Insurance Bad Faith: What Are We Facing? and How Can We Avoid It?

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The attached written materials for the Defense Research Institute's teleconference: "Bad Faith: What are We Facing and How Can We Avoid It?" include: (1) a paper on the tactical and practical guidance provided by the Supreme Court's decision in ***State Farm Mut. Automobile Ins. Co. v. Campbell*** and the cases that have applied, followed, and distinguished it over the past two years; (2) an outline for evaluating and developing a strategically sound defense to a bad faith claim; and (3) an outline of the claim handling behaviors that contribute to the success or failure of the bad faith case against insurers.

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State Farm Mut. Automobile Ins. Co. v. Campbell: As a Practical Matter, What Instruction Does it Provide to Counsel?

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As two years have passed since the Supreme Court issued its decision in *State Farm Mut. Automobile Ins. Co. v. Campbell*, it is worthwhile for defense counsel and their clients to reassess this decision and ensuing cases which rely upon *Campbell.* As discussed below, *Campbell* and its progeny reinforce a number of practical considerations that shape the outcome of bad faith cases.

While at first glance, *Campbell* may have appeared to be a major victory for the defense bar, the victory has clearly been tempered by the Supreme Court's October 4, 2004 Order denying State Farm Mutual Automobile Insurance Co.'s petition for a writ of *certiorari*. The Supreme Court refused to review the Utah Supreme Court's $9 million award issued after remand. Moreover, subsequent decisions relating to a number of raised in the April 2003 *Campbell* decision demonstrate that it should not be viewed a ringing win for the defense bar.

In *Campbell*, the underlying claim involved a motor vehicle accident that killed one person and rendered another permanently disabled. "A consensus was reached early on by the investigators and witnesses that [the insured] Campbell's unsafe pass had indeed caused the crash . . . Nonetheless, [State Farm] decided to contest liability and declined offers . . . to settle the claims for the policy limit of $50,000 ($25,000 per claimant)." That this claim did not ultimately cost State Farm more than $145 million, but will *only* cost it $9 million plus an untold cost in terms of attorneys' fees, bad press, anxiety on the part of the corporate directors, officers and other individuals involved, cannot fairly be characterized as a ringing victory.

When it was decided last year, the prudent practitioner recognized that *Campbell* does not support the proposition that a double-digit or even a triple-digit multiple of compensatory damages is a *per se* violation of the due process clause of the Fourteenth Amendment. In denying State Farm's petition for *certiorari* on the judgment determined on remand, the Supreme Court reaffirmed that it is "reluctant to identify concrete constitutional limits on the ratio between harm, or potential harm, to the plaintiff and the punitive damages award . . . [though] single-digit multipliers are more likely to comport with due process . . . than awards with ratios in the range of 500 to 1 [citing *Gore*] or, in this case, 145 to 1."

Viewing it objectively, the *Campbell* decision reinforces the fundamental consideration in assessing and developing a defense in any bad faith claim: bad facts will make bad law. The Court observed that "the precise award in any case must be based on the facts and circumstances of the defendant's conduct and the harm to the plaintiff," and suggested that when the compensatory damages are relatively small, a higher ratio may be necessary. As reflected in the post-*Campbell* cases discussed below, defendants still

face vast exposure to punitive damages in smaller cases. In one case a nominal damage award of $1 was found to support in a punitive damage of $10,000.

In addition to this "big picture" lesson, *Campbell* reinforces the conclusion that paying an excess verdict after the fact will not necessarily insulate an insurer from punitive damages or other extra-contractual damages. *Cf., Birth Center v. St. Paul Companies, Inc.* 787 A.2d 376 (Pa. 2001) (although insurer paid full amount of excess judgment, court held insured could recover consequential damages for other losses claimed to be caused by insurer's failure to settle underlying claim). In *Campbell*, State Farm ultimately paid the $50,000 in coverage and the excess liability of $135,849. It still has to pay the $1 million in compensatory bad faith damages, the punitive damages that will be determined by the trial court and twenty years of post-judgment interest.

Another practical point should be gleaned from the Supreme Court's decision's emphasis of the "reprehensibility" factor and its explicit rejection of the argument that the wealth of a defendant can justify a huge punitive damage award. As practitioners, in defending claims for punitive damages, attorneys not only fight vigorously to oppose the discovery of financial information, they object to its introduction as evidence to support a punitive damage award. Based on the *Campbell* court's holding on this point, these motions for protective orders and motions *in limine* should now be more readily granted.

Similarly, and as importantly, the *Campbell* decision makes it clear that evidence of the "perceived deficiencies of [State Farm's] operations throughout the country" cannot be "used a platform to expose and punish" State Farm. Accordingly, the decision may be relied upon to oppose discovery into the nation-wide operations of a defendant and to preclude the introduction of "dissimilar and out-of-state conduct evidence."

Finally, the prudent practitioner will recognize that *Campbell* does not support the proposition that a double-digit or even a triple-digit multiple of compensatory damages is a *per se* violation of the due process clause of the Fourteenth Amendment. The Court reaffirmed that it is "reluctant to identify concrete constitutional limits on the ratio between harm, or potential harm, to the plaintiff and the punitive damages award," while noting that "single-digit multipliers are more likely to comport with due process . . . than awards with ratios in the range of 500 to 1 [citing *Gore*] or, in this case, 145 to 1." However, it also noted that "the precise award in any case must be based on the facts and circumstances of the defendant's conduct and the harm to the plaintiff," and suggested that when the compensatory damages are relatively small, a higher ratio may be necessary.

The cases discussed below reflect some of the anticipated and unanticipated ways in which the *Campbell* decision has affected the development of the law and practice in the context of bad faith claims. In particular, to the chagrin of insurers and their counsel, many courts have relied upon the *Campbell* Court's proposition that a double-digit or even a triple-digit multiple of compensatory damages is not a *per se* violation of the due process clause of the Fourteenth Amendment to maintain the trend of highly disproportionate punitive damage awards.

CONSIDERING DEFENDANT'S WEALTH IN DETERMINING THE PUNITIVE DAMAGES AWARD

District of Columbia

In Daka, Inc. v. McCrae, the District of Columbia Court of Appeals failed to follow the *Campbell* decision regarding the relevancy of a defendant's wealth in punitive damages. 839 A.2d 682 (2003). Here, the question at issue was whether the defendant, by placing in evidence his financial statements, raised his wealth as an issue. Id. at 695. The Daka court not only ignored *Campbell*'s directive that the defendant's net wealth should have no bearing on how large a punitive damage award can be granted, but instead, analyzed the defendant's net wealth issue in terms of whether the plantiff was entitled to the benefit of the information regarding the defendant's net worth where the plaintiff has failed to put that issue in evidence. Id.

Indiana

Despite the *Campbell* proposition that the defendant's wealth should not be considered in awarding punitive damages, the Stroud v. Lints court disagreed. 790 N.E.2d 440 (2003). Here, the court noted that if punitive damages are appropriate, the wealth of the defendant is relevant to a determination of the appropriate amount. Id. at 445. While conceding the *Campbell* notion that defendant's wealth cannot justify an otherwise unconstitutional punitive damages award, factoring in defendant's wealth in a punitive award is consistent with the goal of deterrence. Id. at 446. The court noted, however, that the "door swings both ways": an award that not only hurts but permanently cripples the defendant goes too far, and the "perpetual inability to get the financial burden of a judgment off his back leaves a defendant with few alternatives." Id. Accordingly, the Stroud court modified the award of punitive damages to a lesser amount. Id. at 447.

New York

Contrary to *Campbell*'s suggestion that the wealth of a defendant should not justify a huge punitive damage, the court in TVT Records v. Island Def Jam Music Group explicitly noted that the *Campbell* decision "cannot be reasonably understood to preclude evidence of a defendant's net worth." 257 F.Supp.2d 737, 745 (SDNY 2003). Here, the court admitted in evidence defendant's net worth, emphasizing that net worth is properly considered given the goals of punishment and deterrence served by punitive damages. Id.

CONSIDERING DEFENDANT'S NATIONWIDE OPERATIONS

Pennsylvania

In Saldi v. Paul Revere Life Ins. Co., the court departed from what would seem a logical consequence of the *Campbell* decision: that motions for protective orders and motions in limine would be more readily granted. 2004 U.S. Dist. Lexis 16318 (E.D. PA 2004). Here, the plaintiff insured sued defendant insurers alleging that termination of his long-term disability benefits was unreasonable and in bad faith. Id. at 3-4. The Saldi court expressly rejected the possibility of limiting discovery in bad faith insurance cases of the defendant's business practices, procedures, and policies including number of documents obtained through similar litigation against the defendants which allegedly were evidence of defendants' bad faith policies regarding the same type of insurance policies as the plaintiff's. Id. Even though the defendants argued that such broad-based discovery is prohibited by the *Campbell* decision, the court here held that the plaintiff was entitled to discover and ultimately present such evidence. Id. at 19. More specifically, the court emphasized that "evidence of the lawful out-of-state conduct of the defendant may be probative when it demonstrates the deliberateness and culpability of the defendant's action in the state where it is tortious..." Id. Accordingly, the plaintiff insured's requests for information about the defendant insurer's policies were granted. Id. at 25.

PUNITIVE DAMAGE AWARDS EXCEEDING COMPENSATORY AWARDS BY MORE THAN TENFOLD.

Utah

On October 4, 2004, the U.S. Supreme Court denied State Farm's petition for review and rejected State Farm's argument that the Utah Supreme Court's recalculation of punitive damages from $145 million to $9 million contradicted the guidelines it set forth in its original opinion. State Farm Mutual Automobile Insurance Co. v. Campbell, No. 04-116, U.S. Supreme Court. The Utah Supreme Court held: "[w]hen considered in light of all of the *Gore* reprehensibility factors, we conclude that a 9-to-1 ratio between compensatory and punitive damages, yielding a $9,018,780.75 punitive damages award, serves Utah's legitimate goals of deterrence and retribution within the limits of due process." Campbell v. State Farm Mutual Automobile Insurance Co., Utah S. Ct. No. 981564 (April 23, 2004) (2004 WL 869188)

In its April 23, 2004, the Utah court noted that it could not use deterrence as a justification for punitive damages based on similar conduct by State Farm toward other insureds. Nevertheless, it stated: "[w]e can, however, find ample grounds to defend an award of punitive damages in the upper range permitted by due process based on our concern that State Farm's defiance strongly suggests that it will not hesitate to treat its Utah insureds with the callousness that marked its treatment of the Campbells." The court concluded that State Farm's conduct is "a candidate for the imposition of punitive damages in excess of a 10-to-1 ratio to compensatory damages."

Idaho

The Idaho Supreme Court, in a case it considered especially egregious, has applied *Campbell* in a quasi-bad faith context, ultimately concluding that a jury's punitive damages award of $300,000 was not unconstitutionally excessive, despite the fact that the plaintiff was only awarded $735.00 in nominal damages and $2,171.85 in costs. In *Myers v. Workmen's Auto Ins. Co.*, 2004 Ida. LEXIS 156 (July 23, 2004), plaintiff was in an automobile accident and was first sued by the other driver's insurance carrier to recover first-party medical benefits paid on her behalf and was subsequently sued by the other driver herself to recover damages sustained in the accident. The carrier received notification of the first complaint but failed to tender any defense, and a default judgment of $5,755.60 was entered against the insured. When the second suit was filed, Workmen's Auto did tender a defense, some two months later, but ignored repeated requests by counsel even to negotiate payment of the first default judgment, leading that counsel to successfully move to have the insured's driving privileges revoked and to file a complaint against Workmen's Auto with the Idaho Department of Insurance. Workmen's Auto responded to the Insurance Department with a letter that misrepresented when it had actually learned of the underlying suit and essentially admitted to a policy of not settling a claim when another claim relating to the same incident had not been presented for settlement.

Plaintiff insured eventually filed suit against Workmen's Auto, alleging breach of contract and bad faith, although the latter claim was dismissed by the plaintiff prior to trial. However, plaintiff successfully moved to amend her complaint to add a prayer for relief for punitive damages, conditioned on her ability to present sufficient evidence at trial to warrant a jury instruction on the issue. After presenting expert testimony about the impropriety of defendant's claim handling, both in the instant case and as a company-wide practice, the jury returned the $300,000 punitive damages award, a multiplier ratio of 408:1 compared to the $735 nominal damages award and 103:1 compared to the $2,171.85 that was nominal damages plus costs.

In affirming the judgment, the Idaho Supreme Court was not receptive to defendant's argument that the plaintiff had dismissed the bad faith cause of action because it was more difficult to prove than a more generalized claim of punitive damages, holding that Workmen's Auto's actions supported a finding that punitive damages were warranted based on the breach of contract cause of action alone. Declining to describe the relationship between punitive damages and other damages as determinative on the issue of whether or not they were excessive, the Court instead looked to "an overall appraisal of the circumstances of the case."

The Court recognized and applied the three guideposts, articulated in *BMW v. Gore* and reiterated in *Campbell*, in the context of whether or not the punitive damages award violated due process. Supporting Workmen's Auto's argument that they were constitutionally excessive, the Court noted the fact that the harm posed was economic rather than physical. However, the Court also noted (1) that the $300,000 award was but 1% of Workmen's total worth, (2) Idaho's interest in protecting its insureds from sharp practices, (3) the financial vulnerability of the insured in this case, and (4) the patent

refusal of Workmen's Auto to concede that any of its conduct may have violated industry norms. Although the Court never explicitly computed the 408:1 or 103:1 ratios of compensatory to punitive damages, it stated such ratios "are of no real assistance in this case where only nominal damages are sought," and the Court affirmed the award of punitive damages.

Second Circuit

The Local Union No. 38, Sheet Metal Workers' Int'l Ass'n v. Pelella court, in upholding a judgment awarding the plaintiff $1 in nominal damages and $25,000 in punitive damages arising from a union dispute, noted that even a 25,000-to-1 ratio in damages would not violate the Due Process Clause where damages are nominal in nature. 350 F.3d 73, 88-89 (2d Cir. 2003). The court explained that where compensatory damages are nominal, a "much higher ratio can be contemplated while maintaining normal respiration" so that it can be deemed consistent with constitutional constraints. Id.

Third Circuit

In Tate v. Dragovich, a prison inmate's First Amendment rights were violated when a prison unit manager prevented the inmate from effectively using the prison grievance system. 2003 U.S. Dist. Lexis 14353 (E.D. Pa. 2003). The inmate was barred from recovering compensatory damages for his emotional and psychological injuries under the Prison Litigation Reform Act. Id. at 28. Nevertheless, the jury awarded the inmate $1 in nominal damages and $10,000 in punitive damages. Id. The Tate court rejected the defendant's argument that the punitive award should be dismissed as being excessive when considered in relation to the amount of non-punitive damages. Id. Instead, it stated that the primary concern in this analysis should be for "reasonableness," and that the punitive damage award here was reasonable and necessary in deterring future unlawful conduct by the prison unit manager. Id. at 30. In doing so, the court relied on the part of *Campbell* decision which stated "[r]atios greater than those we have previously upheld may comport with due process where a particular egregious act has resulted in only a small amount of economic damages." Id. at 29 (citing State Farm Mut. Auto. Ins. Co. v. Campbell, 538 U.S. 408, 425 (2003)).

Likewise, in Willow Inn, Inc. v. Public Serv. Mut. Ins. Co., the court awarded an insured restaurant owner $150,000 in punitive damages where compensatory damages amounted to only $2,000. 2003 U.S. Dist. Lexis 9558 (E.D.Pa. 2003). Here, the restaurant owner promptly undertook efforts to recover insurance proceeds under its insurance policy with the insurer when his restaurant, which also served as his residence, was significantly damaged by a windstorm. Id. at 1-2. The court granted the insured punitive damages because the insurer failed to provide the insurance proceeds to the insured until more than two years after the date of the windstorm. Id. at 3-4. The 75-to-1 ratio in damages was appropriate and complied with due process in light of the insurer's outrageous conduct: the insurer purposefully and unreasonably refused to act on the insured's claim at a time when the need for obtaining the insurance proceeds was particularly pressing. Id. at 6.

Sixth Circuit

The court in Dunn v. Put-In-Bay, Ohio found a 15-to-1 ratio between compensatory damage and punitive damage awards constitutional. 2004 U.S. Dist. Lexis 882 (N.D. Ohio, 2004). Here, an arrestee brought an excessive force case against the police officers of Put-In-Bay, Ohio, for spraying him with pepper spray after he was already handcuffed, fully subdued, and cooperative. Id. at 3. The jury returned a verdict against one of the police officers in $1,577.50 in compensatory damages and $23,422.50 in punitive damages. Id. at 1. Noting the *Campbell* decision, the Dunn court stated that there is "no bright line rule that makes any award of punitive damages that exceeds a single digit ratio to compensatory damages unacceptable." Id. at 5. The use of pepper spray under the circumstances was "particularly egregious," and thus the amount of the punitive damage award was not excessive under the Due Process Clause. Id. at 7.

Seventh Circuit

The court in Matthias v. Accor Econ. Lodging, Inc. granted hotel guests $186,000 in punitive damages though only $5,000 in compensatory damages resulted. 347 F.3d 672 (7th Cir. 2003). These hotel guests were attacked by bedbugs that resulted from the hotel owner's willful and wanton failure to warn or eliminate its bedbug problems. Id. at 673. In justifying the amount of the punitive damages, the Matthias court noted that the *Campbell* case did not lay down a single-digit-ratio rule but rather that it merely said "there is a presumption against an award that has a 145-to-1 ratio." Id. at 676 (citing Campbell at 425). Instead, the "punishment should fit the crime" in the sense of being proportional to the wrongfulness of the defendant's action. Id. Here, the hotel owner deliberately exposed its hotel guests to the health risks created by insect infestations by instructing its desk clerks to hide the bedbug problem and renting rooms that were designated as unfit to rent. Id. at 675. The defendant's act was outrageous and may well have profited from its misconduct of concealing the bedbug infestation and continuing to rent rooms; in comparison, compensable harm was slight. Id. at 677. The award of punitive damages served the additional purpose of limiting the defendant's ability to profit from its fraud, rendering the 37-to-1 ratio in punitive and compensatory damages appropriate. Id. at 678.

Connecticut

In Hadelman v. DeLuca, the defendant franchiser challenged $150,000 in punitive damages issued against him in an action where he intentionally made misrepresentations about the franchisees that prevented their candidacies as the Board of Directors. 2003 Conn. Super. Lexis 1748, 2 (June 2003). The defendant argued that an award of $150,000 in punitive damages violated the due process clause of the fourteenth amendment that prohibits grossly excessive punitive damages, because no compensatory damages were awarded. Id. In assessing the appropriateness of the punitive damages award, the Hadelman court relied on the *Campbell* factors of reprehensibility of the person's conduct, the disparity between the harm suffered and the punitive damages awarded, and the difference between the punitive damages awarded and the civil

penalties authorized. Id. at 10. The court found that the defendants engaged in willful malicious misconduct, and despite the fact that the compensatory damages award was $0, the punitive damages of $150,000 was appropriate under *Campbell*: "[t]he principles set forth in . . . *Campbell* establish that the inquiry as to whether an award of punitive damages is reasonable does not end with a comparison of the ratio between the amount of compensatory damages and the amount of punitive damages. Courts must look to the nature of the harm suffered by the plaintiff at the hands of the defendant and determine whether the award of punitive damages was reasonable. As the [*Campbell* court] recognized, this is so because some types of harm are not readily susceptible to monetary qualification. Id. at 14-15. Hence, the court rejected the defendants' argument that the ratio was excessive and a per se a violation of due process. Id. at 18.

Georgia

In Craig v. Holsey, the court upheld an award of $8,801 in compensatory damages and $200,000 in punitive damages, where the defendant caused a car accident while driving under the influence of drugs and alcohol. 590 S.E.2d 742 (Ga. 2003). The court justified the 22-to-1 ratio in compensatory and punitive damages by noting that the *Campbell* decision required that the court consider whether "the harm caused was physical as opposed to economic; the tortious conduct evinced an indifference to or a reckless disregard of the health or safety of others; the target of the conduct had financial vulnerability; the conduct involved repeated actions or was an isolated incident; and the harm was the result of intentional malice, trickery, or deceit, or mere accident." Id. (citing Campbell, 538 U.S. at 419). Noting that the defendant here caused physical harm, acted in reckless disregard of others' safety by driving after drinking and using drugs, and has driven repeatedly after drinking or smoking marijuana, the court held that the $200,000 punitive damage award did not violate the Due Process Clause of the Fourteenth Amendment. Id. at 748.

Pennsylvania

The court in Hollock v. Erie Ins. Exch. was more modest in its award of punitive damages: here, an insured recovered compensatory damages of $278,825 and punitive damages of $2,800,000 from its insurance company for bad faith. 842 A.2d 409, 413 (Pa.Super.Ct. 2004). In this case, the insured, Hollock, carried an automobile insurance policy issued by Erie Insurance Exchange. Id. at 412. When Hollock was struck from behind and injured by a third-party driver, he sought compensation from Erie. Id. In handling Hollock's insurance claim, Erie misrepresented the amount of Hollock's coverage, established an arbitrary reserve with "absolutely no relationship" to available loss documentation, discounted Hollock's projected wage loss projections without supporting medical evidence, refused to contact Hollock's employer to determine the extent of her inability to complete assigned tasks, and refused to pay her claim for UIM benefits although it had previously accepted and paid her first-party claims arising from the same accident. Id. at 419. The Hollock court found that Erie displayed "deliberate indifference and . . . blatant dishonesty" in dealing with Hollock's insurance claims, and relied on the *Campbell* decision to justify the 100-to-1 ratio in punitive and compensatory

damages. The court relied on the fact that the *Campbell* decision reiterated that the "most important indicium of reasonableness of punitive damages award is the degree of reprehensibility of the defendant's conduct" and found Erie's affirmative acts of misconduct and concealment of its improper motive "outrageous." Id. at 421. The court then went on to *Campbell's* second guidepost: the disparity between actual or potential harm suffered by the plaintiff and the punitive damage award. Id. In doing so, it noted that the United States Supreme Court has expressly rejected the assertion that a punitive damages award must bear a certain proportionality to the amount of compensatory damages in its *Campbell* opinion. Id. The court emphasized that the *Campbell* decision refused to set forth a "bright line" and that where a particularly egregious act results in only a small amount of economic damages, a greater ratio may be accepted. Id. Accordingly, the Hollock court held that where the compensatory award is small in spite of the defendant's egregious conduct, it may be appropriate to award a larger amount of punitive damages. Id.

The court next contemplated the appropriateness of the punitive damage award by comparing the disparity between the punitive damages award and the civil penalties authorized in comparable cases, as outlined in *Campbell.* Id. The Hollock court held that under the Unfair Insurance Practices Act, the Commissioner may impose a penalty of up to $5,000 for each of Erie's violations, and even suspend or revoke Erie's license. Id. In view of these potentially harsh penalties faced by Erie, the court found the punitive damages award justified and in compliance with due process. Id.

Wisconsin

In Trinity Evangelical Lutheran Church v. Tower Ins. Co., the Supreme Court of Wisconsin upheld an award of $3,500,000 in punitive damages when Tower Insurance (Towers), as a result of mistake, failed to provide automobile coverage that Trinity Evangelical Lutheran Church requested (Trinity). 661 N.W.2d 789 (2003). Trinity offered religious services and grade school to young children and sought to renew its automobile insurance coverage it carried for its teachers who transported students to functions. Id. at 791. Trinity explained to a Tower agent its need for hired and non-owned coverage, then accepted the insurance from Tower after receiving a quote. Id. After a teacher at Trinity, while transporting students from the school, collided with another vehicle, Trinity sought compensation from Tower under its insurance policy. Id. Trinity then learned of the fact that the Tower agent had inadvertently failed to include the requested form of coverage and that Tower was refusing to backdate the insurance coverage. Id. The court found that Tower acted with bad faith towards Trinity by failing to understand its obligation to provide the requested coverage where a mutual mistake had occurred and later refusing to backdate its insurance coverage. Id. at 794. The court relied on *Campbell* in deciding whether the award of punitive damage was excessive. Id. at 799. It noted that the reprehensibility of Tower's behavior was clear from the fact that Tower engaged in prohibited conduct while knowingly or recklessly disregarding the lack of a reasonable basis for denying the claim. Id. Additionally, the court explained that if it accepted the evidence Trinity, rather than Tower, presented in its estimate of potential damage in this case, the punitive damages award represented a 7:1 ratio of punitive

damages to compensatory damages. Id. at 803. This ratio, considered with the Wisconsin legislature which provides a criminal penalty, including a fine of up to $10,000 for any violation of "any insurance statute or rule of this state," supported the finding that the award of punitive damages was not excessive. Id. at 804.

OTHER INTERESTING WAYS IN WHICH COURTS HAVE RELIED ON CAMPBELL

Tenth Circuit

In a June 13, 2003 decision, a Federal Magistrate Judge, in one of the first cases to cite *Campbell*, relied on the case for the unexpected proposition that it was adequate for an insurance carrier to provide affidavits from its "apex" (i.e. top executive) employees, rather than submit them to depositions, at least where those affidavits stated that the senior employees had no personal knowledge of the events at issue. In *Evans v. Allstate Ins. Co.*, 216 F.R.D. 515, 519 (N.Dist. Okl. 2003), plaintiffs brought suit against their insurance carrier for, *inter alia*, breach of the implied duty of good faith and fair dealing, stemming from the failure to fully repair plaintiffs' house after a series of two independent fires. Plaintiffs argued that they had the need to depose the "apex" employees "to prove their theory that a pervasive practice of inadequate supervision over Allstate claims adjusters exists within the corporation" in support of an action for bad faith. In granting defendant employees a protective order prohibiting the depositions, the court stated that the previously taken depositions of all adjusters and supervisors directly involved in handling plaintiffs' claims was sufficient, and that "[t]his holding is in accord with . . . *State Farm Mutual Auto Ins. Co. v. Campbell.*" Few would have predicted that one of the first cases to apply *Campbell* would have done so on grounds not related to the central punitive damages issue.

Eighth Circuit

One United States District Court has used the single-digit ratio between compensatory and punitive damages posited by the Supreme Court to find a lack of an adequate amount of money in controversy to establish diversity jurisdiction. In *Adams v. Bank of America*, 317 F.Supp.2d 935 (S.Dist. Iowa, 2004), plaintiff homeowners obtained an insurance policy on their house, as required by the terms of their mortgage, but they incorrectly listed the mortgagee, defendant Bank of America, as the payer of the insurance premium. After a tortuous series of miscommunications, Bank of America ultimately learned that it had been paying the insurance premium and began passing the charge on to plaintiffs, who ignored that portion of their bill and remitted only the regular mortgage payments. Bank of America repeatedly returned the monthly payments as insufficient and eventually referred the matter to their legal department, which initiated foreclosure proceedings. Before the proceedings could conclude, however, plaintiff husband died of a heart attack, after which Bank of America moved to dismiss the foreclosure without prejudice.

The plaintiff wife filed suit in Iowa state court, alleging "bad faith breach of contract," wrongful death, and several violations of the federal Fair Debt Collection Practices Act. Bank of America successfully removed the case to federal district court,

based on the federal questions posed and a diversity of citizenship coupled with an amount greater that $75,000 in controversy. Soon, however, all the claims were dismissed except the bad faith breach of contract claim, and the court held a hearing on whether it should grant supplemental jurisdiction over that state-law claim or remand the case to Iowa state court.

Because Iowa's pleading system does not allow specified damages, plaintiff was only able to allege "damages in excess of $5,000," and as her only ascertainable damages were the costs incurred in defending the foreclosure action (not disclosed), under *Campbell*, the court concluded a trier of fact could not award her damages sufficient to reach the $75,000 jurisdictional threshold without violating due process and remanded the case to state court. Here, then, a court prospectively applied the "single-digit ratio" admonition from the Supreme Court at the procedural level to decline asserted federal jurisdiction.

California

California courts have so far dutifully applied the precepts embodied in *Campbell*, at least in the context of insurance bad faith punitive damage awards. However, all three cases have come from the Third Division of the Fourth District Court of Appeal, regarded by many as one of the most conservative in the state. The first response to *Campbell* came in an unpublished Court of Appeal decision in which the court affirmed an award of punitive damages but reduced the award from $5 million to $1 million atop a compensatory damages finding of $293,000. In *Taylor Woodrow Homes, Inc. v. Acceptance Insurance Companies, Inc.*, 2003 Cal. App. Unpub LEXIS 5208 (4th Dist. May 28, 2003), new homeowners suffered a major water leak due to a construction defect and notified the plaintiff homebuilder, Taylor Woodrow, who in turn notified the plumbing subcontractor, who had added Taylor Woodrow to its insurance policy. Based on verbal and written assurances made to the homeowners by the Acceptance that it would reimburse covered repair costs, Taylor Woodrow paid for the repairs. However, apparently after reviewing and extrapolating several recent California Supreme Court decisions (*Foster-Gardner, Inc. v. National Union Fire Ins. Co.*, 18 Cal. 4th 857 (1998) and *Certain Underwriters at Lloyd's of London v. Superior Court*, 24 Cal. 4th 945 (2001)), defendant later denied having any obligation to cover the costs of repair because the homeowners never actually filed an action in a court of law. At the trial for bad faith, the jury awarded $293,000 in compensatory damages and another $5 million in punitive damages.

While admonishing the defendant carrier for a strained and "rather self-serving distortion" of the case law, the Court of Appeal nevertheless found the 17:1 ratio between compensatory and punitive damages too high to affirm. While noting that the reprehensibility factor was high, the court recognized that the second guidepost, relationship between the harm threatened and the damages awarded, militated against a $5 million award, because Acceptance would have had to pay for a legal defense of Taylor Woodrow, regardless, had it not relied on Acceptance's initial position that it would reimburse the claim. In addressing the third factor, the court concluded that the most in civil fines to which Acceptance could have been subjected was a comparatively

small $55,000. Specifically citing *Campbell*, the court settled on a punitive damages award of $1 million, a somewhat smaller 3.4:1 ratio between compensatory and punitive damages than that awarded in *Campbell.*

The Court of Appeal's next attempt to reconcile *Campbell* with preexisting case law came in a case where causes of action for breach of contract, bad faith, and fraud were all proven, but the only punitive damages that were awarded were associated with the fraud claim. In *Diamond Woodworks, Inc. v. Argonaut Ins. Co.*, 109 Cal. App. 4th 1020 (4th Dist. 2003), an insured employee-leasing agency (BSC) assumed employment of all of plaintiff's employees, ostensibly providing them Workers' Compensation insurance under the agreement, and then "leased" them back to the plaintiff, a woodworking contractor. On the first day of his employ, a worker had four of his fingers severed in a woodcutting accident. Because plaintiff Diamond had not provided a completed employee information packet to BSC, as required by the terms of the contract but in actuality never enforced, BSC denied he was an employee. Based primarily on BSC's contention that the injured worker was not an employee, rather than a substantive, independent investigation, BSC's insurer Argonaut denied the Workers' Compensation claim, and when the injured worker sued Diamond for failure to obtain Workers' Compensation insurance, Argonaut denied the tender of defense. Eighteen months later, Argonaut negotiated a global settlement with the injured worker, and Diamond sued Argonaut for breach of contract, bad faith, and fraud.

After trial, the jury returned a verdict in Diamond's favor, awarding it $24,780.75, $229,209.30, and $424,100 for the breach of contract, bad faith, and fraud causes of action, respectively, and $14 million in punitive damages based on the finding of fraud. The trial court conditionally granted Argonaut's motion for a new trial unless Diamond accepted a remittitur of the fraud compensatory damages to $404,270 (based on a 7% rather than 10% rate of interest) and a reduction of the punitive damages to $5.5 million, which Diamond did accept.

On appeal, Argonaut argued that Diamond could not maintain an action for breach of an implied covenant of good faith and fair dealing without being a party to the insurance contract, which was issued to BSC, but the Court of Appeal quickly disposed of the argument by finding Diamond an intended third-party beneficiary, and the implied covenant ran to both BSC and Diamond.

On the fraud cause of action, the court found that BSC never actually required workers to complete the employee information packet before being allowed to work and earn pay and that the company rather cravenly asserted the position in an attempt to evade liability. Argonaut's ratification of this conduct and the fact that it permitted BSC to enter into legally binding insurance agreements on behalf of it rendered Argonaut a principal to BSC, liable for its fraud.

The Court of Appeal reduced the compensatory damages of the fraud claim by approximately $145,000, reversing Diamond's award for all of the fees and prejudgment interest it paid BSC, since BSC actually did perform the services it was contracted to on behalf of Diamond, bringing the damages down further to $258,570. In reviewing the $5.5 million punitive damages award, the court applied the three guideposts articulated by the United States Supreme Court, finding that Argonaut had engaged in reprehensible

conduct (first factor) but that there were no usefully analogous statutory sanctions (third factor).

On the second factor, the ratio of punitive damages to compensatory damages, the court faithfully adhered to the United States Supreme Court's language in *Campbell*, stating, "we have no doubt that anything exceeding a four-to-one [ratio] would not comport with due process under *Campbell*." Concluding that – absent either extremely high or low compensatory damages and conduct that is either exceptionally reprehensible or inconsequential – the "outer constitutional limit on the amount of punitive damages is approximately four times the amount of compensatory damages," the court fixed the punitive damages at $1 million, approximately 3.8 times that of the adjusted compensatory award of $258,570.

In the most recent case to apply Campbell to a punitive damages award in the insurance bad faith context, the Court of Appeal, as it did in *Diamond Woodworks*, followed the admonitions delivered by the Supreme Court in *Campbell*, reducing a punitive damages claim it had previously affirmed. The procedural history of *Textron Financial Corp. v. National Union Fire Ins. Co.*, 118 Cal. App. 4th 1061 (4th Dist. 2004) (time for Supreme Court grant of review extended to September 28, 2004) warrants a brief description. After an underlying trial on causes of action for breach of contract, breach of the covenant of good faith and fair dealing, and fraud, a jury returned a verdict of $165,414 in compensatory damages and $10 million in punitive damages, but the trial court remitted the latter award to $1.7 million. On appeal, the Court of Appeal affirmed the judgment in an unpublished opinion, but the United States Supreme Court granted certiorari, vacated the judgment, and remanded the case for review in consideration of *Cooper Industries, Inc. v. Leatherman Tool Group, Inc*, 532 U.S. 424 (2001).

On remand, the Court of Appeal reaffirmed the judgment in its entirety, but the United States Supreme Court again granted certiorari, vacated the second opinion, and remanded the matter again, this time for review in light of *Campbell*. Within this procedural landscape, the Court of Appeal revisited the issue of punitive damages.

The actions giving rise to the claim of bad faith, while convoluted, can be briefly summarized. Plaintiff Textron loaned money to a bus operator, acquiring a security interest in a particular bus that required that it be insured and that Textron be notified in advance of any cancellation of the policy. The policy terminated for a period of three days as the bus operator renegotiated the terms of the policy with the carrier, agreeing not to operate several buses, including the one in which Textron had a secured interest, in exchange for more favorable premium rates, but the bus was not actually deleted from the policy. Textron was not informed of the brief policy cancellation nor of its altered reformation.

Shortly thereafter, the bus in which Textron had an interest suffered extensive damage in a collision, but the insurance carrier's agent denied coverage, claiming that the bus had actually been deleted from the policy in its reformation, and the agent prepared a postdated policy endorsement that purported to reflect the deletion of the bus from the policy. In all correspondence in which the carrier's agent mailed the policy endorsement created after the accident, the date on which it was created was covered by a certificate of mailing, thus fraudulently making it appear to have been drafted prior to the accident.

In revisiting a punitive damages award for bad faith that it had twice already affirmed, the court took clear note of the import of *Campbell.* In applying the first "guidepost," the court found defendant's agents had engaged in reprehensible conduct through "deceit and trickery" and by continuing to deny the validity of the claim, but noted that the only harm was economic rather than physical and that Textron, as a solvent financial lending institution, could hardly be described as "financially vulnerable." In noting that the $1.7 million award was 10 times higher than the total compensatory damages award, the court held this number was too high under the second guidepost, the disparity between compensatory and punitive damages, and concluded such an award was an unconstitutional deprivation of due process.

Importantly, the court agreed with defendant, who argued that the only compensatory damages that could be considered in establishing a ratio were those attributable to defendant's tortious conduct: in this case the $89,744 recovered for bad faith and fraud and not the $75,670 recovered under the breach of contract cause of action. Thus, the court concluded by reducing the award of punitive damages to $360,000, an approximately 4:1 ratio of punitive to compensatory damages.

INSURANCE BAD FAITH: WHAT ARE WE FACING AND HOW CAN WE AVOID IT?

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I. CAUSES OF ACTION

A. Claim Handling Context

1. Inadequate investigation
2. Unfair claim settlement practices
3. Misconduct by claim handlers
4. Delay
5. Excess of limits verdicts in the third party context.

B. Extra-Contractual Liability Outside the Claim Handling Context.

1. Unfair Claim Practices Acts often delineate viable claims.
2. Misrepresentation and fraud.
3. Underwriting: cancellation, reducing or limiting coverage retro-premiums.
4. False advertising.
5. Intentional Torts
    a. Tortious interference with contract/business relationship.
    b. Intentional infliction of emotional distress.
    c. Defamation.
    d. Discrimination.
    e. Malicious prosecution, malicious or negligent defense (vicarious liability for defense counsel).
6. Negligent inspection.
7. Spoliation.