation marks omitted). The jury awarded Alliance \$19,000 in compensatory damages and \$10 million in punitive damages on its counterclaim for slander of title.

The Supreme Court held that the punitive damages award did

not violate due process:

On this record, the jury may reasonably have determined that petitioners set out on a malicious and fraudulent course to win back, either in whole or in part, the lucrative stream of royalties that it had ceded to Alliance. The punitive damages award in this case is certainly large, but in light of the amount of money potentially at stake, the bad faith of petitioner, the fact that the scheme employed in this case was part of a larger pattern of fraud, trickery and deceit, and petitioner's wealth, we are not persuaded that the award was so "grossly excessive" as to be beyond the power of the State to allow.

Id. at 462 (footnote omitted).

Exxon's fraudulent conduct in this case is at least as reprehensible as the conduct in *TXO*. Exxon engaged in a pattern of "trickery and deceit." *BMW*, 517 U.S. at 576 (citation omitted); *TXO*, 509 U.S. at 462. It "repeatedly engaged in prohibited conduct while knowing or suspecting that it was unlawful." *BMW*, 517 U.S. at 576. It engaged in "deliberate false statements, acts of affirmative misconduct, [and] concealment of evidence of improper motive." *Id.* at 579. As in *TXO*, Exxon "set out on a malicious and fraudulent course to win back, either in whole or in part, the lucrative stream of royalties that it had ceded" to the State. *TXO*, 509 U.S. at 462. And it was Exxon's senior management, not lower-level employees acting on their

own, who formulated Exxon's fraudulent scheme.⁷⁶

Numerous decisions of this Court confirm that conduct amounting to a pattern of trickery and deceit is highly reprehensible.⁷⁷ This Court's decision in *Talent Tree Personnel Services, Inc. v. Fleenor*, 703 So.2d at 926, for example, involved a fraud claim premised upon the underpayment of sales commissions. In rejecting the claim that the punitive damages award was unconstitutionally excessive, this Court noted that the defendant's conduct amounted to "affirmative acts of misconduct," and agreed that the defendant had "repeatedly engaged in prohibited conduct while knowing or suspecting that it was unlawful." *Id.* (citing *BMW*, 517 U.S. at 576).

⁷⁶ Cf. *Gibson v. Total Car Franchising Corp.*, 223 F.R.D. 265, 277 (M.D.N.C. 2004); *Eden Elec., Ltd. v. Amana Co.*, 370 F.3d 824, 828 (8th Cir. 2004); *Diesel Mach. Inc. v. B.R. Lee Indus.*, 328 F. Supp. 2d 1029, 1052 (D.S.D. 2003). See also *Bardis v. Oates*, 14 Cal. Rptr. 3d 89, 105 (Cal. Ct. App. 2004) (noting defendant's "systematic pattern ... of bilking his partners out of funds legitimately belonging to the partnership," and that defendant "was unrepentant at trial, insisting that 'in [his] heart [h]e believed he did nothing wrong"); *Mission Resources, Inc. v. Garza Energy Trust*, 2005 Tex. App. Lexis 3443, *30 (Tex. App. May 5, 2005) (where defendant breached its contract and committed a trespass by diverting plaintiff's gas (on which defendant would otherwise owe royalty) to its own use, defendant's "conduct was sufficiently repugnant to justify a punitive damages award befitting a substantial degree of reprehensibility").

⁷⁷ See, e.g., *Cooper & Co. v. Lester*, 832 So.2d 628, 643, 645 (Ala. 2000); *Employees' Benefit Ass'n v. Grissett*, 732 So.2d 968, 979 (Ala. 1998); *Orkin*, 832 So.2d at 39.

Similarly, in *Duck Head Apparel Co. v. Hoots*, 659 So.2d 897 (Ala. 1995), the defendant had manipulated sales data as part of an effort to reduce the plaintiffs' sales commissions. In affirming a \$15 million punitive damages award, this Court agreed that the defendant's conduct was "reprehensible in the extreme." 659 So.2d at 914. Noting that the evidence supported "inferences of systematic efforts by Duck Head to deprive [the plaintiffs] of nearly \$1,000,000 in commissions," *id.*, the Court concluded that the case was a "perfect example" of a "pattern or practice of intentional wrongful conduct" since "over a period of time, five or six months or longer, Duck Head engaged in a series of intentional wrongful acts designed to defraud its salesmen of their earned commissions." *Id.* at 914 n.6. See also *Gregory*, 38 F. Supp. 2d at 625.

Exxon's conduct in this case is closely analogous to the conduct found by this Court to be reprehensible in *Talent Tree* and *Duck Head*, except that Exxon's conduct continued over a much longer period of time, involved much larger sums of money, and effectively cheated present and future generations of Alabamians by diminishing the Alabama Trust Fund. ALA. CONST., art. XI, § 219 (1901).

Against this record of grossly reprehensible misconduct,

Exxon argues that it merely took a good faith position regarding the meaning of the lease. Br. 117. But Exxon did not simply adopt a reasonable interpretation of an ambiguous contract; rather, as the jury and the trial court found, it knowingly and secretly adopted an **unreasonable** "interpretation" of an **unambiguous** contract, and it then engaged in misrepresentations and acts of suppression to conceal what it had done.⁷⁸

If Exxon was acting in good faith, as it now claims, why did it not inform the State of its position and seek to resolve the issue **before** it commenced production? Why did Exxon tender, month after month, royalty payments that it knew were far less than the State believed were due under the lease? Why did Exxon continue to hide the ball about its practices all the way through the **second** trial? In short, why was Exxon not straightforward and honest with the State about Exxon's "good faith" difference of opinion regarding the meaning of the lease's royalty provisions? The answers to these questions are as obvious as they are damning: Exxon formulated its secret "interpretation" of the lease and concealed it from the State because it

⁷⁸ Indeed, Exxon's attempt to rely upon its unreasonable interpretation of the lease, in the face of both the plain language of the its royalty provisions and the language and operation of the ambiguity clause, is closely analogous to the frivolous declaratory judgment action that the defendant filed in *TXO*. See

knew that the interpretation was untenable, that the State would reject it, and that its plan to cheat the State out of its bargained-for royalties would be stillborn.⁷⁹

Exxon also argues that any fraud it committed was "short-lived." Br. 116. But Exxon's misconduct endured much longer than the periods of fraudulent conduct that this Court found highly reprehensible in cases such as *Duck Head* and *Talent Tree*. Moreover, even after the basic contours of Exxon's secret royalty payments were uncovered, Exxon continued to try to frustrate the State's attempts to learn the full scope and extent of Exxon's fraudulent practices, and continued to conceal important details of its royalty underpayments through discovery and right up until the eve of the second trial. See *supra* at 43-45; C2319-22; C2332. Such evidence of concealment is highly relevant to the reprehensibility analysis.⁸⁰

In any event, if Exxon's deception was indeed "short-

TXO, 509 U.S. at 449. See also *Gregory*, 38 F. Supp. 2d at 624.

⁷⁹ Condray admitted that if Exxon knew its interpretation of the leases was wrong but nevertheless deliberately underpaid the State pursuant to that interpretation, such conduct "would not be ethical." 1HG374 (Condray).

⁸⁰ See, e.g., *Green Oil*, 539 So.2d at 223-24; *Gibson*, 223 F.R.D. at 275 (evidence that defendant attempted to conceal information in discovery supported finding in fraud case that the "degree of reprehensibility ... is very high"); *Southern Union Co. v. Southwest Gas Corp.*, 281 F. Supp. 2d 1090, 1098 (D. Ariz. 2003).

lived," it was only because, as a result of developments unforeseen by Exxon (such as the hiring of Nancy Cone and the retention of outside auditors), DCNR's inquiries and audits ultimately uncovered - partially - Exxon's misconduct. If punitive damages are to serve their deterrent and punitive function, the law must look not only to the duration, but to the **intended duration**, of the misconduct at issue. In this case, Exxon believed that Alabama's "inexperienced regulatory staff and processes" would likely never uncover Exxon's misconduct. That the State was fortunate enough to uncover Exxon's fraud does not make Exxon's conduct any less reprehensible.

Finally, Exxon has ignored one crucial factor that **enhances** the reprehensibility of its fraud. Exxon's fraud victimized not just one of its commercial partners, but **all** of the citizens of Alabama. See *Brock v. Pierce County*, 476 U.S. 253, 262 (1986) ("[P]rotection of the public fisc is a matter that is of interest to every citizen.") (emphasis added). This fact makes Exxon's fraud categorically more reprehensible than it would otherwise be.⁸¹

⁸¹ See, e.g., *Bajakajian*, 524 U.S. at 339 (stressing, in finding that forfeiture was excessive, that "[t]here was no fraud on the United States, and respondent caused no loss to the public fisc"); *Southern Union*, 281 F. Supp. 2d at 1096, 1100 (approving 153:1 punitive damages ratio in case involving intentional

2. Ratio of punitive damages to actual and potential harm.

1. While it is true that *State Farm* suggested that ratios greater than ten-to-one may raise due process concerns, especially in cases in which substantial compensatory damages have been awarded, 538 U.S. at 424-25, it took pains to emphasize that it was "reluctant to identify concrete constitutional limits on the ratio between harm, or potential harm, to the plaintiff and the punitive damages award," and that it was "declin[ing] again to impose a bright-line ratio which a punitive damages award cannot exceed." *Id.* Exxon concedes that *State Farm* imposes no such bright-line test. Br. 119. And numerous cases applying *State Farm* confirm that the most that that decision does is suggest that punitive damages ratios exceeding single digits raise "red flags" that trigger closer scrutiny.⁸² No matter how the ratio is calculated here, the punitive damages award as remitted must stand.

"breach of the public trust.").

⁸² See *Mathias v. Accor Econ. Lodging, Inc.*, 347 F.3d 672, 676 (7th Cir. 2003) ("The Supreme Court did not, however, lay down a 4-to-1 or single-digit-ratio rule ... and it would be unreasonable to do so."); *In re Exxon Valdez*, 296 F. Supp. 2d at 1104; *Boeken v. Philip Morris, Inc.*, 26 Cal. Rptr. 3d 638, 681 (Cal. Ct. App. 2005); *Mission Res.*, 2005 Tex. App. LEXIS 3443, at *31; *Boyd v. Goffoli*, 608 S.E.2d 169, 183-84 (W.Va. 2004); *Hangarter v. Provident Life & Accident Ins. Co.*, 373 F.3d 998, 1014-15

Moreover, *State Farm's* ratio analysis cannot be divorced from the very different nature of the compensatory damages award in that case. That award was for emotional distress, not economic loss, and the Supreme Court emphasized that such damages "likely were based on a component which was duplicated in the punitive award." *State Farm*, 538 U.S. at 426. The compensatory award in this case, by contrast, is based solely on the State's economic loss, and so there is no danger of overlap between the compensatory damages award and the punitive damages award. Cf. *In re Exxon Valdez*, 296 F. Supp. 2d at 1104.

Perhaps most important, the Supreme Court has repeatedly made clear that the relevant comparison is the punitive damages award to both the actual harm caused by the defendant's misconduct and the **potential** harm that could have been caused by that conduct if it had succeeded. Once again, *TXO* is instructive. The Supreme Court upheld a \$10 million punitive damages award that was more than 500 times the compensatory damages award in large part because the punitive damages award bore a reasonable relationship to the actual and potential harm associated with the defendant's scheme to evade its royalty obligations:

It is appropriate to consider the magnitude of the po-

(9th Cir. 2004); *Lincoln v. Case*, 340 F.3d 283, 293 (5th Cir. 2003).

tential harm that the defendant's conduct would have caused to its intended victim if the wrongful plan had succeeded, as well as the possible harm to other victims that might have resulted if similar future behavior were not deterred.... [T]he jury could well have believed that TXO was seeking a multimillion dollar reduction in its potential royalty obligation....

While petitioner stresses the shocking disparity between the punitive award and the compensatory award, that shock dissipates when one considers the potential loss to respondents, in terms of reduced or eliminated royalties payments, had petitioner succeeded in its illicit scheme. Thus, even if the actual value of the "potential harm" to respondents is not between \$5 million and \$8.3 million, but is closer to \$4 million, or \$2 million, or even \$1 million, the disparity between the punitive award and the potential harm does not, in our view, "jar one's constitutional sensibilities." *Haslip*, 499 U.S. at 18.

TXO, 509 U.S. at 460-62 (plurality opinion) (emphasis added) (footnotes omitted).⁸³

Likewise, this Court has consistently held that a punitive damages award must be measured against the harm that defendant's conduct could have caused, as well the harm that the conduct actually did cause.⁸⁴ Indeed, in *Duck Head*, this Court noted that

⁸³ While there was no majority opinion in *TXO*, no justices expressed any disagreement with the proposition that it was appropriate to compare the punitive damages award to both actual harm and potential harm. Indeed, Justice O'Connor's dissent made clear that consideration of potential harm "not only substantially furthers the State's weighty interests in deterrence and retribution, but also can be traced well back in the common law." *TXO*, 509 U.S. at 484 (O'Connor, J., dissenting).

⁸⁴ See, e.g., *USA Petroleum Corp. v. Hines*, 770 So.2d 589 (Ala. 1999); *Employees' Benefit Ass'n*, 732 So.2d 968; *Life Ins. Co. of Georgia v. Smith*, 719 So.2d 797 (Ala. 1998); *Ford Motor Co. v.*

effective deterrence **requires** that punitive damages bear a reasonable relationship to actual and potential harm. *Duck Head*, 659 So.2d at 913.⁸⁵

Exxon claims that the TXO potential harm analysis has been "severely limited" by *BMW* and *State Farm*, Br. 135, but it never really attempts to explain why or how this is so. In fact, TXO's approach to the ratio issue was explicitly endorsed in *BMW*. *BMW*, 517 U.S. at 581. And *State Farm* cited approvingly to *BMW*'s formulation of the due process "guideposts," including the one relating to the "disparity between the actual or potential harm suffered by the plaintiff and the punitive damages award." *State Farm*, 538 U.S. at 418.

Although it is true that in discussing the application of the ratio guidepost to the facts in *State Farm*, the Supreme Court spoke in terms of the ratio to compensatory damages, *id.* at 425, that was because the facts of that case did not lend themselves to an analysis of potential harm. Nothing in *State Farm* suggests that in an appropriate case, such as TXO or this

Sperau, 708 So.2d 111 (Ala. 1997); *Talent Tree*, 703 So.2d at 927-28.

⁸⁵ Similarly, in *Sheffield v. Andrews*, 679 So.2d at 1056-57, this Court affirmed a \$1 million punitive damages award in a case in which \$10 in compensatory damages were awarded, in part because there was evidence that the defendant "stood to gain much from his fraudulent activities had they not been discov-

case, a punitive damages award should not be assessed in relation to potential harm. Indeed, numerous cases decided since *State Farm* have confirmed the viability and applicability of such a potential harm analysis.⁸⁶ In fact, just two weeks ago, the Supreme Court of California observed that "[i]n the wake of *TXO*, *BMW*, and *State Farm*, a large number of federal and state courts have, in a variety of factual contexts, considered uncompensated or potential harm as part of the predicate for a punitive damages award." *Simon v. San Paolo U.S. Holding Co.*, No.

ered." See also *id.* at 1056.

⁸⁶ See, e.g., *In re Exxon Valdez*, 296 F. Supp. 2d at 1098 ("While neither *BMW* or *State Farm* involved potential harm, both cases acknowledged that potential harm is part of the ratio analysis"); *id.* at 1090, 1103; *Southern Union*, 281 F. Supp. 2d at 1104 ("[T]he Supreme Court has not limited the ratio calculation to actual compensatory damages, and has suggested that comparisons to potential harm are appropriate.") (emphasis in original); *Trinity Evangelical Lutheran Church v. Tower Ins. Co.*, 661 N.W.2d 789, 803 (Wisc. 2003) (comparing punitive damages award to potential harm). *Asa-Brandt, Inc. v. ADM Investor Servs.*, 344 F.3d 738, 747 (8th Cir. 2003) (comparing punitives to harm that would have resulted if defendant's tortious "scheme had worked"); *Williams v. Philip Morris Inc.*, 92 P.3d 126, 144 (Or. Ct. App. 2004) (court is "guided" by *TXO* potential harm analysis); *Craig v. Holsey*, 590 S.E.2d 742, 748 (Ga. Ct. App. 2003) (conducting potential harm analysis). See also *Mathias*, 347 F.3d at 676 ("The term 'punitive damages' implies punishment, and a standard principle of penal theory is that 'the punishment should fit the crime' in the sense of being proportional to the wrongfulness of the defendant's action, though the principle is modified when the probability of detection is very low ... or the crime is potentially lucrative..."); *Willow Inn, Inc. v. Public Serv. Mut. Ins. Co.*, 399 F.3d 224, 234 (3d Cir.

5121933, 2005 Cal. LEXIS 6558, at *20 (June 16, 2005).

Exxon also argues that potential harm is relevant only when the compensatory damages actually awarded are "minimal." Br. 122-23. Exxon can cite to no controlling case that so holds,⁸⁷ and a moment's reflection confirms that if the purpose of punitive damages is to deter and punish misconduct, it makes little sense to consider potential harm only when the tortfeasor succeeds only a little bit but not when his scheme actually bears some (but not all) of its expected fruit. To create an effective deterrent, as this Court noted in *Duck Head*, a court must instead look at the size of "the stakes." See *Duck Head*, 659 So.2d at 913 (emphasis added). Notably, the *Duck Head* Court analyzed the potential harm issue even though that case involved an "unusually high" award of actual damages. *Id.* at 909. See also *Boeken*, 26 Cal. Rptr. 3d at 681.

Exxon next argues that there is no potential harm in this case because the likelihood that it would succeed in its fraudulent conduct was **zero**. Br. 123-24. The caselaw makes clear, however, that the defendant's likelihood of succeeding in its

2005) ("[P]unitive damages awards can match the scale of the attempted swindle.").

⁸⁷ The best Exxon can do is cite to dicta in a footnote in a West Virginia decision cited in *TXO*. Br. 122 (citing *Garnes v. Fleming Landfill, Inc.*, 413 S.E.2d 897 (W. Va. 1991)).

illicit scheme is irrelevant to the potential harm inquiry. In TXO itself, for example, the Supreme Court did not inquire into the likelihood that TXO's scheme to evade its royalty obligations would have succeeded, but instead focused on the harm that TXO would have caused if its plan had succeeded.⁸⁸

In any event, Exxon's argument that its fraudulent scheme in this case was not likely to succeed is simply contradicted by the record evidence and by the findings of the jury and the trial court. See C2325; *supra* at 15-20. The evidence establishes that at the time it formulated its scheme to underpay royalties, Exxon believed that because of the State's inexperienced and overextended audit staff, its scheme would likely succeed.⁸⁹

2. Notwithstanding Exxon's suggestions to the contrary, Br. 127-30, the trial court carefully considered and addressed

⁸⁸ See also *Bajakajian*, 524 U.S. at 339 (examining whether government would have been injured "[h]ad his crime gone undetected"); *Simon*, 2005 Cal. LEXIS 6558, at *28 ("A potential injury that was foreseeable from the defendant's conduct - whether because it constituted an unintended but reasonably likely risk or because it was a goal of the tortfeasor's conduct -- is properly considered") (emphasis added).

⁸⁹ See also C2327 ("Exxon's after-the-fact protestations to this Court that it actually knew, all along, that it was destined to get caught are but part and parcel of its disingenuous effort now to dispel what it had previously thought would be the non-existent downside to its fraud.").

all of the relevant evidence offered at trial and the *Hammond* hearings and specifically found that the State's evidence "credibly and persuasively" established at least \$930 million in potential harm, C2327, and that while "that figure may not reflect perfect mathematical certainty," it was "the best available calculation to be drawn from the competing evidence and testimony offered in this case." C2329. Moreover, that figure is in important respects quite conservative, since none of the State's calculations took into account the substantial additional economic benefit that Exxon would obtain from its return on investing the sums withheld from the State. See *supra* at 49.

Exxon's complaints about the State's potential harm calculations are meritless. Exxon criticizes Solomon's reliance upon Exxon's own 1989 gas price forecast. Br. 128. But as discussed previously, the trial court specifically found that the 1989 forecast was more probative than the 1990 forecast to which Exxon now points, because (among other things) it is the only forecast that included Exxon's projections for the life of the leases. C2328. The trial court similarly rejected Exxon's after-the-fact criticism of Solomon for unknowingly using information that included a small amount of federal lease production. *Id.* See *supra* at 51.

Along these same lines, Exxon's argument that the State's calculation ignores the "time value" of money, Br. 129, finds no support in applicable law, which does not require that potential harm estimates be discounted to present value. See C2328. Indeed, the potential harm calculation presented in TXO was not discounted to present value. See also *Continental Trend Res. v. Oxy USA*, 101 F.3d 634, 639-40 (10th Cir. 1996) (calculating potential benefit on an undiscounted basis). See also R2505 (Solomon).⁹⁰

In sum, Exxon seeks a far greater precision in the calculation of potential harm than the law requires. See TXO, 509 U.S. at 462.⁹¹ What is perhaps most revealing about Exxon's criticisms of the State's potential harm calculations is that Exxon does not suggest that the Court adopt or even consider the com-

⁹⁰ Moreover, Exxon ignores that even if the potential harm calculation were discounted to present value, it would still be substantial, since it would need to be adjusted to "account for the ongoing and future returns Exxon would realize from the monies it withheld." C2328. See also 2HG421-22 (Solomon).

⁹¹ There is no requirement that potential harm be calculated with the same "reasonable certainty" that is required for the calculation of future compensatory damages. This is evident from TXO itself, where the Court assessed the reasonableness of the punitive damages by comparing the award to a wide range of possible calculations of potential harm. See TXO, 509 U.S. at 462. See also *Associates Fin. Servs. Co. v. Barbour*, 592 So.2d 191, 199 (Ala. 1991). See also *In re Exxon Valdez*, 296 F. Supp. 2d at 1098.

peting potential harm calculation that Exxon's experts presented below. Revealing, but not surprising, since it was Exxon's calculations, not the State's, that were patently "manipulated," "indefensible," and "outlandish." Br. 128. To take just one example, Exxon's experts attempted to convince the trial court that the correct measure of potential harm for the entire 35-year life of the leases was substantially *less* than the harm the State *actually* suffered during the first ten years of production. See C2328. See *supra* at 50.

The trial court's remitted punitive damages award bears a ratio of less than 3.8:1 when compared to the potential harm to the State of \$930 million. Even utilizing Solomon's more conservative potential harm calculation of \$386 million would preserve a single digit ratio (9.1:1). In either event, and especially in light of the extreme reprehensibility of Exxon's misconduct, the punitive damages award satisfies the requirements of due process. See also *Mission Res.*, 2005 Tex. App. LEXIS 3443, at *30-31 (approving 20:1 ratio in case involving dispute between royalty owner and landowner).

3. Sanctions For Comparable Misconduct.

This Court has noted that the third *BMW* guidepost is relevant to the issue of whether the tortfeasor has been provided

adequate notice of the nature and range of the potential punishment that could be imposed for the misconduct. *BMW*, 701 So.2d at 510. There can be no doubt that Exxon had adequate notice that if it engaged in fraudulent conduct, it ran the risk of a large punitive damages award. Nor can there be any doubt that Exxon was on notice that one of the factors that would govern the size of any punitive damages award was potential harm. Thus, "[Section] 6-11-20, in conjunction with the body of case law supplementing it, serves as clear notice to all of the action Alabama deems sufficiently reprehensible to warrant an award of punitive damages and the level to which a defendant may be punished for such conduct." *BMW*, 701 So.2d at 511.

The punitive damages award is also strongly supported by the fact that, under the Federal Oil and Gas Royalty Management Act of 1982, 30 U.S.C. § 1701 *et seq.* ("FOGRMA"), knowingly or willfully failing to make royalty payments to the federal government is punishable by a civil penalty of up to \$10,000 per violation per day, 30 U.S.C. § 1719(c)(1), and knowingly or willfully submitting false or misleading royalty reports can be punished by up to \$25,000 per violation per day. *Id.* at § 1719(d)(1). Exxon's fraud, if directed at the federal leases covering areas in Mobile Bay immediately adjacent to the areas

covered by its leases with the State, would have subjected it to potential civil penalties under the FOGRMA amounting to billions of dollars. HPX19(A-23); HPX19(A-24); 2HG363-64 (Solomon).

Exxon argues that FOGRMA does not apply by its terms to Exxon's conduct. Br. 133. This argument misses the point entirely. This *BMW* guidepost focuses upon the sanctions for "**comparable** misconduct." *BMW*, 517 U.S. at 583 (emphasis added). There is no suggestion in the caselaw that the only relevant penalties under this guidepost are those that apply only under state law or those that directly apply by their very terms to the conduct at issue.⁹²

Exxon's second attack on the FOGRMA penalties is its claim that the FOGRMA civil penalty provisions are rarely invoked by the federal government. Br. 133-34. Whether true or not, this contention is beside the point, for the relevant inquiry under this guidepost is the maximum **allowable** civil penalty. Cf. *State Farm*, 538 U.S. at 428 (referring to "**penalties authorized** or imposed in comparable cases) (emphasis added). Numerous

⁹² Cf. *In re Exxon Valdez*, 270 F.3d 1215, 1246 (9th Cir. 2001) (looking to penalty provision of statute enacted **after** conduct at issue for purposes of assessing penalties for comparable conduct). In fact, Exxon seems to understand this point when it suits its purposes, as it cites as "highly relevant" the civil penalty provisions of ALA. CODE § 40-2A-11(d), the statute governing tax fraud, Br. 131-32, although the terms of that statute

cases apply this guidepost in the same manner it was applied by the trial court.⁹³

Exxon further argues that the 12% simple interest "penalty" applicable to royalty underpayments is adequate to punish Exxon's deliberate royalty underpayments. Br. 131. This remarkable argument fails for multiple reasons. First, there is no evidence suggesting that the Alabama Legislature intended the 12% simple interest provision to preclude the award of punitive damages. *Cf. Okland Oil*, 144 F.3d at 1320 (statutory 12% interest on royalty underpayments "does not exclude punitive damages"). Second, the statute applies to all royalty underpayments, whether they stem from an inadvertent error, an honest disagreement, or, as here, calculated fraudulent misconduct. Surely, intentionally fraudulent conduct should be subject to greater financial exposure than an inadvertent math error.

Finally, Exxon's argument that imposition of the simple interest "penalty" is sufficient to **deter** similar conduct is ludicrous on its face. By Exxon's own admission, it was aware of the 12% interest "penalty" when it formulated its fraudulent

apply no more to Exxon's conduct than does the FOGRMA.

⁹³ See, e.g., *Boeken*, 26 Cal. Rptr. 3d at 683; *Planned Parenthood v. Am. Coalition of Life Activists*, 300 F. Supp. 2d 1055, 1065 (D. Or. 2004); *Lincoln*, 340 F.3d at 294; *Union Pac. R.R. Co. v. Barber*, 149 S.W.3d 325, 349-50 (Ark. 2004).

scheme – indeed, it explicitly factored that interest obligation into its cost-benefit analysis – yet it nevertheless decided to go forward with that scheme. In such circumstances, limiting Exxon's exposure to the payment of statutory interest amounts to a gift to Exxon, not a "penalty." See *Okland Oil*, 144 F.3d at 1321 n.18 (12% interest does not amount to penalty given defendant's high rate of return on the withheld funds).⁹⁴

In assessing other sanctions that could have been imposed for Exxon's misconduct, it is also important to note that the lease authorized DCNR to declare a **forfeiture** if Exxon failed to honor its obligations to pay royalties in a timely manner and to provide correct information and reports to DCNR. PX50. Exxon thus agreed that intentionally underpaying its royalties to the State could subject it to a sweeping forfeiture of its multi-

⁹⁴ Exxon's references to the supposed "above-market" nature of the 12% statutory interest requirement ignores the difference between simple and compound interest. See R2410-12 (Solomon). Perhaps more importantly, Exxon ignores the fact that it earned returns far greater than 12% simple interest by holding onto the State's royalties. Even factoring in Exxon's obligation eventually to pay the royalties it owes plus 12% simple interest, through 2003, Exxon has made more than \$85 million just by its refusal to turn over the funds it owes to the State. See HPX19(A-1). It is notable that just last month, a federal district court observed in another case that the effect of Exxon's conduct in delaying payments it owed to the plaintiffs was to allow Exxon "to make use of its money at a higher internal rate of return." *Allapattah Servs. Inc. v. Exxon Corp.*, No. 91-0986-CIV-GOLD, 2005 U.S. Dist. LEXIS 10257, at *84 (S.D. Fla. May 18,

billion dollar stake in the Mobile Bay field.

B. The Hammond/Green Oil And Statutory Factors Also Support The Punitive Damages Award.

The relevant remaining criteria under *Hammond* and *Green Oil* and under ALA. CODE § 6-11-23(b) support the jury's punitive damages award no less than do the *BMW* guideposts.

Reprehensibility. Under section 6-11-23(b), this Court is authorized to consider "the extent of any effort the defendant made to remedy the wrong and the opportunity or lack of opportunity that plaintiff gave the defendant to remedy the wrong complained of." See also *USA Petroleum Corp.*, 770 So.2d at 594. These factors argue powerfully against a remittitur. Exxon had multiple opportunities, after the State completed its audit, to cure its royalty underpayments. But to this day, Exxon has not paid (or even escrowed) a penny of the royalties it withheld.

Removal of profit from misconduct. Exxon argues that any improper profit from its fraud has been removed by the compensatory damages award. Br. 134-35. This is incorrect as a factual matter. As noted, Exxon knew that even if it had to repay the royalties plus 12% simple interest, it could make a much higher return over the many years it could stall a day of judgment.

Exxon's financial position. "The gravity of the wrong may

2005). See also *id.* at *90-91.

be the same, whether the defendant is a salaried employee or a multimillion dollar corporation, but ... [w]hat it takes to punish the one bears no relationship to what it takes to punish the other." *Green Oil*, 539 So.2d at 223 (citing *Ridout's-Brown Serv., Inc. v. Holloway*, 397 So.2d 125, 127-28 (Ala. 1981) (Jones, J., concurring specially)). Exxon has not disputed its ability to pay the entire judgment. It could hardly have contended otherwise, since the evidence shows that the punitive damages award, despite its size in the abstract, will have minimal impact on the company. See *supra* at 52.⁹⁵

This Court has noted that a punitive award amounting to less than ten percent of a defendant's net worth would ordinarily not be considered to have a devastating financial impact for purposes of the excessiveness inquiry. *BMW*, 701 So.2d at 514. In this case, the punitive damages award amounts to less than 4% of Exxon's net worth of \$88.8 billion as of year-end 2003. HPX19(A-21). Cf. *Patel v. Patel*, 708 So.2d 159, 163 (Ala. 1998) (award equals 7.5% of defendant's net worth); *Orkin*, 832 So.2d at 42-43 (award equals 4.8% of net worth).⁹⁶

⁹⁵ See *In re Exxon Valdez*, 296 F.Supp.2d at 1105 ("There is absolutely no chance of a \$5 billion punitive damages award amounting to an economic death sentence for Exxon.").

⁹⁶ See also *Boeken*, 26 Cal. Rptr. 3d at 685 ("A multiplier of 5 to 10 percent of net worth may be necessary to deter a very

Exxon argues that a defendant's wealth cannot "excuse an excessive award." Br. 135. To the extent Exxon is contending that evidence of a defendant's wealth cannot be used to justify what would otherwise be an unconstitutional award, the State does not disagree. See *State Farm*, 538 U.S. at 427. But this does not mean that evidence of wealth is irrelevant or can be admitted only to show that the punitive damages award should be reduced.⁹⁷ Evidence of a company's financial condition is also relevant to whether a punitive damages award is large enough to serve either as effective punishment or as an effective deterrent. "[F]or punitive damages to be effective the amount of damages 'ought to be large enough to hurt. It ought to sting in order to deter' " *Associates Fin. Serv. Co.*, 592 So.2d at 199 (quoting *Ridout's*, 397 So.2d at 127) (Jones, J., concurring specially)).⁹⁸

wealthy wrongdoer."); *Bardis*, 14 Cal. Rptr. 3d at 108 (Cal. Ct. App. 2004) ("When compared to the magnitude of the misconduct, [punitive damages award of less than 1% of defendant's net worth] would be tantamount to a slap on the wrist."); *Union Pac.*, 149 S.W.3d at 347; *Diesel Machinery*, 328 F.Supp.2d at 1053.

⁹⁷ *State Farm* itself makes clear that the use of such evidence is neither "unlawful" nor "inappropriate." *State Farm*, 538 U.S. at 428 (quoting *BMW*, 517 U.S. at 591 (Breyer, J., concurring)). See also *TXO*, 509 U.S. at 462.

⁹⁸ See also *Continental*, 101 F.3d at 641; *Johansen*, 170 F.3d at 1338; *Williams*, 92 P.3d at 145; *Kemp v. AT&T*, 393 F.3d 1354,

C. Conclusion.

Exxon essentially argues that no punitive damages are warranted in this case because (1) it knew all along that its conduct would be detected and (2) the statutory 12% simple interest on its royalty underpayments is sufficient to deter it from engaging in future misconduct. But if the prospect of paying 12% simple interest on royalty underpayments was disturbing enough to prevent it from going forward with its fraudulent scheme, why did it go forward with its fraudulent scheme? Obviously, even if Exxon had truly believed that it would get caught, the prospect of paying 12% simple interest on unpaid royalties was not sufficient to deter it, **because it was not deterred.**⁹⁹

The truth is that Exxon was not deterred from cheating the State because it concluded that doing so was **risk-free**: the po-

1365 & n.9 (11th Cir. 2004); *Simon*, 2005 Cal. LEXIS 6558, at *48.

⁹⁹ In *Cooper Industries*, the Supreme Court downplayed the role that such "efficient deterrence" economic theories should play in the punitive damages analysis, noting both that "deterrence is not the only purpose served by punitive damages," and that "it is not at all obvious that even the deterrent function of punitive damages can be served only by economically 'optimal deterrence.'" *Cooper Indus.*, 121 S. Ct. at 1687 (emphases in original). See also *id.* ("Citizens and legislators may rightly insist that they are willing to tolerate some loss in economic efficiency in order to deter what they consider morally offensive conduct.") (quoting Marc Galanter & David Luban, *Poetic Justice: Punitive Damages and Legal Pluralism*, 42 AM. U. L. REV. 1393, 1450 n.13 (1993)).

tential rewards were enormous, the prospects of success were high, and the consequences of getting caught were, at worst, negligible.¹⁰⁰ For Exxon, the question whether to cheat the people of Alabama was analyzed no differently than a decision to drill a new well – it was purely a matter of costs and benefits.

Exxon now turns to this Court to vindicate its cost-benefit analysis: it has been caught, it has been ordered to pay the State \$103 million in wrongfully withheld royalties and interest, and it urges this Court to hold that the law does not permit it to be punished any further. In other words, Exxon invites this Court to bless the no-risk premise of Exxon's fraudulent scheme.¹⁰¹ This Court should decline that invitation.¹⁰²

¹⁰⁰ To be clear, this is not to say that Exxon viewed its scheme as a chance to borrow funds at 12% simple interest – at least in today's market, it can presumably get a lower rate than that. Rather, Exxon's calculation was that the scheme would be profitable **even if** it got caught and had to pay 12% simple interest, because its internal returns are higher than that. Stated differently, Exxon's "interest rate" on the **State's** funds was 12% simple interest **discounted** by the likelihood of not getting caught. Given its focus on Alabama's "inexperienced regulatory staff and processes," Exxon must have heftily discounted the 12% to a much lower rate, making its underpayment scheme a very attractive source of cash indeed.

¹⁰¹ *Allapattah*, 2005 U.S. Dist. LEXIS 10257, at *52 (sanctions appropriate because "otherwise Exxon will be rewarded for continuing to successfully delay payment of the money it owes").

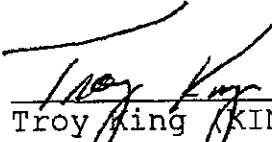
¹⁰² For the same reason the punitive damages award does not violate due process, it is not "excessive" within the meaning of the Excessive Fines Clause. See Br. 136-37. The "excessive-

CONCLUSION

For the foregoing reasons, the judgment should be affirmed.

ness" analysis under that provision precisely tracks the "excessiveness" analysis under the *BMW* due process inquiry. See *Cooper Indus.*, 121 S. Ct. at 1684-85.

Respectfully submitted,


Troy King (KIN047)
Attorney General
Alabama State House
11 South Union Street
3rd Floor
Montgomery, AL 36130
(334) 242-7300
(334) 242-4891 (fax)

Charles J. Cooper (COO002)
Deputy Attorney General
COOPER & KIRK, PLLC
1500 K Street, N.W.
Suite 200
Washington, DC 20005
(202) 220-9600
(202) 220-9601 (fax)

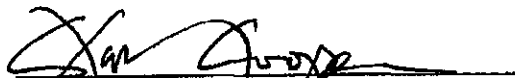
Of Counsel:

Vincent J. Colatriano
Derek L. Shaffer
Nicholas A. Oldham
COOPER & KIRK, PLLC
1500 K Street, N.W.
Suite 200
Washington, D.C. 20005
(202) 220-9600
(202) 220-9601 (fax)

Jere Locke Beasley (BEA020)
Cole Portis (POR018)
BEASLEY, ALLEN, CROW,
METHVIN, PORTIS & MILES, PC
P.O. Box 4160
Montgomery, AL 36103-4160
(334) 269-2343
(334) 954-7555 (fax)

John T. Crowder (CRO027)
Deputy Attorney General
Robert T. Cunningham, Jr.
(CUN003)
Richard T. Dorman (DOR004)
David G. Wirtes, Jr.
(WIR002)
George M. Dent (DEN005)
CUNNINGHAM, BOUNDS, YANCE
CROWDER & BROWN
1601 Dauphin Street
Mobile, AL 36604
(251) 471-6191
(251) 471-1031 (fax)

Respectfully submitted,



Troy King (KIN047)
Attorney General
Alabama State House
11 South Union Street
3rd Floor
Montgomery, AL 36130
(334) 242-7300
(334) 242-4891 (fax)

Charles J. Cooper (COO002)
Deputy Attorney General
COOPER & KIRK, PLLC
1500 K Street, N.W.
Suite 200
Washington, DC 20005
(202) 220-9600
(202) 220-9601 (fax)

Of Counsel:

Vincent J. Colatriano
Derek L. Shaffer
Nicholas A. Oldham
COOPER & KIRK, PLLC
1500 K Street, N.W.
Suite 200
Washington, D.C. 20005
(202) 220-9600
(202) 220-9601 (fax)

Jere Locke Beasley (BEA020)
Cole Portis (POR018)
BEASLEY, ALLEN, CROW,
METHVIN, PORTIS & MILES, PC
P.O. Box 4160
Montgomery, AL 36103-4160
(334) 269-2343
(334) 954-7555 (fax)

John T. Crowder (CRO027)
Deputy Attorney General

Robert T. Cunningham, Jr.
(CUN003)
Richard T. Dorman (DOR004)
David G. Wirtes, Jr.
(WIR002)

George M. Dent (DEN005)
CUNNINGHAM, BOUNDS, YANCE
CROWDER & BROWN
1601 Dauphin Street
Mobile, AL 36604
(251) 471-6191
(251) 471-1031 (fax)

CERTIFICATE OF SERVICE

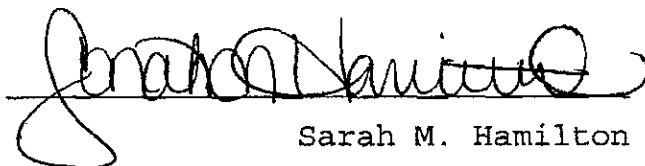
I hereby certify that on this 30th day of June, 2005, I cause to be served a true and correct copy of the foregoing document via first class mail, postage prepaid, upon the following:

David R. Boyd
W. Joseph McCorkle, Jr.
Balch & Bingham LLP
Post Office Box 78
Montgomery, AL 36101
(334) 834-6500

Sam C. Pointer, Jr.
Samuel H. Franklin
M. Christian King
Lightfoot, Franklin & White LLC
400 20th Street N
Birmingham, AL 35203
(205) 581-0700

Ernest C. Terry
McGinnis, Lochridge & Kilgore LLP
3200 One Houston Center
1221 McKinney Street
Houston, TX 77010-2009
(713) 615-8500

Walter E. Dellinger III
John F. Daum
Charles C. Lifland
O'Melveny & Meyers LLP
1625 Eye Street, NW
Washington, DC 20006
(202) 383-5300


Sarah M. Hamilton