Alabama Supreme Court: Role of Court in Key Corporate Cases

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Introduction

In recent races for the Supreme Court of Alabama, the subject of "judicial activism" and the Alabama Supreme Court's rulings in favor of oil companies and drug companies have attracted significant attention. Some have criticized the Court's rulings in the state's cases against oil companies and drug companies as outcome-oriented decisions by judges interested in currying favor with large corporations. Others maintain that the majority of the Court was merely fulfilling its obligation to apply the law as written, regardless of the identity of the parties to the case.

Accusations of this sort are increasingly common, and perhaps more visible, at the national level. In the recent hearings on the nomination of Elena Kagan to be an Associate Justice of the U.S. Supreme Court, for instance, some Senators criticized the Court's rulings in *Citizens United v. Federal Election Commission*[1] and *Ledbetter v. Goodyear Tire & Rubber Co.*[2] In both cases, the Supreme Court had ruled in favor of corporations who argued that the Constitution or federal law was on their side. While some defended the Court's rulings in those cases as straightforward applications of the Constitution and the law to arguably unsympathetic facts, others accused the court of favoring corporations as part of an effort to favor the interests of big business to the detriment of those deemed more deserving of empathy.

In Alabama, one of the cases most frequently targeted for accusations of favoritism has been *Exxon Mobil Corp. v. Alabama Dept. of Conservation and Natural Resources.* Justice Champ Lyons summarized the cases against Exxon this way:

> Two separate juries of conscientious Alabama citizens have found Exxon's conduct so infuriating as to lead them to award enormous sums in punitive damages. Although these verdicts may reflect extremely adversely on Exxon's business ethics, their entry does not alter this Court's obligation to set the current verdict aside if Exxon's conduct does not, as a matter of Alabama law, constitute a tort.[3]

According to Justice Lyons's reasoning, if Exxon's conduct did not constitute a tort, the Court's duty was to set a judgment in tort aside. Similarly, if the state proved that Exxon was guilty of a tort, the Court's duty was to affirm the lower court and grant an appropriate award of punitive damages. The most important question before the Court was not whether one party had sufficiently deep pockets to pay for another party's injuries, or even whether there were damages. The most important question was whether the state proved that, under Alabama law, Exxon was guilty of committing a tort.

In an effort to encourage broader public discussion about cases like *Exxon*, the role of courts and the meaning of imperfect, but frequently used, terms like "judicial activism," this paper will explore the Court's ruling in *Exxon* as well as a few other prominent Alabama Supreme Court decisions.

This paper will examine the accusations of favoritism against the Alabama Supreme Court since 1994, and put its decisions in their legal context. For readers who are interested in studying the Court's jurisprudence in more detail, I recommend three papers previously published by The Federalist Society, on which this paper builds: *The Road Back from "Tort Hell": The Alabama Supreme Court, 1994-2004* by Professor Michael DeBow; *Staying the Course: An Update on the Alabama Supreme Court* by Marc Ayers; and, the most recent, *Alabama Supreme Court Justice Harold See: His Twelve-Year Legacy* by E. Berton Spence.

The Court's Decisions in Context

A. The Oil Company Cases

After the discovery of oil in Mobile Bay in 1979, the state (through its Department of Conservation and Natural Resources) and Exxon entered into a number of leases, pursuant to which Exxon drilled wells and produced oil, gas, and various by-products. In 1996, the state brought in independent auditors to audit Exxon's royalty payments. When the audit was complete, the

state asserted that Exxon had been underpaying for years and that the state was owed millions of dollars in royalties, plus interest. Exxon disagreed and filed a lawsuit arguing that its interpretation of the contract was correct. The state responded with a counter-suit asserting breach of contract and fraud claims. After a trial, a jury in Montgomery County found for the state and awarded $87.7 million in compensatory damages and $3.42 billion in punitive damages.

In an unsigned per curiam decision, the Alabama Supreme Court reversed the trial court's judgment.[4] It held that the trial court abused its discretion in admitting an opinion letter written by one of Exxon's in-house lawyers into evidence. That letter was a privileged attorney-client communication that was intended to remain confidential. The Court rejected the state's contention that the letter's confidentiality was waived as well as the argument that the error in admitting the letter in evidence was harmless. The Court remanded the case for a new trial.

Justice Gorman Houston concurred in part and dissented in part, suggesting that the Court should have affirmed the judgment on the breach of contract claim instead of sending the case back for a new trial. Chief Justice Roy Moore agreed with Justice Houston's view that the Court should have affirmed the judgment in the state's favor on its breach of contact claim. However, Chief Justice Moore as well as Justice J. Douglas Johnstone dissented. Both disagreed with the conclusion that the letter was improperly admitted into evidence.

About eighteen months later, in *Hunt Petroleum Corp. v. Alabama*,[5] the Alabama Supreme Court reversed the denial of Hunt's motion for judgment as a matter of law on a claim of fraud. The ruling invalidated an award of $20 million in punitive damages. In an opinion by Justice See, the Court held that the state could not prove that it had been defrauded because it did not show that it relied on Hunt's alleged misrepresentations. Justice Houston concurred specially "to note that even if there had been evidence of reliance, there would still be many problems with the trial court's judgment against Hunt."[6] Justice Champ Lyons recused himself, and only Justice Johnstone dissented.

This case also arose out of the lease agreement between the state and Exxon and Hunt, pursuant to which Hunt was entitled to drill for oil and gas in certain parts of Mobile Bay. The lease called for Hunt to pay royalties calculated as 25% of the "gross proceeds" from the production and sale of the oil, gas, and other products produced. Hunt valued the gas at the point of extraction, or at the wellhead, and deducted certain costs before paying the state, and the state disagreed with some of those deductions and valued the gas "at the tailgate." Hunt based its payments on the wellhead price, which was the lower of the two, and the state concluded that it was being underpaid.

The state made a breach of contract claim in the lawsuit that it filed, and the trial court ruled in its favor on that claim without a trial. As a result, the state was entitled to recover for the underpayments, and the price going forward would be the "tailgate" price.

The state also claimed that Hunt's monthly reports fraudulently misrepresented the amounts actually owed and sought compensatory and punitive damages for fraud. A jury from Mobile County found that the state had been defrauded and awarded $3,403,200 in compensatory damages and $20 million in punitive damages. Hunt appealed, complaining that the trial court should have ruled in its favor as a matter of law and that the punitive damages were excessive.

In an opinion written by Justice See, the Alabama Supreme Court reversed the punitive damages portion of the judgment.[7] The Court noted that proof of reliance "is an essential element of fraud in Alabama."[8] It explained, "Reliance requires that the misrepresentation actually induced the injured party to change its course of action."[9] The Court pointed out that the state did not meet its burden to prove, by substantial evidence, that it relied on Hunt's representations. It noted that the state always intended to do an audit of the oil companies' books. Moreover, even if the state had assumed that Hunt's payments were correct, there was nothing to suggest that the state would have behaved differently.

In his concurring opinion, Justice Houston observed that many of the problems with the trial court's fraud judgment "stemm[ed] from a problem that permeates this case and many other cases: a misunderstanding of the fundamental difference between claims of breach of contract and claims of fraud."[10] In particular, "a fraud claim cannot be

maintained simply because a party—even mistakenly, intentionally, or maliciously—did not properly perform a contract."[11] In order to prove its fraud claim, the state would have had to show that Hunt knew what the state thought "gross proceeds" meant, and, knowing that, "attempted to deceive the state into believing (and then into acting or refraining from acting on the belief) that what Hunt was submitting was in accordance with the state's understanding of that term."[12]

After the Alabama Supreme Court reversed the judgment from the first Exxon trial, the state and Exxon were seen before a jury in Montgomery County. That jury again found for the state on its claim for unpaid royalties and awarded $100 million in compensatory damages and $11 billion in punitive damages, which the trial judge reduced to $3.5 billion. Exxon once again appealed, and the Court largely affirmed the award of compensatory damages and set aside the award of punitive damages.[13]

This time the Alabama Supreme Court affirmed a substantial portion of the damage award for breach of contract and (again) reversed the award of punitive damages for fraud. Eight of the Justices agreed that the state did not prove its fraud claim. Justice Parker, joined by Justices Woodall, Stuart, Smith, and Bolin, found that the state had failed, once again, to prove that it had relied on Exxon's alleged misrepresentations. Justice See concurred in part and concurred in the result. Justices Bolin and Smith joined Justice See's opinion on the fraud claims, in which Justice See wrote that the state did not put forth substantial evidence that it had reasonably relied on any alleged misrepresentations.

In his opinion concurring in part and concurring in the result, Justice Lyons explained the difference between breach of contract and tort. In particular, while only compensatory damages may be awarded for a breach of contract, compensatory and punitive damages may be awarded in a tort case. He explained, "If Alabama law fails to recognize a remedy in tort under the circumstances here presented, then the trial court never should have allowed the claims . . . against Exxon grounded in tort to go to a jury."[14]

Justice Lyons next analyzed the fraud claims the state might have made. He noted that, when a party acts fraudulently during the negotiations leading up to the making of a contract, the other party can make a claim of fraud in the inducement. But, the state did not assert fraud in the inducement. Once a contract has been made, "subsequent events can, but as a general rule do not, give rise to a remedy in tort." [15] Again, to the extent that a claim for promissory fraud might be made when a party makes a promise it has no intention of keeping, the state did not make that claim. Furthermore, the bad-faith breach of a contract is not a tort unless an insurer is involved. The state did not pursue a bad-faith breach of contract claim either.[16]

With respect to the possibility that Exxon might have cheated while performing the contract, Justice Lyons pointed out that the state "presented absolutely no evidence of any misstatement of any facts by Exxon."[17] In particular, it did not misrepresent either that amount of gas it was extracting or the amount of the costs it was deducting from the gross revenues before making its payment. Even if Exxon's monthly reports were not detailed to put the state on notice of the deductions being claimed, the state got a complete explanation of Exxon's interpretation of the leases at a meeting in February 1995. The state then "continued to accept payments from Exxon without comment and did not begin its audit until more than a year later."[18]

Given that the state did nothing different after Exxon explained how it was calculating the amounts due, Justice Lyons observed that it was "simply too speculative" that the state would have done anything differently if Exxon's disclosures had been made earlier.[19] Furthermore, Justice Lyons stated that the case left the Court:

> with a situation in which one of the parties to a contract has taken a hard-nosed bargaining position, cynically relying on a downside that is accurately deemed to be limited to compensatory damages plus interest, without any risk of exposure to punitive damages. Although a jury could reasonably conclude from the evidence that Exxon's business practices would pass only the first part of the Rotary Club's "4-Way Test," that circumstance does not give rise to a basis under settled Alabama law for an award of punitive damages.[20]

Chief Justice Cobb dissented from the Court's ruling on the state's fraud claim. She argued that there

was substantial evidence to support submitting that claim to the jury. She suggested that the Court agreed that Exxon made false representations that its royalty payments were made in the correct amounts,[21] but disagreed with the conclusion that the state did not show that it relied on the misrepresentations. In her judgment, the record contained evidence that the state relied on what it was told, in that the state used the reports for budgetary purposes and did not conduct an audit sooner and less expensively.[22] She concluded by accusing the majority of substituting itself for the jury so that it could "hold[] blameless a practice that everyone acknowledges was deceitful and based on a rationale designed to maximize corporate profits by underpaying the agreed-upon price for the resources of the State of Alabama."[23]

B. The Drug Company Cases

Most recently, in *AstraZeneca LP v. State*, the Alabama Supreme Court again found that the state failed to prove its case.[24] The state brought an action against seventy-three pharmaceutical manufacturers, including AstraZeneca, claiming that the manufacturers fraudulently inflated their prices. This, in turn, would cause the state's Medicaid agency to overpay for the prescription drugs. A number of the drug companies settled, but AstraZeneca, Novartis, and GlaxoSmithKline did not.

The Medicaid program provides joint federal and state funding of medical care for impoverished individuals. The Federal Centers for Medicaid and Medicare Services (CMS) monitor the states' compliance with federal law to make sure that, among other things, the states do not pay too much or too little for prescription drugs. For the state to obtain federal reimbursement for the drugs it purchases, the reimbursement must not exceed the lesser of the estimated cost of acquiring the medication or the provider's usual and customary charge.[25] The scheme depends on the availability of accurate drug pricing data, which is typically reported in the form of the wholesale acquisition cost (WAC) or both WAC and the "average wholesale price" (AWP).

The state claimed that from 1991 to 2005, it believed that both the reported WAC and AWP represented actual prices and based its payments on that belief. In an opinion by Justice Woodall, joined by five other Justices, the Court rejected this claim, pointing to evidence that, in its dealings with the federal CMS, the state was notified that the AWP was an average that did not reflect actual cost. The state's payments to the drug providers were based on a discount from the reported AWP. As for the WAC, the state recognized a mathematical linkage between AWP and WAC. The Court concluded that the state's "understanding of the meaning of WAC derived, not from the manufacturers' misrepresentations or suppressions, but from [the state's] own studies and surveys."[26] The state's "truly independent inquiry" undercut its claim of reliance on the accuracy of WAC and made the dissent's argument "unpersuasive."[27]

Concurring in the result, Chief Justice Cobb reiterated her disagreement with the majority's reliance on *Hunt Petroleum*. Even so, she concluded that "the record contains compelling evidence indicating that the state was aware that neither the Average Wholesale Price nor the W[holesale] A[cquisition] C[ost] were actual costs."[28] Given that evidence, she found that the state could not meet its burden to show that it reasonably relied on the AWP and WAC as a representation of actual cost.

Justice Parker alone dissented. In his view, while the evidence was sufficient to show that the state knew that the AWP was not the true price paid, the same could not be said about the state's knowledge of the limitations on the WAC's accuracy.

C. "Reasonable" or "Justifiable" Reliance?

Since the Court's decision in *Foremost Ins. Co. v. Parham*[29] in 1997, a plaintiff attempting to prove fraud has been required to show reasonable reliance on the other party's representation. That standard stands in contrast to the more plaintiff-friendly standard of "justifiable" reliance that then-Chief Justice Sonny Hornsby had proposed in 1989, and that the Court applied to both consumer and commercial transactions in a 1991 decision.[30]

In *Foremost*, the Alabama Supreme Court stated that the application of the more relaxed reliance standard had been a mistake and went back to the

reasonable reliance standard.[31] The facts in *Foremost* were representative of the kind of litigation that had commonly occurred under the justifiable reliance standard: Purchasers of insurance on their mobile homes based claims of fraud on the fact that the agent who sold them the policies told them something inconsistent with the documents the plaintiffs signed.[32] Pointing to "tension" among the members of the Court since the change in reliance standards, Justice Houston circled back to Justice Reneau Almon's dissent in *Hicks v. Globe Life & Accident Ins. Co*, in which Justice Almon explained:

> The traditional standard of "reasonable reliance" provided a flexible concept adaptable to the circumstances of each case, including the relative sophistication and bargaining powers of the parties. The new standard of "justifiable reliance" gives to parties claiming fraud undue leeway to ignore written contract terms and allows in some cases the automatic creation of a jury issue by a plaintiff's statement in contradiction of such written terms.[33]

Noting the "practical[ity]" of the reasonable reliance standard, the Court returned the state to the reasonable reliance standard for all cases filed after the date of the *Foremost* decision.

In her opinion, concurring specially, Justice Janie Shores agreed with the decision to return to the reasonable reliance standard. She wrote, "In my opinion, this court made a mistake in departing from a standard in fraud cases that had worked well. As a member of the majority that made that departure, I am willing to admit that the rule should not have been changed."[34]

Justice See also concurred, pointing to the way in which the change in the legal standard relieved buyers of the duty to act reasonably. He concluded,

> Weighed against the cost of requiring buyers to act as reasonable citizens, the cost of the experiment with "justifiable reliance" has been too high. Unbound by the terms of their contracts, unimpeded by any prospect of summary judgment, and lured by the promise of gain, plaintiffs have choked the courts with a flood of fraud litigation.[35]

The Court's decision in *Foremost* is noteworthy for two reasons. First, by changing the standard back to reasonable reliance, the Court addressed one of the factors that some believe had contributed to the state's reputation as a "tort hell": the ease of bringing and maintaining lawsuits for fraud. To those critics of the old Court majority, the change was clearly the product of experience with the justifiable reliance standard.

Second, the change in the standard was not the product of today's majority, calling into question the charge that the change is somehow the result of a "pro-business, Republican" Court. In 1997, only Chief Justice Perry Hooper, who defeated Chief Justice Sonny Hornsby in 1994, and Justice See, who defeated Justice Kenneth Ingram in 1996, were on the Court. Justice Houston, who had been hesitant about the change, wrote an opinion in which Chief Justice Hooper and Justices Maddox and Kennedy concurred. Justices Almon, who had dissented in *Hicks*, Shores, and See each wrote concurring opinions, and Justice Ralph Cook concurred in the result without opinion. Only Justice Butts dissented. The change was the product of a combination of Democratic Justices like Kennedy, Shores, Almon, Houston, Maddox and Cook, and the new Republicans, Hooper and See.[36]

III. Conclusion

As outlined above, the Alabama Supreme Court has been the target of accusations of corporate favoritism. A judge's duty is to apply the law fairly and impartially, regardless of who the parties to the case are or what the judge's personal views might be. To do so, a judge will at times rule in favor of popular parties, and at other times will rule in favor of unpopular parties.

In the aforementioned cases, supporters say that the majority of the Court sought to apply well-established principles of law and the majority and dissent in each case disagreed about the importance and sufficiency of evidence. They say, whatever one thinks of the result or the successful parties, one can make out a plausible case that the application of well-settled principles of law, combined with the state's failure to prove every element of its case, justified overturning the judgments entered by the trial courts against the unsympathetic defendants. Some argue that the Court has been favoring corporate parties over individuals. The

question should be whether the majority of the court has issued its rulings based on the law, or not.

Some will argue that by holding the state to its burden the Alabama Supreme Court served the rule of law as it has done for the past sixteen years. Others will continue to argue that the Justices in the majority of these decisions are beholden to corporate interests. Whatever the case, the citizens of Alabama should engage in a thoughtful and vigorous debate about the role of courts, the meaning of terms like "judicial activism" and "judicial restraint," and the importance of applying the law fairly and impartially to all parties. It is the author's hope that this paper's examination of a few of the high profile cases that have animated the resurgence of those subjects will help enlighten that debate.

Endnotes

1 558 U.S. ___, 130 S. Ct. 876 (2010).

2 550 U.S. 618 (2007).

3 Exxon Mobil Corp. v. Alabama Department of Conservation and Natural Resources, 986 So. 2d 1093, 1129 (Ala. 2007) (Lyons, J., concurring in part and concurring in the result). Justice Lyons, a respected Mobile lawyer and an authority on the Alabama Rules of Civil Procedure, was appointed to the Court in 1998 and has been twice reelected.

4 Exxon Corp. v. Department of Conservation and Natural Resources, 859 So. 2d 1096 (Ala.2002).

5 901 So. 2d 1 (Ala. 2004).

6 901 So. 2d at 9 (Houston, J., concurring specially).

7 The Court noted that Hunt did not appeal from the trial court's entry of partial summary judgment in the state's favor on its breach of contract claim. 901 So. 2d at 14.

8 901 So. 2d at 4.

9 *Id.*

10 *Id.* at 9-10 (Houston, J., concurring specially).

11 *Id.* at 11 (Houston, J., concurring specially).

12 *Id.* at 15 (emphasis in original).

13 Exxon Mobil Corp. v. Alabama Dep't of Conservation and Natural Resources, 986 So. 2d 1093 (Ala. 2007).

14 986 So. 2d at 1129 (Lyons, J., concurring in part and concurring in the result).

15 *Id.* at 1130.

16 Justice Lyons noted that, in her dissent, Chief Justice Cobb "repeatedly refer[red] to the obligation to act in good faith and Exxon's failure to conform to that standard and even refer[red] to Exxon's bad faith." He explained, "[B]ecause of the absence of a tort remedy for bad-faith breach of an oil and gas contract, such observations do not justify affirming that aspect of the judgment awarding punitive damages." 986 So. 2d at 1130 n.28 (Lyons, J., concurring in part and concurring in the result).

17 *Id.* at 1131.

18 *Id.* at 1132-33 (emphasis in original).

19 *Id.* at 1133.

20 *Id.* at 1134 (internal footnote omitted), Justice Lyons implied tha,t while what Exxon said might have been true, it was not "Fair to all concerned," was unlikely to "build Goodwill and Better Friendships," and was not "Beneficial to all concerned." *Id.* at 1134 n.30.

21 Justice Lyons took issue with this assertion, disagreeing because he did not "consider an aggressive interpretation of the legal effect of a contract, unaccompanied by any misstatement of any underlying fact and under circumstances where all underlying facts are available to the other party to the contract, to constitute 'false representations as to a material matter.'" *Id.* at 1132 n.29.

22 Justice See responded to these contentions. *See id.* at 1126-28 (See, J., concurring in part and concurring in the result).

23 *Id.* at 1145 (Cobb, C.J., dissenting).

24 __ So. 3d __, 2009 WL 3335904 (Ala. Oct. 16, 2009).

25 2009 WL 3335904 at *2 (citing 42 C.F.R. § 447.512(b)).

26 2009 WL 3335904 at *14.

27 *Id.*

28 2009 WL 3335904 at *17 (Cobb, C.J., concurring in the result) (emphasis added).

29 693 So. 2d 409 (Ala. 1997).

30 Johnson v. State Farm Ins. Co., 587 So. 2d 974, 979 (Ala.1991).

31 Foremost Ins. Co. v. Parham, 693 So. 2d 409 (Ala. 1997).

32 *Id.* at 414; *see also id.* at 436 (Almon, J. concurring specially) ("This is another case in which a plaintiff is attempting to bring a fraud action based on allegations of oral misrepresentations that contradict the plain terms of a written contract. . . .") (quoting McCullough v. McAnalley, 590 So. 2d 229, 235 (Ala. 1991) (Almon, J., concurring in part and dissenting in part)).

33 *Id.* at 421 (quoting Hicks v. Globe Life & Accident Ins. Co., 584 So. 2d 458, 469-70 (Ala. 1991) (Almon, J., dissenting)).

34 *Id.* at 437(Shores, J., concurring specially)

35 *Id.* at 439 (See, J., concurring specially) (internal footnote omitted).

36 Justices Houston and Maddox were later reelected as Republicans.

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