

DAMAGES THEORIES AND TRIAL STRATEGIES

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I. Where punitive damages are headed:

In *BMW of North America, Inc. v. Gore*, ___ U.S. ___, 116 S.Ct. 1589, 134 L.Ed.2d 809 (1996) the U.S. Supreme Court held that a punitive damage award of 500 times the amount of compensatory damages is grossly excessive and is in violation of the Due Process Clause of the Fourteenth Amendment.

Dr. Ira Gore, Jr. purchased a black BMW sedan for \$40,750.88 from the BMW dealer in Birmingham, Alabama. After driving it for nine months, he took it to “Slick Finish” to have it cleaned. Mr. Slick detected evidence that the car had been repainted which led Dr. Gore to file suit against BMW of North America. BMW acknowledged at trial that its policy was as follows: If the cost of repairing the damage to the vehicle exceeds 3% of the car’s “suggested retail” price, the car was placed in a fleet for company service for a period of time and then sold as used. If the repair cost did not exceed 3% of this “suggested retail” price, then the car was sold as new without advising the dealer that any repairs had been made.

To prove his actual damages of \$4,000.00, Dr. Gore relied on the testimony of a former BMW dealer, who estimated that the value of a repainted BMW was approximately 10% less than the value of a new car that had not been damaged and repaired. To support his claim for punitive damages, he introduced evidence that since 1983 BMW has sold 983 refinished cars as new, including 14 in Alabama, without disclosing the repairs. Evidence showed that the average cost of the repairs were more than \$300.00 per vehicle.

The jury returned a verdict finding BMW liable for compensatory damages of \$4,000.00 and \$4,000,000.00 in punitive damages. The Alabama Supreme Court found that the jury improperly computed the amount of punitive damages by multiplying Dr. Gore’s compensatory damages by the number of similar sales in other jurisdictions and remitted the punitive damages to only \$2,000,000.00.

The U.S. Supreme Court reversed and remanded the cases. Stating that elementary notions of fairness enshrined in our constitutional jurisprudence dictate that a person receive fair notice not only of the conduct that will subject him to punishment but also of the severity of the penalty that a State may impose. There are three guideposts for determining whether a defendant had adequate notice of the size of the sanction that a state might impose for a defendant’s misconduct: (1) the degree of reprehensibility of the defendant’s conduct; (2) the disparity between the harm or potential harm suffered by the plaintiff and his punitive damages award; and (3) the difference between this remedy and the civil penalties authorized or imposed in comparable cases.

The Court said further that first, none of the aggravating factors associated with particularly reprehensible conduct was present. Second, “when the ratio is a breathtaking 500 to 1, the award must surely raise a suspicious judicial eyebrow”. Lastly, the \$2,000,000.00 economic sanction imposed on BMW is substantially greater than the statutory fines available in Alabama of \$2000.00. The Court refrained from drawing a

bright line marking the limits of a constitutionally acceptable punitive damage award, but held that a 500 to 1 ratio is grossly excessive and unconstitutional.

II. Other courts holdings since BMW:

In *Continental Trend Resources, Inc. v. OXY USA, Inc.*, 101 F.3d 634 (10th Cir. 1996), independent producers and marketers of natural gas sued the operator of natural gas pipeline system alleging tortious interference with contracts and with prospective business advantage. A jury entered a verdict for the plaintiffs awarding \$269,000.00 in compensatory damages and \$30,000,000.00 in punitive damages. The Court of appeals affirmed the \$30 million punitive award. The Supreme Court vacated the judgment and remanded the case to be reconsidered in light of its decision in *BMW v. Gore*, ___ U.S. ___, 116 S.Ct. 1589, 134 L.Ed.2d 809 (1996).

Again at issue was whether a punitive damage award of \$30 million was grossly excessive in violation of the Due Process Clause of the 14th Amendment.

The Court of Appeals held that the defendant must receive fair notice not only of the conduct that will subject him to punishment but also of the severity of the penalty that a State may impose. It is with respect to this requirement that the Supreme Court set forth 3 “guideposts”:

- (1) the degree of reprehensibility of the defendant’s conduct;
- (2) the ratio of the punitive award to the actual harm inflicted on the plaintiff; and
- (3) the comparison between the punitive award and the civil or criminal penalties that could be imposed for comparable misconduct.

There was sufficient evidence in the record of the reprehensibility of OXY’s conduct to support a “substantial penalty”. From the rulings of the Supreme Court, this court surmised that in economic injury cases if the damages are significant and the injury not hard to detect, **the ratio of punitive damages to the harm generally cannot exceed a ten to one ratio.**

In figuring harm, both actual and potential harm may be considered. Although the jury found compensatory damages of \$269,000, the court found that the potential damages to these plaintiffs had OXY’s course of action succeeded was substantially more. The court found that the plaintiff’s evidence would support a jury finding of approximately \$1 million in combined actual and potential loss. The court found that OXY’s misconduct involved a violation of common law tort duties that do not lend themselves to a comparison with statutory penalties unlike the BMW case.

In summary, this court was satisfied that a significant punitive damages award against OXY was proper and constitutionally permissible. With the guidance of the BMW opinion, the court concluded that the \$30 million exceeded the constitutional limit. The harm in the case, though egregious, was entirely economic, and thus less worthy of punishment than harm to health and safety. The ratio between OXY's wealth was not irrelevant, but \$30 million was far more than was necessary to secure its attention and modify its behavior in Oklahoma. The court held that \$6 million would be the maximum constitutionally permissible punitive damages award justified by the facts of this case. This ratio of 6 to 1 is within the range of a 4 to 1 and a 10 to 1 ratio the court believed BMW imposes in such cases.

In *Foremost Insurance Co., Grand Rapids, MI v. Parham*, Nos. 1950507 and 1951238 (Ala. March 14, 1997) the Alabama Supreme Court remitted a fifteen million dollar punitive damage award which was awarded to two families (7.5 million each) to three hundred and forty eight thousand dollars. This case involved small out of pocket damages but egregious acts of Foremost.

The Court discussed the *BMW v. Gore* rationale, but declined to state what ratio of compensatory to punitive damages was appropriate. Each family had two claims and was awarded a separate amount of compensatory and punitive damage for each claim. On one claim, the Court allowed a 50 to 1 compensatory to punitive damages ratio, and on the other claim, the Court allowed a 489 to 1 compensatory to punitive damage ratio.

Therefore, after Foremost, arguably, a 489 to 1 ratio of punitive to compensatory damages is constitutionally permissible.

III. Customer lists from discovery:

A. Why they are needed.

One of the most common defenses in lender litigation is that the bad actor, acting as agent for the lender, was a renegade agent. In other words, the lender argues that while it tries to police the people working for it, it is an imperfect world and sometimes mistakes are made in monitoring its agents. To combat this argument, similar occurrence evidence is needed. Similar occurrence evidence serves to combat the one bad apple defense and also to show notice of a problem. If a lender knew there was a problem and closed its eyes to the problem in order to make money, then an effective punitive damage argument can be made. One of the most effective ways of identifying other similar occurrences is to get the customer list from the lender.

B. How to get the list.

Initial discovery should include a request for a list of all customers' names, addresses and phone numbers. The scope of this request may be limited to certain geographic areas and will almost certainly be objected to by defendants. Use the following cases to show this discovery should be allowed:

Ex Parte Asher, Inc., 569 So.2d 733 (Ala. 1990); Ex Parte New York Life 1997 WL 7719 (Ala. 1977); Ex Parte State Farm, 452 So. 2d 861 (Ala. 1984)

C. How to get their testimony into evidence:

The witnesses generated by the customer list are excellent evidentiary additions to any case. Some courts will limit the number of such pattern and practice witnesses allowed to testify at trial. Be sure to select the ones with facts most similar to yours. You must also pay attention to the date the witness dealt with the lender in relation to the date the Plaintiff dealt with the lender. Case law, in Alabama, establishes these time of occurrence and similar acts guidelines.

Do not overlook this type of discovery in any case. The magnitude of a such a lender's alleged wrongdoing may only be truly identified by such pattern and practice testimony.

Other areas of discovery that deserve attention are:

Study state and federal agencies for any complaints;
Locate any ex-employees of defendant to testify about practices;
Request policy and procedures manuals that employees of the company are required to follow;
Request any training videotapes;
Request statistics such as penetration rates and loss ratios;
Do a Westlaw search to see if the company has been sued for similar acts;
Access the Administrative Offices of the Courts computer to find other similar lawsuits;
Check your Attorney General's Consumer Division to see if there have been any investigations of the company;
Check the Better Business Bureau for complaints against the company.

CONCLUSION

A successful practitioner must be aware of ways to enhance punitive damages in his/her case. The above provides some workable methods to enhance such damages.

COMMON LAW FRAUD CASES

Alabama has some of the weakest consumer protection laws in the entire country, especially in the area of consumer finance. Most states have a limit on the interest rate that can be charged on consumer loans. In Alabama, on loans over \$2,000.00, there is no numerical limit. The only limit is that the interest rate cannot be "unconscionable". (Code of Alabama, (1975) §8-8-5).

Most finance companies target consumers who are unable to make loans from traditional lending sources. The finance companies make loans to these people at a much higher interest rate. Many times there are needless and useless charges placed on the loans. Most consumers are not aware of these charges. Apparently, finance companies justify these practices by arguing that they are willing to make loans to people that traditional banks would not make loans to. However, this extra risk is reflected in the higher interest rate. It should not be reflected in add on fees that are useless to consumers.

The following are several theories of liability that pertain to such transactions.

I. **REQUIRING INSURANCE (AKA INSURANCE PACKING)**

Finance Companies have a motive to place insurance on all loans. The premium charged increases the amount financed, which increases the interest and profit to the company. Also, the finance company or its employees receive a commission from the sale of some of these products. Many times the sale of the insurance product is through one of the finance company's subsidiaries or sister corporations which add to the profit. Alabama law allows the finance companies to sell insurance through their subsidiaries if it is disclosed somewhere in the documents (usually the fine print). The following sections discuss different types of insurance that is placed on the loans.

A. **CREDIT INSURANCE**

Credit insurance takes many forms. Credit life insurance is one form of credit insurance. It is designed to pay off the loan balance in the event of the consumer's death. Many consumers have been told by finance companies that they were required to purchase credit life insurance in order to receive the loan. Credit life insurance is the most costly life insurance allowed to be sold in Alabama.

It is illegal to require credit life insurance as a condition to receiving the loan. (Code of Alabama, (1975) §5-19-20). The fine print of the loan documents signed by the consumer always states that the insurance is not required and that it is completely voluntary. Many people who deal with the finance companies do not read the documents they sign. They usually trust who they are dealing with.

The fraud theory is:

Lie: I promise you the insurance is required;

Reliance: taking out the insurance;

Damage: the cost of the premium plus the interest.

Most of the time, there are health questions that are required to be answered before the credit life insurance policy can be issued. The finance companies realize that if the questions are answered in a fashion showing the consumer is in bad health that the insurance will not issue. Therefore, some don't ask the health questions so that the policy will issue. Later, when a claim is made, the insurance company can use the bad health of the consumer as grounds to deny the claim. The theory here is known as "clean sheeting". Clean sheeting is fraud. See *Liberty National v. Waite* 551 So. 2d 1003 (Ala. 1989), See *John Hancock v. Variable Life Insurance Company vs. Pierce*, 537 So.2d 719 (Ala. 1987)

Another form of credit insurance which has been required as a condition to receiving a loan is credit disability or credit accident insurance. This insurance is designed to make the payments of the consumer while he is disabled or in an accident. Many consumers have made claims on such insurance that have never been paid. The major ground used to deny claims is that the consumer was disabled at the time he took the policy out. However, many times no questions are asked regarding whether or not the consumer is disabled at the time the loan is made. The theory of fraud here is:

Lie: I promise that disability insurance will pay in the event you are disabled;

Reliance: purchasing the insurance;

Damages: paying the premium for it, plus interest.

Alternatively, if the consumer is uneducated and cannot read and write a fraudulent failure to disclose theory may be appropriate.

Another type of credit insurance is involuntary unemployment insurance. This insurance is designed to make the payments of the consumer if he loses his job involuntarily. In the fine print of the insurance policy, there is a provision that the consumer must be employed for 12 consecutive months before taking out the insurance in order for there to be coverage (see sample policy attached in appendix). No questions are asked regarding the length of the consumer's employment at the time he takes out the insurance. However, the consumer's lack of employment is used by the insurance company as grounds to deny coverage. The fraud theory here is:

Lie: I promise you the insurance will pay in the event you are unemployed;

Reliance: taking out the insurance;

Damages: the premium payment plus interest.

B. PROPERTY DAMAGE INSURANCE

Another area of insurance packing in the consumer finance industry deals with collateral protection insurance. Many finance companies require that the collateral protection insurance be sold through the finance company. Of course, it is perfectly permissible to require insurance on the collateral. However, it is illegal to require the consumer to purchase collateral protection insurance through the finance company. (Code of Alabama (1975) §5-19-20(b)). On many occasions, consumers are told they must buy the collateral protection insurance through the finance company in order to obtain the loan. Many times, the value of the collateral is inflated, which causes the premium on the insurance to be higher than the premium which the consumer would pay elsewhere. As stated above, there is a motive for the finance company to charge as high a premium as possible. The finance company receives interest on the total amount financed, commissions and many times the insurance is sold through a related corporation.

The theory of liability again is fraud:

Lie - I promise you that you are required to purchase insurance through the finance company;

Reliance: purchasing insurance through the finance company;

Damages: difference in the cost of insurance plus interest minus the amount the consumer could have paid elsewhere for the same insurance.

C. NON-FILING INSURANCE

This is a type insurance where the finance company charges a fee to the consumer in lieu of filing a UCC financing statement. The finance company charges a premium and supposedly gives the premium to an insurance company to cover it in case it has to repossess the collateral and is unable to repossess it solely because it failed to file a UCC financing statement to perfect its security interest. Theoretically, the finance company can then look to the insurance company for payment of the value of the collateral.

There is much abuse in this practice. Many times, there is no insurance at all. The finance company simply keeps the money. Other times, the money is paid to an insurance company and 100% of the premium is returned to the finance company. Other times, the non-filing insurance is charged on collateral that the debtor finances at point of purchase. This involves the finance company's purchase money security interest. Non-filing insurance on this transaction is useless because UCC financing statements are not required to perfect the security interest in such goods. Therefore, non-filing insurance is not necessary. As stated above, the motive for this is to increase the amount financed.

The theory of liability here is a scheme to defraud, or, fraudulent failure to disclose. See *Smith v. First Family*, 626 So.2d 1266 (Ala. 1993), which allowed a scheme to defraud theory to go to the jury. The non-filing insurance costs ten to fifteen dollars per transaction; therefore, this type theory lends itself more to a class action.

D. HOUSEHOLD GOODS AS COLLATERAL

The Federal Trade Commission has enacted strict regulations regarding household goods being used as collateral in consumer loans. Generally, most household goods cannot be used as collateral. 16 *C.F.R.* §444.2(a)(4). Since they cannot be used as collateral, they certainly cannot be repossessed. However, many finance companies take a security interest in these goods solely to be able to charge collateral protection insurance on it.

Some finance companies take a security interest in such things as fishing poles, clock radios, blankets, televisions, and other similar items. Since it is not real collateral, it is improper to charge insurance on it. The company has no insurable interest in it. They rarely try to repossess the collateral. The fraud theory here is a scheme to defraud and a fraudulent failure to disclose that the insurance charges are not required.

Normally, the defendants will try to remove these cases, stating that since FTC rules are the basis for the claim that the claim involves a federal question. However, the *Gully v. First National Bank in Meridian*, 299 U.S. 109, 57 S.Ct. 96 (1936); *Merrell Dow Pharmaceuticals, Inc. v. Thompson*, 478 U.S. 804, 106 S.Ct. 3229 (1986) cases require remand. These cases state that removal is not allowed simply because an element of your state law claim involves federal law.

E. FORCE PLACED INSURANCE

This type insurance deals with collateral protection. At the time of the loan, many consumers take out their own collateral protection insurance from a separate company. However, if the consumer does not keep the collateral protection insurance, the finance company in the loan contract has the right to purchase collateral protection insurance on the collateral. It is permissible, for the finance company to buy insurance similar to the insurance that the consumer let lapse. However, many finance companies have abused this privilege by purchasing insurance that gives them more protection than the consumer

originally had with his insurance. For example, there are some policies force placed that protect the finance company against the consumer's default. In other words, if the borrower doesn't make his payments to the finance company, the insurance will make the payments. The premiums are the highest allowed by law and the finance companies are allowed to charge interest on the premium.

Perhaps the area that is most abused is that the insurance premium on this type insurance is based on the total gross balance of the loan, but in the event of a total loss of the collateral, the insurance will only pay the actual cash value, or depreciated value of the collateral. Many times, the collateral is worth less than the gross balance of the loan; i.e., cars, mobile home, and things that depreciate.

While the consumer pays a higher premium based on the total amount owed plus interest, the most the insurance will ever pay is a lesser amount; i.e., the value of the collateral. This violates the Alabama Insurance Department bulletin of February 22, 1994, (AB-133).

The theory of liability is fraud. It can be couched in a failure to disclose or a scheme to defraud theory.

II. DEALER FRAUD

Many consumer financial transactions take place through dealers; i.e., sellers of goods and services such as cars, mobile homes, televisions, satellite systems, stereos, washing machines, etc. Most of us have seen things advertised wherein the dealers state they can handle the financing.

A. Yield-Spread Premium

Most of the time, this dealer arranged financing is handled in the following manner. The finance company gives the dealer all of the necessary documents for the consumer to sign in order to consummate a loan, i.e., a retail installment contract, mortgage or UCC financing statements, truth in lending documents, etc. The dealer then sells the product and gets the consumer to sign all of the finance papers. In actuality, this is a loan from the finance company to the consumer, with the consumer making his payments back to the finance company from the very beginning. However, on paper, the dealer is shown to be the finance company.

This paper trail is created so the finance company can claim that it is purchasing the loan from the dealer and not making a direct loan to the consumer. Since the finance company is purchasing the loan, it can assert that it can purchase the loan for less than the face value of the loan (at a discount). Many times the finance company purchases the loan at a discount, which was agreed upon prior to the underlying loan ever being consummated.

Other times, the finance company will simply keep a certain amount of the amount financed in each deal. In other words, when the finance company "buys the loan", the finance company will keep for example \$500.00 of the amount financed and never give it to the dealer. This is money that never leaves the hands of the finance company, yet the consumer is charged interest on it.

Practically, the act of buying the loan at a pre-approved discount or keeping part of the amount financed requires the dealer to raise his prices by \$500.00 (in the example above) to make the same profit he would make if the money had not been kept by the finance company. It can be argued that the \$500.00 that the finance company kept or the discount is a finance charge (Code of Alabama (1975) §5-19-1). If it is a finance charge, it should be disclosed to the buyer.

Another form of the dealer discount works as follows. The dealer will call the finance company and ask what interest rate the finance company is willing to make the loan to the particular consumer. The finance company agrees to make the loan for example at 10%. The dealer will then add 2% on top and make the loan at 12%. The dealer and finance company will split the 2%. The consumer is never told that the finance company was willing to make him the loan at 10%. This is sometimes referred to as a yield spread premium. It is a jury question whether or not the finance company and dealer are required to disclose the yield spread premium to the consumer. The theory of liability in the dealer discount area is that the company fraudulently failed to disclose to the consumer that there was a finance charge. Many times, the consumer never would have entered into the loan if he had known the true facts or if he had known that he could have gone elsewhere and gotten the financing cheaper. See *Smith v. First Family*, *supra*.

Since the *Smith* opinion, the finance lobby supported and got passed an amendment to the mini-code, §5-19-6(c), which states that there is no duty, under the mini-code, to disclose the above mentioned hidden finance charge. This amendment had retroactive application. It is questionable whether or not retroactive application will be upheld as constitutional. Also, the amendment dealt with the mini-code only. It did not affect whether or not there was a common law duty to disclose. Of course, when deciding whether or not there is a common law fraud duty to disclose, one must look to the Alabama Pattern Jury Instruction §18.08. Certainly, there is an argument there is still a duty to disclose this information.

B. Revolving Satellite Sales

Another area of consumer fraud involves revolving credit in which some financiers have designed a custom credit card program to cater to satellite dish financing. The satellite dish industry has used this scheme to finance products, normally thought of as a one time purchase item such as satellite dishes, to many low income consumers.

Many times, this credit program is structured like that of a dealer in a yield-spread situation. The financier is removed by a shell agreement from the distributor who in turn

recruits local dealers in area targeted by the program. The financier again takes the position of a buyer of financial paper and not the actual entity behind the credit scheme.

Often, the fraud occurs when the dealer's employee makes misrepresentations to the consumer regarding the price of the satellite system or fails to disclose the actual interest and finance charges included in the credit purchase. Many times the sale is made as though it is a sale over time with a local company with low monthly payments for a fixed period of time. Many times, the consumer has no idea of the nature of the revolving credit he has just entered into.

CONCLUSION

There are numerous theories of liability against lenders which involve common law fraud. A careful practitioner should be aware of all of these.