

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

ANTHONY R. ZELLE
Robinson & Cole LLP
One Boston Place
Boston, MA 02108
(617) 557-5939
tzelle@rc.com

DAINA E. KOJELIS
Zurich North America
1400 American Lane
Schaumburg, IL 60196
(847) 605-6030
daina.kojelis@zurichna.com

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.

The content of this presentation is the sole responsibility of the authors and may not represent the views or positions of Zurich American Insurance Company or any of its parent, subsidiary, related or affiliated entities, Robinson & Cole LLP, or its clients.

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

Anthony R. Zelle, Robinson & Cole LLP, tzelle@rc.com

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 plaintiff 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

