

## ***BMW of North America, Inc. v. Gore: The Supreme Court Rejects a Punitive Damage Award on Due Process Grounds***

The Supreme Court of the United States has addressed the validity of punitive damages awards many times over the years, but until now has never overturned one based on a claim of excessiveness under the Due Process Clause of the Fourteenth Amendment. *BMW of North America, Inc. v. Gore*<sup>1</sup> is the first case in which the Court reversed and remanded a large punitive damage amount based on those grounds.

### **I. FACTS AND PROCEDURAL HISTORY**

In *BMW of North America, Inc. v. Gore*, the United States Supreme Court applied a three-part test to identify a punitive damage award that violated the Due Process Clause<sup>2</sup> of the Fourteenth Amendment.<sup>3</sup> The controversy in *Gore* began when Dr. Ira Gore purchased a new sedan from the local authorized BMW dealer in Birmingham, Alabama.<sup>4</sup> Nine months after the purchase, an independent car dealer informed Dr. Gore that the car had been repainted prior to his purchase.<sup>5</sup> Gore brought suit against BMW of North America ("BMW") and the American distributor of BMW automobiles, claiming that the failure to disclose the car's condition constituted suppression of a material fact.<sup>6</sup>

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1. 116 S. Ct. 1589 (1996).

2. U.S. CONST. amend. XIV, § 1 which states: "No State shall make or enforce any law which shall abridge the privileges or immunities of citizens of the United States; nor shall any State deprive any person of life, liberty, or property, without due process of law; nor deny to any person within its jurisdiction the equal protection of the laws." *Id.*

3. 116 S. Ct. 1589 (1996).

4. *Id.* at 1593.

5. *Id.*

6. *Id.*

Dr. Gore's allegation was based on an Alabama statute<sup>7</sup> that codified Alabama's common-law cause of action for fraud.<sup>8</sup> At trial, BMW acknowledged its policy of not disclosing to dealers any predelivery damages that were less than three percent of the suggested retail price.<sup>9</sup> Apparently, the car had come into contact with acid rain on its trans-Atlantic trip from Germany.<sup>10</sup> The cost of repainting Dr. Gore's car was only one and one-half percent of its value.<sup>11</sup> Dr. Gore's complaint prayed for five hundred thousand dollars in compensatory damages, punitive damages, and costs.<sup>12</sup> BMW argued that it was not obligated to report the repairs because they did not materially affect the car.<sup>13</sup> BMW maintained that transactions in jurisdictions other than Alabama should not be used by the jury to assess the amount of damages to award.<sup>14</sup>

The jury found actual costs of four thousand dollars and then multiplied this by the approximate number of damaged cars sold in the United States<sup>15</sup> to arrive at the four million dollar punitive damage award.<sup>16</sup> In a post trial motion to deny the punitive award, BMW produced evidence that its nondisclosure policy was consistent with the laws of twenty-five states.<sup>17</sup> None of those states required disclosure of repairs costing less than three percent of the suggested retail price.<sup>18</sup> The motion also indicated that BMW's policy had never been found unlawful before this action was filed.<sup>19</sup> The trial judge held that the award was not excessive and denied the motion.<sup>20</sup>

On appeal, the Alabama Supreme Court affirmed the lower court's decision.<sup>21</sup> The court applied a combination of factors it had developed in prior cases and rejected BMW's claim that the award transcended

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7. See ALA. CODE § 6-5-102 (1993). See also ALA. CODE § 4299 (1907). The statute provides, "Suppression of a material fact which the party is under an obligation to communicate constitutes fraud. The obligation to communicate may arise from the confidential relations of the parties or from the particular circumstances of the case." *Id.*

8. 116 S. Ct. at 1593

9. *Id.*

10. *Id.*

11. *Id.*

12. *Id.*

13. *Id.*

14. *Id.*

15. *Id.* BMW sold approximately one thousand cars, in different areas of the United States, with similar percentages of undisclosed predelivery damages. *Id.*

16. *Id.* at 1593-94.

17. *Id.* at 1594.

18. *Id.*

19. *Id.*

20. *Id.*

21. 646 So. 2d 619 (Ala. 1994).

constitutional limits.<sup>22</sup> However, the court found that the jury's verdict was wrongly calculated because it was based in part on incidents from other jurisdictions.<sup>23</sup> The court held that "a reasonable punitive damages award in this case" was two million dollars.<sup>24</sup> The Supreme Court of the United States granted certiorari and reversed the Alabama Supreme Court, holding that the two million dollar punitive damages award was grossly excessive, and therefore exceeded the constitutional limit.<sup>25</sup>

## II. LEGAL BACKGROUND

The decision in *Gore* was the first one in which the United States Supreme Court expressly held a punitive damage award unconstitutional under the "grossly excessive" language in the Due Process Clause. Prior to *BMW*, the Supreme Court, as well as the individual Justices, had expressed concern over the constitutionality of large punitive damage awards.<sup>26</sup> The court had mentioned the due process analysis in recent opinions, but the Court always stopped short of reversing on "grossly excessive" grounds.<sup>27</sup>

For example, in *Browning Ferris Industries of Vermont, Inc. v. Kelco Disposal, Inc.*,<sup>28</sup> petitioner sought due process protection based on the amount of the damages awarded. However, the claim of excessiveness under the Due Process Clause had not been raised in either the district court or the court of appeals; therefore, the Court put the inquiry off until another day.<sup>29</sup>

In *Pacific Mutual Life Insurance Co. v. Haslip*,<sup>30</sup> the Court finally considered a Fourteenth Amendment Due Process challenge to a punitive damage award. In that case, the Court conceded that a jury with unlimited discretion in the fixing of punitive damages "may invite extreme results that jar one's constitutional sensibilities."<sup>31</sup> The Court also stated that it need not, and could not, draw a mathematical line

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22. *Id.* at 625-27.

23. *Id.* at 627.

24. *Id.*

25. 116 S. Ct. at 1598.

26. *Browning Ferris Indus., Inc. v. Kelco Disposal*, 492 U.S. 257 (1989); *Bankers Life & Cas. Co. v. Crenshaw*, 486 U.S. 71 (1988).

27. See *Browning Ferris*, 492 U.S. at 276-77; *Bankers Life*, 486 U.S. at 87-88.

28. 492 U.S. 257 (1989).

29. *Id.* at 276-77.

30. 499 U.S. 1 (1991). In this case, plaintiffs were insured by defendant and brought action for fraud, alleging that defendant's agent had accepted several premium payments from plaintiffs even though the policy had been canceled without notice. *Id.*

31. *Id.* at 18.

between the constitutionally acceptable and the constitutionally unacceptable awards that would fit every case.<sup>32</sup> The Court held that the punitive damages in question did not violate the Due Process Clause of the Fourteenth Amendment.<sup>33</sup> In reaching its conclusion, the Court analyzed the factors used in *Green Oil Co. v. Hornsby*,<sup>34</sup> a case from the Supreme Court of Alabama. The objective application of the *Green Oil* factors to the facts in *Haslip* allowed the Court to find "a sufficiently definite and meaningful constraint on the discretion of the fact finders in awarding punitive damages."<sup>35</sup> The Court reasoned that the Alabama Supreme Court's post-verdict review ensured that punitive damage awards were not grossly out of proportion to the severity of the offense and that the awards had some understandable relationship to compensatory damages.<sup>36</sup>

In a later case, *TXO Production Corp. v. Alliance Resources Corp.*,<sup>37</sup> the Supreme Court again recognized that the Constitution imposes a substantive limit on the size of punitive awards. The Court decided whether a particular punitive award was so "grossly excessive" as to violate the Due Process Clause.<sup>38</sup> The Court upheld the award under its analysis of the objective factors announced in *Haslip*.<sup>39</sup>

The first case in which the Supreme Court actually reversed a punitive damage award was in *Honda Motor Co. v. Oberg*.<sup>40</sup> In that case, the Court was "not directly concerned with the character of a standard that will identify unconstitutionally excessive awards; rather [the court] was confronted with the question of what procedures are necessary to ensure that punitive damages are not imposed in an

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32. *Id.*

33. *Id.* at 19.

34. 539 So. 2d 218 (Ala. 1989). The following were announced in *Green Oil* for consideration in deciding whether an award is excessive or inadequate: (a) a reasonable relationship between the punitive award and the harm likely to result from defendant's conduct as well as the actual harm sustained; (b) the degree of reprehensibility of defendant's conduct, the duration of that conduct, the defendant's awareness, any concealment, and the existence and frequency of similar past conduct; (c) the profitability to the defendant of the wrongful conduct and the desirability of removing that profit and of having the defendant also sustain a loss; (d) the financial position of the defendant; (e) all costs of litigation; (f) the imposition of criminal sanctions on the defendant for its conduct; and (g) the existence of other civil awards against the defendant for the same conduct. *Id.* at 223-24.

35. 499 U.S. at 22.

36. *Id.*

37. 509 U.S. 443 (1993).

38. *Id.* at 454 (citing *Waters-Pierce Oil Co. v. Texas*, 212 U.S. 86, 111 (1909)).

39. *Id.* at 456.

40. 512 U.S. 415 (1994).

arbitrary manner.<sup>41</sup> In particular, the Court addressed the Due Process Clause as it related to the requirement of judicial review of punitive awards.<sup>42</sup>

### III. THE SUPREME COURT'S ANALYSIS

The Supreme Court of the United States found the punitive damage award in *Gore* to be unconstitutional for two reasons.<sup>43</sup> First, the award violated the Commerce Clause by restricting defendant's action in other states through the imposition of penalties in one state based on out-of-state actions.<sup>44</sup> Second, the award was "grossly excessive" under the Due Process Clause of the Fourteenth Amendment.<sup>45</sup>

The Court reversed the decision of the Alabama Supreme Court because it found the punitive damage award to be "grossly excessive" in relation to the State's legitimate interest in punishing unlawful conduct and deterring repetition.<sup>46</sup> The Court stated, "[o]nly when an award can fairly be categorized as 'grossly excessive' in relation to these interests does it enter the zone of arbitrariness that violates the Due Process Clause of the Fourteenth Amendment."<sup>47</sup> The Court identified Alabama's legitimate interests in punishing BMW,<sup>48</sup> and then referred to *Healy v. Beer Institute*,<sup>49</sup> where it had previously held that "[p]rinciples of state sovereignty and comity forbid a state to enact policies for the entire Nation, or impose its own policy choice on neighboring States."<sup>50</sup> The Court expressly stated that this type of imposition was a violation of the federal power over interstate commerce.<sup>51</sup> The Court required Alabama to support its economic penalties by focusing on the interests of protecting its citizens and economy, not those of the Nation.<sup>52</sup> The opinion centered on the notion of fairness that requires notice not only of the conduct that will subject a person to sanctions, but also of the severity of the punishment that a state may impose.<sup>53</sup>

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41. *Id.* at 420-21.

42. *Id.*

43. 116 S. Ct. at 1597-98.

44. *Id.* at 1604.

45. *Id.*

46. *Id.* at 1595.

47. *Id.*

48. *Id.*

49. 491 U.S. 324 (1989).

50. *Gore*, 116 S. Ct. at 1597 (citing *Healy*, 491 U.S. at 335-36).

51. *Id.*

52. *Id.* at 1598.

53. *Id.*

The Court accepted the Alabama Supreme Court's interpretation of the jury verdict, but disagreed with respect to the amount imposed in the correction of the computation.<sup>54</sup> Despite the fact that the United States Supreme Court had previously upheld the *Green Oil* factors that were the basis of the Alabama ruling in this case,<sup>55</sup> the Court analyzed this situation under a different standard.<sup>56</sup> The Court used three guideposts to find that BMW did not have any reasonable basis for believing that a two million dollar award could be the cost of not adhering to its nondisclosure policy, especially considering the policy was not in violation of any other state's laws.<sup>57</sup>

The first guidepost used to indicate a punitive damage award's excessiveness is the degree of reprehensibility of the defendant's conduct.<sup>58</sup> The Court reasoned that BMW's infliction of harm was purely economic in effect.<sup>59</sup> There was no particularly malicious intention behind the action, and BMW made no deliberately false statements, acts of affirmative misconduct, or concealment of improper motive.<sup>60</sup> The second guidepost focused on the ratio between the compensatory damage and the punitive damage awards.<sup>61</sup> The Court did not define an acceptable range, but found that the punitive award was five hundred times the compensatory award determined by the jury, and clearly outside of any acceptable range.<sup>62</sup> The third guidepost consisted of a contrast between the punitive award and the civil or criminal sanctions that could be imposed under the particular state's laws.<sup>63</sup> Alabama's fine for a similar action was two thousand dollars.<sup>64</sup> This was substantially smaller than the punitive award of two million.<sup>65</sup> This discussion also considered the possible categorization of BMW as a recidivist because of the previous suits filed by disgruntled customers.<sup>66</sup> This characterization was dispelled by the lack of notice put forth from any state statute.<sup>67</sup> The Court briefly mentioned the lack of basis for assuming a less severe punishment would not fulfill the

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54. *Id.*

55. See *TXO*, 509 U.S. at 458; *Haslip*, 499 U.S. at 20.

56. *Gore*, 116 S. Ct. at 1598.

57. *Id.*

58. *Id.*

59. *Id.* at 1599.

60. *Id.* at 1601.

61. *Id.*

62. *Id.* at 1602.

63. *Id.* at 1603.

64. *Id.*

65. *Id.* at 1600.

66. *Id.*

67. *Id.*

objectives of imposing punitive damages.<sup>68</sup> Finding all three guideposts dispositive of the conduct required for imposition of a large economic penalty, the Court reversed and remanded the case to the Alabama Supreme Court.<sup>69</sup>

The concurring opinions sought to explain why the Court overcame the presumption of validity that is based in reliance upon a tradition of allowing the jury to decide matters through an impartial trial procedure.<sup>70</sup> The concurrence also addressed the apparent inconsistency between *Gore* and the opinion in *TXO*.<sup>71</sup> The concurring Justices stated that the Alabama courts "applied the 'factors' intended to restrain punitive damage awards in a way that belies that purpose."<sup>72</sup> The Alabama Supreme Court's decision resulted in a lack of protection from unconstitutional and arbitrary results, and thus the United States Supreme Court reversed.<sup>73</sup>

The dissenting opinions focused on what the Justices believed was an improper intrusion onto grounds appropriately left for state courts.<sup>74</sup> The basis for these arguments came from the skeptical view of the Court's intrusion into this established area of the law.<sup>75</sup> Justice Scalia stated, "[t]he Constitution provides no warrant for federalizing yet another aspect of our Nation's legal culture . . . , and the application of the Court's new rule of constitutional law is constrained by no principle other than, the Justices' subjective assessment of the reasonableness of the award in relation to the conduct for which it was assessed."<sup>76</sup> The result, in the dissenters' view, will be a confusion in the interpretation of what has now been proscribed.<sup>77</sup>

#### IV. THE IMPLICATIONS

*Gore* will likely have important implications in future litigation over punitive damages.<sup>78</sup> In civil litigation, plaintiffs' lawyers will be

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68. *Id.*

69. *Id.* at 1604.

70. *Id.* at 1606-08 (Breyer, J., concurring).

71. Only three years earlier in *TXO*, the Supreme Court confirmed its use of the *Green Oil* factors that it had used in *Haslip* as a standard by which to judge excessive punitive damage awards. 509 U.S. at 458; see *supra* note 34 and accompanying text.

72. 116 S. Ct. at 1606.

73. *Id.* at 1605.

74. *Id.* at 1609-20 (Scalia, J., dissenting).

75. *Id.* at 1610.

76. *Id.* at 1610-11.

77. *Id.*

78. Victor E. Swartz, *BMW v. Gore: What Does It Mean For The Future*, 15 No. 1 PROD. LIAB. L. & STRATEGY, July 1996, at 1.

limited in the extent to which they may present the tortfeasor's conduct on a nationwide basis.<sup>79</sup> If a defendant's conduct is lawful in one state, it cannot be used as evidence to increase or obtain punitive damages in the state where the same conduct is deemed unlawful.<sup>80</sup> Congress must decide what should happen after the punitive damages are paid, and when, if ever, the defendant should be punished again.<sup>81</sup>

In throwing out as exorbitant the punitive damages award in *Gore*, the Court has invited a flood of challenges to the traditional belief in the wisdom of state juries in this area.<sup>82</sup> The decision may influence Congress and state legislatures to enact specific statutory limits on the amount of punitive damage awards.<sup>83</sup> This could have a negative impact on the legal system.<sup>84</sup> The unpredictability of a potential punitive award is the cornerstone for deterrence of wrongful conduct by a large corporation.<sup>85</sup> If punitive damages are predictably certain, they become just another item in the cost of doing business, much like other production costs, and thereby induce a reluctance on the part of the manufacturer to sacrifice profit by removing a correctable defect.<sup>86</sup>

Another problem will arise out of the conflict between the *Gore* factors and the *Green Oil* factors developed in earlier cases.<sup>87</sup> The Court did not fully address its earlier opinions that do not follow the guideposts put forth in *Gore*.<sup>88</sup> A definitive test remains obscure.<sup>89</sup> Lower courts must choose from these conflicting standards in deciding how to objectively evaluate a punitive award for excessiveness.<sup>90</sup> The Court's opinion created a need for legislative action so that citizens and corporations can rely on the law, and not randomness, when it comes to civil punishment.<sup>91</sup>

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79. *Id.*

80. *Id.*

81. *Id.*

82. Editorial, *Law and Justice*, NAT'L L.J., June 3, 1996, at 8.

83. *Id.*

84. *Id.*

85. Brief for Respondent at 44, *BMW of North America v. Gore*, 116 S. Ct. 1589 (1996) (No. 94-896).

86. *Id.* (quoting *Campus Sweater & Sportswear Co. v. M.B. Kahn Constr. Co.*, 515 F. Supp. 69, 107 (D.S.C. 1979), *aff'd*, 644 F.2d 877 (4th Cir. 1981)).

87. *Gore*, 116 S. Ct. at 1614 (Ginsberg, J., dissenting).

88. *Id.*

89. *Id.*

90. *Id.*

91. *Id.*



In his dissent, Justice Scalia found what he called a "loophole" in the majority's holding.<sup>92</sup> He believes the three guideposts proscribed could possibly be overridden if there is a finding by some court that the punitive damages are "necessary to deter future misconduct."<sup>93</sup> Justice Scalia predicted that state courts will often uphold punitive damage awards as necessary in order to protect state interests.<sup>94</sup>

The ultimate winner is not apparent yet, but the average consumer will likely notice some changes resulting directly from this case. For example, BMW enacted a nationwide policy of full disclosure soon after the initial verdict was rendered,<sup>95</sup> and some states have made headway in passing laws related to these issues since this case arose.<sup>96</sup> Many state legislatures have enacted a variety of measures designed to curtail awards of punitive damages.<sup>97</sup> Also, at least one state legislature has prohibited punitive damages altogether, unless a statute explicitly provides for them.<sup>98</sup>

In August of 1996, three months after the Court's opinion in *Gore*, the National Conference of Commissioners on Uniform State Laws approved a model punitive damages act that was designed to improve state procedures for the award and review of punitive damages.<sup>99</sup> The Act would require plaintiffs to show by "clear and convincing" evidence that a defendant "maliciously intended to cause the injury or consciously and flagrantly disregarded the rights or interests of others in causing the injury."<sup>100</sup> The Act does not impose an explicit cap on punitive damage awards,<sup>101</sup> but it does require a consideration of factors that track those in *Gore*.<sup>102</sup> The act was approved by forty four of the over fifty jurisdictions voting.<sup>103</sup>

The initial announcement of the United States Supreme Court's decision in *Gore* caused much celebration in the business community.<sup>104</sup> However, the jubilation may not last because of the effect on

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92. *High Court Finds Gore Award Excessive, Reverses \$2 Million In Punitives*, 5 No. 4 MEALY'S EMERGING TOXIC TORTS 10, May 31, 1996.

93. *Id.*

94. *Id.*

95. 116 S. Ct. at 1592.

96. Appendix to opinion in 116 S. Ct. 1032.

97. 116 S. Ct. at 1610 (Scalia, J., dissenting).

98. *Id.* at 1612.

99. Marcia Coyle, *Model Act Would Tighten Punitives*, NAT'L L.J., Aug. 5, 1996.

100. *Id.*

101. *Id.*

102. *Id.*

103. *Id.*

104. Pamela Anagnos Liapakis, *Don't Rely On The 'Gore' Decision*, NAT'L L.J., June 17, 1996.

commercial as well as consumer cases.<sup>105</sup> The ruling opens the door for introduction of past corporate misdeeds.<sup>106</sup> The practical effect comes from the Court's linkage of large punitive damage awards to habitual offenders, suggesting that, in these instances, there could be a deterrent value to such awards.<sup>107</sup> Obviously, this will not be the Supreme Court's last case on excessive punitive damages, but for now, awards in business cases will at least receive a higher level of judicial scrutiny than other tort cases.<sup>108</sup>

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105. *Id.*

106. *Id.*

107. *Id.*

108. *Id.*