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TRANSPORTATION INSURANCE CO. v. MORIEL: TEXAS SUPREME COURT LASSOS THE PUNITIVE DAMAGES BRONCING BULL (MAY THAT BULL STILL RUN FREE IN THE FEDERAL COURTS?)[d1]

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I. Introduction

It's rodeo time in Texas! In Houston, real cowboys apply their skills each night in a two-week extravaganza at the Astrodome in late February and early March.

On February 2, 1994, in the jurisprudential rodeo in Austin, the Texas Supreme Court lassoed what may well be the wildest and most ornery bull ever bred on the plaintiffs' range, punitive damages.[1] In *Transportation Insurance Co. v. Moriel,*[2] the Texas Supreme Court held that in all future punitive ***230** damage cases, the determination of the amount of punitive damages shall be bifurcated from the remaining issues in the case.

This decision will impact all tort claims in the state of Texas. For the intellectual property practitioner, the most obvious impact of this decision will be in the areas of trade secret and common law unfair competition litigation. Due to the facially procedural nature of the requirements imposed by the Texas Supreme Court, one of the most interesting questions raised by this decision will be the extent to which it must be implemented by the federal courts, pursuant to the *Erie* doctrine.[3] A substantial number (if not the majority) of Texas trade secret and unfair competition claims are brought in federal court. Thus, the applicability of the *Moriel* decision to federal practice should be highly relevant to trade secret and unfair competition practitioners.

II. Factual and Procedural Background

The *Moriel* case was an insurance "bad faith" case in which the plaintiff/insured, Juan Moriel, sued the defendant/carrier, Transportation Insurance Company, after repeated delays by the carrier in paying Mr. Moriel's medical bills. Mr. Moriel initially filed a worker's compensation claim against Transportation Insurance Company, securing an award of $30,022.77 from the Industrial Accident Board. Transportation Insurance Company appealed that award to the district court and Moriel counterclaimed for additional compensation, unpaid medical bills, and bad faith claims practices. In July 1988, Moriel and Transportation Insurance Company settled the worker's compensation claim, leaving the bad faith claim to be tried by the district court.[4]

The jury found that Transportation had delayed paying Mr. Moriel's medical bills without a reasonable basis and that it acted "with heedless and reckless disregard" of Mr. Moriel's rights.[5] The jury awarded Mr. Moriel $1,000 in actual damages, excluding mental anguish, $100,000 in mental anguish damages, and $1,000,000 in punitive damages. The trial court entered judgment on the verdict and overturned Transportation's motions for JNOV, new trial, remittitur and to disregard the jury findings.[6] The Court of Appeals affirmed the judgment of the trial court.[7]

III. Scope of the *Moriel* Decision

On the first page of its opinion, the Texas Supreme Court notes that the parties have presented the court with three issues: (1) in a bad faith case, how should Texas courts apply the definition of gross negligence from *Burk Royalty Co. v. Walls*[8] to determine whether punitive damages are appropriate; (2) what constitutes legally sufficient evidence of gross negligence to support an award of punitive damages; and (3) what limits do the due process clause of the Fourteenth Amendment to the United States Constitution and the due process clause of the Texas Constitution place on punitive damages.[9] The Court ***231** declined to address the third issue, holding that:

> Juan Moriel did not present legally sufficient evidence of gross negligence. Therefore, Moriel is not entitled to punitive damages. It necessarily follows that the constitutional issues -- whether the size of the punitive damage award or the procedures the trial court followed violated Transportation's due process rights -- are questions that must await another day . . . . Because the court has not specifically addressed punitive damages in the bad faith context or required the procedures that we announced today in any prior case, and because this opinion represents a substantial clarification of our gross negligence standards, we remand this case for a new trial in the interest of justice.[10]

It is interesting to note that in the less than extraordinary situation where there was simply insufficient evidence of gross negligence to support the jury verdict, the Texas Supreme Court introduced new procedural requirements to be followed in all future punitive damage cases in Texas.

The Texas Supreme Court also analyzed the Texas gross negligence standard and the "no evidence" review of gross negligence findings. With regard to gross negligence, the Supreme Court emphasized that gross negligence involves two components, (1) the defendant's acts or omissions, and (2) the defendant's mental state.[11]

With regard to the "no evidence" issue, the Court emphasized the distinction between "materiality of the evidence and the issue of evidentiary sufficiency."[12] The Court quoted the timeless words of Professor McCormick: "a brick is not a wall."[13] Applying this standard to the facts before it, the Court concluded that, although the carrier had delayed for two years in paying Moriel's testing expenses and for over a year in paying Moriel's subsequent treatment expenses, the evidence did not support the inference that (1) the carrier had any subjective awareness that Moriel would probably suffer serious injury because of the delay; or (2) the carrier's actions created any risk of serious harm to Moriel.[14] The Court then held that, since its decision "represents a substantial clarification" of these issues, a new trial would be required in the interest of justice.[15]

IV. The Applicability of the *Moriel* Decision to Federal Practice

The Court's clarification of the gross negligence standard is unquestionably substantive in nature and should, therefore, be applied by federal courts adjudicating punitive damage claims arising under Texas law. Determining whether the bifurcation requirement imposed in *Moriel* must be followed by federal courts is much more difficult because of the "procedural" appearance of this requirement. Addressing this issue entails a review of *Erie* and its progeny, the Rules Enabling Act,[16] and Rule 42(b) of the Federal Rules of Civil Procedure.

A. The Texas Supreme Court's Articulated Rationale for the Bifurcation Requirement

One of the joys of analyzing the *Moriel* decision is the Court's lengthy explanation of its rationale for the bifurcation requirement. The Court carefully reviewed the U.S. Supreme Court's two most recent ***232** "rides" on the punitive damage bronco, *TXO Production Corp. v. Alliance Resources Corp.,*[17] and *Pacific Mutual Life Insurance Co. v. Haslip.*[18] The Texas Supreme Court expressed concern as to whether the procedures employed by Texas courts could pass muster under *TXO* and *Haslip,* stating that "many aspects of the procedures employed up to now by Texas courts do not compare favorably to those examined in *Haslip* and *TXO*."[19] The Court in *Moriel* noted that "the evidence supporting a punitive damage award is scrutinized less closely on appeal to the highest court here than in some other states."[20]

With these perceived weaknesses in the Texas trial and appellate procedures regarding punitive damages, the Court held:
The broad jury discretion that is the hallmark of the common law punitive damages system must be complimented by procedural safeguards that will ensure against excessive or otherwise inappropriate awards. We conclude that the Texas procedures for assessing and reviewing punitive damage awards, both at the trial and appellate levels, in some respects may not adequately ensure that such awards "are not grossly out of proportion to the severity of the offense and have some understandable relationship to compensatory damages."[21]
The Texas Supreme Court then explained that although evidence of a defendant's net worth is relevant and admissible in determining the amount of punitive damages, such evidence highlights the relative wealth of a defendant and "has a very real potential for *prejudicing the jury's determination* of other disputed issues in a tort case."[22] In view of this potential for prejudice, the Texas Supreme Court then held:

> We therefore conclude that a trial court, if presented with a timely motion, should bifurcate the determination of the amount of punitive damages from the remaining issues. . . . If the jury answers the punitive damage liability question in the plaintiff's favor, the same jury is then presented evidence of defendant's net worth, plus any other evidence relevant only to the amount of punitive damages, and determines the proper amount of punitive damages, considering the totality of the evidence presented at both phases of trial.[23]

The Court noted that "at least thirteen states now require bifurcation of trials in which punitive damages are sought" and that ten of these thirteen states bifurcate the amount of punitive damages from the remaining issues in the case.[24] The Court elected to adopt this mode of bifurcation, holding that "*[b]ifurcating only the amount of punitive damages* therefore *eliminates the most serious risk of prejudice,* while minimizing the confusion and inefficiency that can result from a bifurcated trial."[25]

The Court concluded its analysis of the bifurcation requirement by defining the issue which necessitated bifurcation as follows:

> The issue in this Court is not whether *bifurcation of punitive damage claims* is constitutionally required, but whether our system of imposing punitive damages, on the whole, provides adequate procedural safeguards to protect against awards that are grossly excessive.[26]

Thus, the Texas Supreme Court's repeated emphasis on preventing prejudice and grossly excessive damage awards provides an ample basis for advocating that this ostensibly procedural requirement is inherently substantive.

***233** *B. The Controlling Legal Test for Applying the Bifurcation Requirement to Federal Courts*

For the purposes of this paper, it is assumed that this issue will most frequently arise in federal district courts within the Fifth Circuit, although it may arise outside the Fifth Circuit. The Fifth Circuit has addressed a very similar bifurcation issue arising under Texas law in *Rosales v. Honda Motor Co.*[27] The Fifth Circuit in *Rosales* defined the issue before it as follows:

> The question to be decided is whether, in a diversity case, a federal district court is authorized within its discretion under Fed. R. Civ. P. 42(b) to order a bifurcated trial on the issues of liability and damages, despite an alleged state-law policy applicable in state courts that in personal injury cases the issues are so intertwined that such bifurcated trials are impermissible.[28]

The state-law policy evaluated in *Rosales* was the holding of the Texas Supreme Court that due to considerations "of long standing policy and practice in this state," the Texas procedural rule that was then identical to Federal Rule 42(b)[29] did not, when properly interpreted, "authorize separate trials of liability and damage issues in personal injury litigation."[30]

The Fifth Circuit held that "when a Federal Rule is clearly applicable, *Erie* does not constitute 'the appropriate test of the validity and therefore the applicability of a Federal Rule of Civil Procedure.'"[31] In further reliance upon the Supreme Court's decision in *Hanna,* the Fifth Circuit stated that "the test is whether the Rule in question is within the scope of the Rules Enabling Act, 28 U.S.C. § 2072, and if so, within a constitutional grant of power."[32] The Fifth Circuit also noted that in *Hanna,* the Supreme Court had rejected the outcome determinative test "in favor of its own analysis that a Federal Rule of Civil Procedure legislatively and constitutionally authorized is controlling over state rules insofar as trial of diversity cases in federal courts is concerned."[33] This is particularly relevant to the punitive damages issue because the plaintiff, Rosales, had pointed out that studies show that defendants win a substantially greater portion of bifurcated trials.[34]

The Fifth Circuit then set out to determine whether the discretion granted to a federal court by Rule 42(b),[35] to permit a bifurcated trial, would "abridge, enlarge, or modify any substantive right,"[36] arising under Texas law, in violation of the Rules Enabling Act.[37] As a starting point in this analysis, the Fifth Circuit indicated that a rule may be primarily substantive rather than procedural if it meets either of the following two criteria:
1. it affects people's conduct at the stage of primary private activity;[38] or

***234** 2. it concerns a right granted for one or more nonprocedural reasons, for some purpose or purposes not having to do with fairness or efficiency of the litigation process.[39]

The Fifth Circuit's use of the above two criteria actually followed the recommendation of another legal scholar, Professor Wellborn, who argues that a "sufficiently inclusive definition of 'substantive' for purposes of the Enabling Act, therefore, must incorporate *both* the Ely formula and the Hart and Wechsler/Harlan approach."[40]

The Fifth Circuit concluded that the alleged prohibition on bifurcation failed to meet either of the above criteria and was, thus, not primarily substantive.[41] The Court explained:
Rather, at best, a rule *authorizing or prohibiting* a bifurcated trial of liability-damage issues falls "within the uncertain area between substance and procedure" and is "rationally capable of classification of either." In such circumstances, *Hanna v. Plumer* teaches, the state's characterization of its own rule as substantive rather than procedural, must nevertheless yield to the strong presumptive validity of the properly promulgated federal procedural rule, which will be upheld as controlling the procedure in the federal court.[42]
One point of distinction between the rule evaluated in *Rosales* and the one promulgated in *Moriel* is that the latter "requires" bifurcation, rather than merely "authorizing" it. The real question is whether that is a distinction without a difference.

C. Applying the Rosales *Test to the Bifurcation Requirement of* Moriel

1. The Plaintiff's Argument--

For the purposes of this discussion, it is assumed that bifurcation decreases the probability of an excessive damage award and is, therefore, not desired by plaintiffs. Plaintiffs should argue that the *Rosales* decision is directly on point with the issue raised by *Moriel.* Plaintiffs should frame the issue in *Rosales* as follows: Does the discretion granted under Rule 42(b)[43] to bifurcate yield to a state law policy or procedure that would rob the federal courts of that discretion?

Plaintiffs should emphasize the language of *Rosales* that "a rule authorizing or prohibiting a bifurcated trial of liability-damage issues" must yield to the federal rules.[44] This argument, coupled with the fact that the Texas Supreme Court has labeled the bifurcation requirement as "procedural," should be very persuasive.

2. The Defendant's Argument--

The defendant will most likely be the movant in federal court seeking to persuade the court that bifurcation is either mandated or, at the very least, warranted under the discretion granted by Rule 42(b). In view of the superficial appeal and ease of comprehension of the arguments available to the plaintiff in opposition to a motion to bifurcate, the defendant's burden of persuasion will be substantial, regardless of the legal correctness of the defendant's position.

***235** The defendant's best shot may be to argue that the bifurcation requirement promulgated in *Moriel* is "primarily substantive" under the test proposed by Professor Ely and applied in *Rosales,* i.e., a rule is primarily substantive if it concerns

a right granted (1) for one or more nonprocedural reasons, and (2) for some purpose or purposes not having to do with the fairness or efficiency of the litigation process.[45]

The Texas Supreme Court articulated at least three nonprocedural reasons for the bifurcation requirement: (1) to prevent excessive punitive damage awards;[46] (2) to prevent the relative wealth of a defendant from prejudicing decisions regarding liability and compensatory damage issues in a tort case;[47] and (3) to enhance predictability ameliorating the potential arbitrariness in the current Texas system.[48] Thus, the bifurcation requirement of *Moriel* easily meets the first component of the Ely test.

The second component of the Ely test is much harder to meet. Of the three rationales for imposing the bifurcation requirement, the first two, preventing excessive damage awards and preventing prejudice, have to do with "fairness." These two rationales fail to meet the second component of the Ely test; however, the third rationale for the bifurcation requirement, "predictability," does have to do with something other than fairness.

Predictability is extremely important to parties engaged in the business of risk assessment. Such parties include insurance carriers. Unpredictable, excessive punitive damage awards may impact the price and availability of insurance coverage. The social and economic implications of that impact extend well beyond the issue of "fairness" to litigants in a particular case.

Thus, a defendant should argue that the bifurcation requirement imposed in *Moriel* is primarily substantive under Professor Ely's test. Accordingly, Rule 42(b) cannot be interpreted to provide a federal court with the discretion to refuse bifurcation because that discretion would modify a substantive right in violation of the Rules Enabling Act.[49] Such a rule is therefore not legislatively authorized.

In this case, the *Erie* doctrine constitutes the appropriate test for determining whether the state procedure must be adopted. The twin aims of *Erie* are: (1) discouragement of forum shopping, and (2) avoidance of inequitable administration of the laws.[50] Assuming all other factors are equal, mandatory bifurcation in the state courts, but not in federal courts, would encourage plaintiffs to file suit in federal courts.[51] The Texas Supreme Court's recognition of the potential for prejudice and excessive damage awards resulting from an unbifurcated trial establishes that an inequitable administration of the laws would result if federal courts could refuse bifurcation when bifurcation is mandated in Texas state courts. Thus, federal courts must adopt the bifurcation procedure in order to satisfy the objectives of *Erie.*

D. The Impact of the Moriel *Case on Rule 42(b) Motions*

Even if a particular federal court takes the position that the bifurcation requirement promulgated in *Moriel* is not primarily substantive and must, therefore, yield to the discretion granted in Rule 42(b), all is not lost for the defendant seeking bifurcation.

As a fall-back position, the defendant should argue that the federal court should exercise its discretion to bifurcate the punitive damage issue because such bifurcation will "avoid prejudice," as explained by the Texas Supreme Court in *Moriel.* The repeated references to the avoidance of prejudice ***236** in the *Moriel* decision provide a persuasive basis for arguing that bifurcation will avoid prejudice and is, therefore, appropriate under Rule 42(b).

V. Conclusion

Unlike punitive damage trials in Texas state courts, the intellectual property bar in Texas tends to be unbifurcated. Thus, many intellectual property litigators will find themselves on different sides of this issue at various points in their career. Until there is a more definitive ruling from a federal appellate court, it appears that practitioners may take either side of the bifurcation/*Erie* doctrine question in good faith under Rule 11, Federal Rules of Civil Procedure. It is, however, the view of the author that the bifurcation requirement promulgated in the *Moriel* case is primarily substantive and must therefore be followed by federal courts.

On a broader scale, *Moriel* illustrates an on-going shift in the jurisprudence of the Texas Supreme Court.[52] The ballad of the Texas tort lawyer may most aptly be sung with the words of Bob Dylan -- "*The Times, They Are A Changin'*."

Footnotes

d1 (c) 1994.

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1 This subject is so controversial that there is even a dispute over the proper rodeo classification for punitive damages. Plaintiffs' attorneys refer to it as a "bronco," while defense attorneys simply refer to it as "bull."

2 37 TEX. SUP. CT. J. 450, 466 (1994).

3 Erie R.R. v. Tompkins, 304 U.S. 64 (1938); Hanna v. Plumer, 380 U.S. 460 (1965). The *Erie* doctrine may be thought of as the gate through the high barbed wire fence that separates the federal ranch from the state ranch, thereby allowing state law herds to roam on federal lands.

4 *Moriel,* 37 TEX. SUP. CT. J. at 452.

5 *Id.*

6 *Id.*

7 *Id.*

8 616 S.W.2d 911 (Tex. 1981).

9 *Moriel,* 37 TEX. SUP. CT. J. at 450.

10 *Id.* at 450-51.

11 *Id.* at 458. Several pages of the *Moriel* decision are devoted to the court's clarification of gross negligence. That clarification is beyond the scope of this paper; however, it is recommended reading for any counsel prosecuting or defending a claim for punitive damages.

12 *Id.* at 461.

13 *Id.*

14 *Id.* at 462.

15 *Id.*

16 28 U.S.C. § 2072 (1988).

17 113 S. Ct. 2711 (1993).

[18] 499 U.S. 1 (1991).

[19] *Moriel,* 37 TEX. SUP. CT. J. at 464.

[20] *Id.*

[21] *Id.* at 464-65 (quoting *Haslip,* 499 U.S. at 22).

[22] *Moriel,* 37 TEX. SUP. CT. J. at 465 (emphasis added).

[23] *Id.*

[24] *Id.* at 465-66.

[25] *Id.* at 466 (emphasis added).

[26] *Id.* (emphasis in original).

[27] 726 F.2d 259 (5th Cir. 1984).

[28] *Rosales,* 726 F.2d at 260.

[29] FED. R. CIV. P. 42(b) provides:
(b) *Separate Trials.* The court, in furtherance of convenience or to avoid prejudice, or when separate trials will be conducive to expedition and economy, may order a separate trial of any claim, cross-claim, counterclaim, or third-party claim, or of any separate issue or of any number of claims, cross-claims, counterclaims, third-party claims, or issues, always preserving inviolate the right of trial by jury as declared by the Seventh Amendment to the Constitution or as given by a statute of the United States. *Id.*

[30] *Rosales,* 726 F.2d at 261 (quoting Iley v. Hughes, 311 S.W.2d 648, 651 (Tex. 1958)).

[31] *Rosales,* 726 F.2d at 260-61 (citing *Hanna,* 380 U.S. at 469-70).

[32] *Rosales,* 726 F.2d at 261.

[33] *Id.* at 261-62.

[34] *Id.* at 261.

[35] FED. R. CIV. P.

[36] *Rosales,* 726 F.2d at 262.

[37] 28 U.S.C. § 2072 (1988).

[38] HENRY M. HART, JR. & HERBERT WECHSLER, THE FEDERAL COURTS AND THE FEDERAL SYSTEM 678 (1953); 19 CHARLES A. WRIGHT ET AL, FEDERAL PRACTICE AND PROCEDURE § 4509 at 144 (1982).

[39] John H. Ely, *The Irrepressible Myth of Erie,* 87 HARV. L. REV. 693, 724-25 (1974); WRIGHT ET AL, *supra,* at 145.

[40] Olin C. Wellborn, III, *The Federal Rules of Evidence and the Application of State Law in the Federal Courts,* 55 TEX. L. REV., 371, 403-04 (1977); WRIGHT ET AL, *supra,* at 145 n.26.

[41] *Rosales,* 726 F.2d at 262.

[42] *Id.* (quoting *Hanna,* 380 U.S. at 472) (emphasis added).

[43] FED. R. CIV. P. 42(b).

[44] *Rosales,* 762 F.2d at 262.

[45] *Rosales,* 726 F.2d at 262.

[46] *Moriel,* 37 TEX. SUP. CT. J. at 466.

[47] *Id.* at 465.

[48] *Id.*

[49] 28 U.S.C. § 2072 (1988).

[50] *Hanna,* 380 U.S. at 468.

[51] Tort practitioners will appreciate a certain irony in this scenario.

[52] This shift is not without internal dissension on the Texas Supreme Court. In a "concurring" opinion, Justices Doggett and Gammage observe, "this majority never met an insurance company it didn't like." 37 TEX. SUP. CT. J. at 469.