Developing Damages in Insurance Bad Faith Cases

By Scott Glovsky

To maximize damages in bad faith cases, it is crucial to develop your case from intake through trial. This article provides a general background to litigating bad faith cases with the goal of maximizing your clients' damages.

Pleading a Bad Faith Case

In *Davaloo v. State Farm Ins. Co.*, (2005) 135 Cal.App.4th 409 [37 Cal.Rptr.3d 528], the court emphasized that a plaintiff in a bad-faith action must plead specific facts sufficient to apprise an insurance company of the factual basis of the claim asserted against it. The court determined that the plaintiffs' initial bad-faith complaint was so devoid of factual allegations that plaintiffs' first amended complaint could not relate back to the initial complaint and, as a result, the action was time barred.

Plaintiffs must ensure that their complaints include sufficient factual specificity. Wherever possible, plaintiffs should attach their insurance policy (including the policy's declarations page) and all significant correspondence regarding the claim to the complaint. Of course, for strategic reasons plaintiffs may want to omit certain facts from the complaint.

In order to sufficiently plead a bad-faith cause of action generally, plaintiffs must plead that:

- they are in a contractual relationship with the insurance company or are an express beneficiary of an insurance policy;
- that benefits are due under the policy; and,
- that the insurance company's withholding of benefits is unreasonable. (*See, e.g., Progressive West Ins. Co. v. Yolo County Superior Court* (2005) 135 Cal.App.4th 263, 278 [37 Cal.Rptr.3d 434].)

But to recover punitive damages, a plaintiff must also plead facts that establish that the insurer's conduct was malicious, oppressive or fraudulent. "The same evidence is relevant both to the finding of bad faith and the imposition of punitive damages, but the conduct required to award punitive damages for the tortuous breach of contract ... is of a different dimension than that required to find bad faith" (*Shade Foods, Inc. v. Innovative Products Sales & Marketing, Inc*. (2000) 78 Cal.App.4th 847, 890 [3 Cal.Rptr.2d 364][internal quotations and brackets omitted].)

Developing the case in discovery

When creating a discovery plan, remember the plaintiffs' burden in the litigation. To win on bad faith and punitive damages, the plaintiff must establish that the insurer's conduct was not only unreasonable, but malicious, oppressive or fraudulent. This means that the plaintiff must prove that the insurer's conduct in withholding benefits was not simply an honest mistake and that the insurer failed to keep its policyholder's interests equal to its own interests. These goals should guide every step taken in the litigation.

Review the insurance policy to evaluate whether the claim was properly denied based on the language of the policy. If there is a coverage question or a dispute concerning the policy interpretation, seek discovery regarding all of the insurer's internal policies, procedures, and guidelines regarding the interpretation of the language at issue. And seek all of the insurer's other documents regarding the interpretation of the

language. The insurer may have documents establishing that it was on notice that the language was ambiguous before it denied the claim at issue. Plaintiffs should also obtain all of the past versions of the policy that were in effect before the relevant time period. If the insurer reduced the policy's coverage in the past, evaluate whether it provided sufficient notice of the reduction in coverage for the reduction to become effective. (Insurance Code § 678 governs the requirements for a notice of reductions in coverage.)

Obtain all documents relating to the insurer's adjustment of the claim. These documents are normally contained in the claim file. The claim file documents the insurer's handling of the claim. It should reflect everything that the insurer did to handle the claim. The claim file should identify all of the individuals who worked on the claim, should detail what investigation they performed, what decisions they made, and the basis for the decisions. Use the claim file to develop a detailed factual chronology of the insurer's handling of the claim.

When reviewing the claim file evaluate whether the insurer performed a thorough investigation of the claim, whether it objectively evaluated the claim, whether it looked for ways to find coverage, and whether it reasonably handled the claim. Also pay attention to what the insurer failed to do. Often, it helps to think of what a perfect investigation into the claim would have involved and then compare the perfect investigation with the insurer's actual investigation. As an aside, you should almost never settle a bad-faith case without reviewing the claim file. If an attorney defending a bad-faith claim wants to negotiate settlement before producing the claim file you can bet that the claim file contains helpful evidence.

Serve a request for production of the underwriting file. The underwriting file should reflect the insurer's activities in connection with the issuance of the policy and can establish what information the insurer knew at the time that it issued the policy. For example, where a property insurer rescinded a policy on the ground that the application failed to disclose that the property had a swimming pool, the insurer's rescission was undermined by the fact that its underwriting file contained a picture of the property that showed the swimming pool. Also obtain a copy of the application for insurance.

Seek discovery of all of the insurer's policies, procedures and guidelines regarding claims handling. Evaluate whether the insurer's handling of the claim at issue complied with its own guidelines. Its failure to do so can be strong evidence of bad faith. If it did adhere to its guidelines, but in doing so it nevertheless acted unreasonably, there could be evidence of systemic bad faith.

Ask for and examine the documents that the insurer used to train its adjusters to handle claims. These documents can help establish that the insurer systemically fails to train its adjusters to handle claims properly. Insurers often do not maintain these documents. If not, their absence may support an inference that there was no training, or that the materials contained information that the insurer did not want to become public.

Because strong trial themes in bad-faith cases include *promises and lies* and *trust and betrayal*, propound document requests for all of the insurer's advertising documents. These documents can be used to create a chart that compares the promises that the insurer made when it sold the policy to the insurer's actual conduct in handling the claim. All too often, the insurer's marketing department and its claims department seem to have never met.

Insurance companies frequently deny claims as a result of company-wide policies or practices that affect many policyholders. In order to determine whether an insurer's conduct towards your client is part of a pattern and practice of similar behavior towards other policyholders, it is crucial to serve *pattern and practice* discovery. California law has long recognized that similar acts of misconduct are relevant in insurance bad-faith actions. (*Colonial Life & Accident Ins. Co. v. Superior Court* (1982) 31 Cal.3d 785 [183 Cal.Rptr. 810]; Moore *v. American United Life Insurance Company* (1984) 150 Cal.App.3d 610 [197 Cal.Rptr. 878].) In *Mock v. Michigan Millers Mut. Ins. Co.* (1992) 4 Cal.App.4th 306 [5 Cal.Rtpr.2d 594], the court emphasized that pattern and practice evidence is crucial to establishing punitive damages against an insurer.

The United States Supreme Court's decision in *TXO Production Corp. v. Alliance Resources Corp.* (1993) 509 U.S. 443, 460-461 [113 S.Ct. 2711], provides an example of one way to obtain pattern and practice evidence. Although not an insurance bad-faith case, the court affirmed a punitive damage award in part because "TXO's pattern of behavior could potentially cause millions of dollars in damages to other victims." The court concluded that although the punitive damages award was large, "in light of … the bad faith of petitioner, *the fact that the scheme employed in this case was part of a larger pattern of fraud, trickery and deceit*, and petitioner's wealth, we are not persuaded that the award was" grossly excessive. (509 U.S. at 462, emphasis added.)

In the wake of *State Farm Mut. Auto. Ins. Co. v. Campbell, et. al.* (2003) 538 U.S. 408 [123 S.Ct. 1513], pattern and practice evidence is paramount in obtaining and keeping punitive damage awards. The Supreme Court in *Campbell* reaffirmed that the degree of *reprehensibility* of an insurer's conduct is the most crucial factor in evaluating a punitive damages award against an insurer. To consider reprehensibility, a court must consider factors including whether the conduct involved repeated actions or was an isolated incident, and whether the harm was the result of intentional malice, trickery, or deceit or simply an accident. Repeated misconduct is more reprehensible than a single instance of misconduct as "a recidivist may be punished more severely than a first offender."

Plaintiffs should also serve form interrogatories that define INCIDENT as the circumstances and events surrounding the insurer's investigation into the claim and denial of the claim at issue. Plaintiffs should check the boxes under the headings 3, 4, 6-9, 12, 13, 15.1, 17.1 (if requests for admission are also served), and 50. Plaintiffs should serve special interrogatories that ask the insurer to identify all policy provisions and facts that it used to deny the claim, all individuals that were involved in the handling of the claim, and all of its files that exist relating to the claim.

After obtaining all of the relevant documents, plaintiffs should depose the important adjusters who were involved in the handling of the claim. It is often helpful to first depose the insurer's "person most knowledgeable" about the handling of the claim. During the adjusters' depositions, review the training they received regarding claims handling and pin down exactly what they did to handle the claim. Ask whether they handled the claim consistent with the way that the company had instructed them to. To establish ratification for punitive damages, ask them if they have been criticized or reprimanded for anything that they did relating to the claim, and whether the company has changed the way it operates in any way as a result of the claim.

Plaintiffs should carefully consider whether to retain insurance experts to testify as expert witnesses regarding insurance industry practices and the insurer's handling of the claim. In *Neal v. Farmers Ins. Exch.* (1978) 21 Cal.3d 910, 924 [148 Cal.Rptr. 389, 396], the court suggested that expert witnesses can be helpful in bad-faith cases. But many bad-faith experts agree that if you need an expert to prove your bad-faith case you are in trouble. The type of bad faith that will make a jury angry enough to award punitive damages is usually apparent from the record alone, without an expert to explain to the jury why the conduct was unreasonable.

Creating evidence grids to prepare for trial

One of the most important steps in preparing for trial is building evidence grids. An evidence grid is a chart listing the elements of a cause of action or affirmative defense and the evidence that will support each element. Creating evidence grids forces you to critically examine what evidence you can use to establish each element of your case and strategize about the admissibility of each item of evidence. Moreover, it will enable you to intelligently structure the order of your witnesses to maximize the impact of your case on the jury. Draft evidence grids for each cause of action and affirmative defense in your case.

Developing themes

The trial of a bad faith case is about competing stories. The policyholder's attorney and the insurer's attorney present different stories to explain the facts of the case. Developing themes is an essential component of storytelling. Themes will provide a context through with the jurors can view and understand the case.

The most prevalent themes in bad faith cases include *trust and betrayal*. The policyholder trusted the insurer, faithfully paid his premiums, and then was betrayed by the insurer in his time of need. Buying insurance is very different than buying other products. When people purchase a cup of coffee at Starbucks they can smell it, taste it and drink it. When people buy a car they can immediately drive it. In contrast, people cannot test drive an insurance policy. Most people buy insurance with the hope that they will never need to use their insurance policy. They purchase health insurance with the hope that they will remain healthy and never need to rely on their health insurance. People purchase homeowners insurance with the hope that their home will not burn down. They purchase insurance to buy peace of mind. They place their trust in their insurers. People rely on the "the good hands people" and the company that "gets you back where you belong."

After trusting their insurer, did the insurer betray the policyholder or honor its obligations? In the policyholder's time of need did the insurer work for the policyholder to protect their interests or did it work against the policyholder? Did the insurer look for ways to find coverage and keep the policyholder's interests equal to the insurer's interests? Or did it take a myopic view of the claim and focus only on ways to deny the claim.

In addition to trust and betrayal, corporate greed is a common policyholder theme. Where policyholders can show that an insurer engaged in a pattern and practice of unreasonable conduct towards its claimants, jurors are more likely to find bad faith and award punitive damages. For example, in the context of homeowners' insurance, where

policyholders can establish that an insurer systemically instructed its adjusters to low ball claims the jurors will be more likely to enter a large bad faith award.

Along with corporate greed, bad faith cases often include a theme of *David v. Goliath*. Human nature favors the underdog. Where the policyholder is an individual or a small business, jurors generally feel more affinity with the policyholder than a large insurance company. This becomes more pronounced when the insurer has a team of defense attorneys in the courtroom and the policyholder is represented by a single attorney.

Although these themes are generally powerful in most bad faith cases, in each case the themes must be tested in focus groups. Focus groups are an invaluable way to explore whether your themes are effective or whether they should be revised or abandoned.

Voire Dire

In addition to learning about the potential jurors, voire dire is your first opportunity to develop themes with the jury. Ask potential jurors about their own insurance policies. Do they have any insurance policies? What kind of insurance do they have? Why did they buy insurance? One of the jurors will eventually explain that they bought insurance for protection and peace of mind. What would they want to happen if they submitted a claim? This focuses the jurors on the nature of insurance and the vulnerability that all claimants face. What good or bad experiences have the potential jurors had with insurance companies? Many are eager to explain their bad experiences with insurers. You must know their feelings about insurers to determine whether you want them on your jury.

Damages is another crucial subject to explore with potential jurors. Many people do not believe in awarding non-economic damages, let alone punitive damages. You can present a great liability case that results in a small verdict because jurors do not believe in awarding non-economic or punitive damages. Where jurors believe that punitive damage awards are too high, agree with them and then discuss the purpose of punitive damages - to punish and deter. Find out if the jurors believe in punitive damages when the evidence supports a finding of malice, oppression or fraud. Emphasize that your case is different that the seemingly silly cases that jurors have read about in newspapers.

Similarly, discuss the type of damage that your client has suffered. For example, where an insurer has denied a disability claim, ask the jurors if they have ever had to live without any source of income. What would they do if they suddenly lost their only source of income? Where an HMO denied medical care that caused the plaintiff to loose a leg, ask questions that focus the jurors on what their lives would be like if they had only one leg.

Tort reform is another essential topic to address. Despite the facts, tort reform marketing campaigns have led many people to believe that lawsuits are out of control. Many jurors now distrust plaintiffs and assume that they unfairly seeking a big payday. Find out whether the jurors, or anyone they know, have been involved in litigation. A juror that has been a defendant in a lawsuit may have a different perspective than a juror that has been a plaintiff.

It can be very helpful to ask potential jurors what newspapers and magazines they read on a regular basis. An individual that reads the Wall Street Journal probably will

have a different philosophical outlook that someone that reads the National Enquirer. The same concept applies to radio and television programs. A Rush Limbaugh fan will generally have a different perspective than a National Public Radio listener.

Juror questionnaires can be helpful in bad faith cases to obtain substantial information about jurors where there is limited time to conduct voire dire. But juror questionnaires frequently benefit the insurer's because their counsel can obtain information that they would not feel comfortable asking the potential jurors directly.

Opening Statement

Opening Statement is the time to establish themes and tell the story. Many attorneys start their opening statements by stating their theme, telling the jury why the case is about their theme, then telling the jury what happened, why it happened and who to believe. As in all storytelling, the opening statement must answer the questions who, what, why, when, where and how. Set the scene and introduce the characters using descriptive and colorful language.

An effective approach is to follow the theme of trust and betrayal focusing on the insurance company's conduct. Show the jury the insurance company's marketing materials such as television commercials and print advertising, and review the company's representations in the insurance policy.

After addressing how the insurance company obtained the policyholder's trust, show the jury your client in the best possible light. Tell the jury the policyholder's life story. Emphasize the policyholder's likeable qualities. For example, discuss testimony that will demonstrate that the policyholder is caring, a hard worker, a good spouse, a family man, and has good values.

After the jury learns about your client, educate the jury about the relevant insurance industry standards that the insurance company is required to follow in handling claims. Although there are many industry standards, present only the important standards that the defendant has violated. Compile the industry standards from published decisions, statutes, regulations, jury instructions, the insurance contract, the insurer's policies and procedures, industry guidelines, insurance experts, the insurer's written discovery responses, and the insurer's deposition testimony. During discovery, obtain testimony from the insurer's adjusters and the insurer's experts confirming that the insurer is required to follow the relevant industry standards.

Next review the company's unreasonable handling of the claim. A simple timeline is an effective way to provide the jury with a reference point through which to view the entire claims handling process. The timeline should emphasize the key liability facts that violate the industry standards at issue. Depending upon the specific facts and issues in your case, you may focus on the company's failure to thoroughly investigate the claim, failure to fully inquire into all bases that might support the insured's claim, failure to objectively evaluate the claim, failure to promptly investigate the claim, failure to timely pay benefits when due, or any other unreasonable conduct. Strongly emphasize any pattern and practice of unreasonable conduct.

To maximize the size of the potential punitive damage verdict, focus on facts that will justify a larger punitive damage award. The degree of reprehensibility of an insurer's conduct is one of the most crucial factors that appellate courts review in evaluating a punitive damages award against an insurer.[1] To consider reprehensibility, a

court must consider (1) whether the conduct involved repeated actions or was an isolated incident, (2) whether the harm was the result of intentional malice, trickery, or deceit or simply an accident, (3) whether the harm caused was physical or economic, (4) whether the conduct evidenced an indifference to, or reckless disregard of, the health and safety of others, and (5) whether the target of the conduct had financial vulnerability. As a result, highlight the facts that emphasize these factors.

To keep the jurors' interest, use a limited number of key exhibits in your opening statement. Computer programs including Sanction, PowerPoint, and Trial Director provide an excellent way to integrate key documents, blowups, and deposition testimony into your opening statement.

Direct examination and cross examination

Generally, the presentation of witnesses should reflect the trial theme and roughly mirror the story that you told in opening statement. But strategic considerations will dictate the order of witnesses in each case. It is crucial to start the case strong, end the case strong, and insert weaker witnesses in the middle of the case. Streamline your case so that it is simple and hard hitting from start to finish. Consequently, keep the case moving efficiently by only calling witnesses that are absolutely necessary to the case.

If the plaintiff makes a great witness, consider calling the plaintiff first. After humanizing the plaintiff, review the promises the plaintiff relied upon before he bought insurance and emphasize how hard he worked to earn the money to pay the premiums. Then review the loss and the insurer's unreasonable handling of the claim. Spend a substantial amount of time addressing all of the damages that the plaintiff suffered in detail. The plaintiff is the victim and must appear to be the victim of the insurer's bad faith at all times.

Call the insurance company adjusters early in your case. Start by having the adjusters confirm that they are required to comply with the industry standards that you listed in opening statement. Then lead them to confirm key facts that help the case. After using the adjusters to acknowledge helpful facts, elicit testimony that establishes the insurer's violations of the industry standards. Show that the adjusters were working against the plaintiff's interests. The same logic applies to the insurer's experts.

The plaintiff's insurance expert can be an effective witness to close the plaintiff's case. They generally begin by explaining the industry standards supporting the implied covenant of good faith and fair dealing. The expert can then explain the unequal bargaining positions of insurance companies and policyholders and the unique nature of the relationship. Following the general discussion, they proceed to list all of the insurance company's unreasonable conduct in handling the claim.

Closing argument

Closing argument is the opportunity to re-tell your story through the evidence. As the jury has already heard the evidence, review the key evidence that supports a bad faith verdict and punitive damages.

Start with your list of industry standards that the insurance company violated. For each standard, review the evidence that proves that the insurer violated that standard. The evidence should include the key documents and trial testimony. Instead of telling the jury your recollections of the evidence, show the jury the specific documents and trial

testimony that support the violations. Let the evidence speak for itself. PowerPoint, Sanction and Trial Director provide great formats through which to communicate the industry standards and evidence.

After reviewing the violations of industry standards, walk the jurors through the key jury instructions. Review the relevant bad faith jury instructions and then show the jury a detailed summary of the insurer's unreasonable conduct that supports a bad faith verdict. Review the punitive damage jury instructions and provide the jury with a list of the insurer's conduct that was malicious, oppressive or fraudulent.

At the end of the closing argument, empower the jury by reminding them that they are the voice of the community and they have the power to stop similar conduct from occurring in the future.

Damages

Damages in insurance bad faith cases are generally straight forward. There are three levels to the analysis – breach of contract, breach of the implied covenant of good faith and fair dealing (bad faith), and punitive damages.

Contract Damages

Where a plaintiff establishes a breach of contract, generally the damages will be the policy benefits plus interest from the date that the benefits were due. *See* Civ. Code §3302; *Howard v. American Nat'l fire Ins. Co.* 187 Cal. App. 4th 498, 537 (2010). Thus, in first-party cases the damage will be the contract benefits plus interest. In third party cases, the damage will be the amount expended or liability incurred by the policyholder up to the policy limit, plus *foreseeable* consequential damages. Where an insurer wrongfully refuses to provide a defense to its insured, the damage will include the cost that the insured incurred to defend the action. In cases involving insurance that directly affects the comfort, happiness or personal welfare of the insured, or that involve a subject matter that affects the self-esteem or feelings of that party, emotional distress damages may be recoverable as foreseeable damages. *Frazier v. Metropolitan Life Ins. Co.* 169 Cal. 3d 90 (1985).

Bad Faith

To recover for bad faith damages, the plaintiff must prove that the insurance company breached the insurance contract by withholding, delaying or denying benefits in bad faith. *See Jonathan Neil & Asoc., Inc. v. Jones* (2004) 33 Cal. 4th 917. Where a plaintiff proves bad faith, the measure of damages will be tort damages. The Plaintiff will be entitled to recover for all damage proximately caused by the insurer's bad faith. *Crisci v. Security Ins. Co. of New Haven, Conn.* 66 Cal.2d 425, 433, 58 Cal.Rptr 13, 18 (1967). These damages are recoverable regardless of whether or not the damage could have been anticipated, in contrast to consequential damages in breach of contract, which must have been within the contemplation of the parties when the contract was entered into. Bad faith damages typically include economic damage, emotional distress, attorneys' fees and prejudgment interest.

Economic damage will include all economic losses that the plaintiff suffered as a result of the insurer's bad faith.

Emotional distress damages will include the emotional distress that the plaintiff

suffered as a consequence of the insurer's bad faith conduct. But in order to recover for emotional distress damages plaintiff must have suffered some threshold economic loss, for example medical treatment resulting from the emotional distress, attorneys' fees or some costs of litigation. *Waters v. United Services Auto Assn*, 41 Cal.App.4th 1063, 1079, 48 Cal.Rptr.2d 910, 920 (1996). When claiming emotional distress, it is wise to have family members, friends and treating providers who witnessed the distress testify about the emotional distress.

Plaintiff can also recover the cost of the attorneys' fees incurred *in establishing that plaintiff is entitled to contract benefits*. But plaintiff cannot recover for attorneys' fees incurred in establishing the insurer's bad faith or in establishing that the plaintiff is entitled to punitive damages. *Cassim v. Allstate Ins. Co*., 33 Cal.4th 780, 16 Cal.Rptr.3d 374, 392 (2006). Where plaintiff's counsel is working for a contingency fee, plaintiff has the burden of proving their entitlement to attorneys' fees and must establish the amount of the attorneys' fees incurred in an effort to obtain policy benefits. *Cassim v. Allstate Ins. Co*., 33 Cal.4th 780, 16 Cal.Rptr.3d 374, 392 (2006). Normally this is an issue for the jury, but counsel often stipulate to have the judge adjudicate this issue after a finding of bad faith.

Punitive damages

Once a plaintiff has established that an insurer has denied benefits in bad faith, it opens the door to potential recovery of punitive damages. Under California law, before a plaintiff can recover punitive damages, he must prove, by clear and convincing evidence, fraud, malice or oppression by the defendant as laid out in Civ. Code section 3294(c). Under this clear and convincing evidence standard, there must be a strong probability that the facts giving rise to the fraud, malice or oppression occurred. Crosky, Heesman Popik & Imre, *California Practice Guide: Insurance Litigation* (Rutter 2012) ¶ 13:527.

It is important that a plaintiff pay special attention to the pleading standards for punitive damages when filing the case. The plaintiff cannot simply say that the defendant acted with oppression, fraud or malice. Specific facts must be alleged demonstrating that the defendant acted with oppression, fraud or malice. For example, in *Anschutz Entertainment Group, Inc. v. Snepp*, 171 Cal. App. 4th (598, 643), allegations that the defendant's conduct was "intentional, willful, malicious, performed with ill will towards plaintiffs and in conscious disregard of plaintiffs' rights" was not sufficiently specific to meet the pleading standards for punitive damages. Moreover, even if the complaint sufficiently alleges the elements of the underlying tort at issue, it does not mean that the plaintiff has adequately plead punitive damages based on that tort. The specific facts alleged regarding the defendant's conduct must show that the defendant acted out of malice, oppression or fraud in committing the tort. *Turman v. Turning Point of Central Calif., Inc.* (2010) 191 Cal. App. 4th 53, 64 (2010).

In order to recover punitive damages, you must prove that the bad faith conduct was authorized or ratified by the insurance company. Specifically, plaintiff must prove that an officer, director or managing agent "had the requisite advance knowledge and conscious disregard," "authorized or ratified the employee's acts," or acted with oppression, fraud or malice toward the injured party. Crosky, Heesman Popik & Imre, *California Practice Guide: Insurance Litigation* (Rutter 2011) ¶ 13:403.

The award of punitive damages lies solely in the province of the jury, and recent

case law reaffirms that the court cannot influence whether or not a jury awards punitive damages. *See Sumpter v. Matteson*, 158 Cal. App. 4th 928, 936 (2008); *Spinks v. Equity Residential Briarwood Apts.*, 171 Cal. App. 4th 1004, 1052 (2009).

The United States Supreme Court's jurisprudence over the past decade has had an impact on getting and, more importantly, keeping punitive damage awards. But the power that punitive damages have to change corporate conduct has not totally disappeared. The Supreme Court's more recent cases have clarified and changed the focus on some issues - and if you pursue those issues, you will lay the groundwork for getting and keeping substantial punitive damages.

Although the principles discussed below are all derived from the Supreme Court's recent decisions, they have not yet been tested in practice. But that certainly does not mean that you should not try them or that they won't succeed. So long as we continue to push the envelope, and use the tools we have, we can do what needs to be done to protect people for overreaching by corporations who do not honor their responsibilities to their customers.

A. The cases to read

The "big 3" cases on punitive damages from the U.S. Supreme Court that you must look to are: *BMW v. Gore*, 517 U.S. 559, 116 S. Ct. 1589, 134 L. Ed. 2d 809 (1996), *State Farm Mut. Auto. Ins. Co. v. Campbell*, 123 S. Ct. 1513 (2003); and *Philip Morris v. Williams*, 127 S.Ct. 1057 (2007).

But there are other important cases you should read, think about and utilize. They include:

- *Johnson v. Ford Motor Co.* (2005) 35 Cal.4th 1191
- *Simon v. San Paolo U.S. Holding Co.* (2005) 35 Cal.4th 379
- *Campbell v. State Farm* (Utah 2004) 98 P.3d 409 [this is the Utah Supreme Court's decision after remand from the U.S. Supreme Court]
- *In re Exxon Valdez* (D. Alaska 2004) 296 F.Supp.2d 1071 [for jury instructions only]

B. Reprehensibility is the key

Although the U.S. Supreme Court has used various means of disposing of punitive damages awards in *BMW, State Farm* and *Williams*, every one of those decisions is predicated on the issue of "fair notice." That means that, constitutionally, the defendant is entitled to have fair notice of what conduct will potentially subject it to punitive damages and the extent of the damages that can rationally be expected to be imposed on the basis of that conduct. Of the three *BMW* "guideposts" that the court always talks about,[2] it consistently emphasizes that the "reprehensibility" guidepost is the

---

[2] The other two guideposts are the disparity between the actual or potential harm suffered by the plaintiff and the punitive damages award (this is often referred to as the ratio of compensatory to punitive damages) and the difference between the punitive damages awarded by the jury and civil

most important. The key for plaintiffs' attorneys is to know what that means, in the context of fair notice, and to use it at every turn.

The reprehensibility factors that have evolved from the case law include:

- Economic v. physical harm
- Note that the Utah Supreme Court concluded that economic harm that causes emotional distress is more reprehensible than mere economic harm.
- Indifference or reckless disregard of health or safety
- Financial vulnerability of the plaintiff
- Pattern and practice
- Recidivism
- Malice, trickery, and deceit versus "mere" accident
- The scale of profitability (*Johnson*)
- Profit motivation
- Similar, out-of-state conduct (*Johnson*)
- Impact on the State
- Impact on others (*Williams)*

Some of these issues are the usual run-of-the-mill topics we deal with in trying punitive damages cases, i.e., trickery, deceit and reckless disregard (or, in California, conscious disregard). But some of these issues are new and different and open up new vistas in discovery and the evidence to use at trial.

While highly reprehensible conduct may lead to larger punitive damages awards, the reverse is also true. Where the degree of reprehensibility of the defendant's conduct is relatively low, the permissible award ratio of compensatory to punitive damages will be lower. For example, if a compensatory damages award includes substantial compensation for physical and emotional distress (which tends to suggest that the jury intended to punish the defendant), but the defendant's reprehensibility is relatively low, one court concluded that the maximum constitutionally permissible punitive damages award ratio of compensatory to punitive damages may be set at 1:1. *Roby v. McKesson Corp.*, 47 Cal. 4th 686, 693 (2009) (given "relatively low degree of reprehensibility" of defendant's acts and the "substantial compensatory damages verdict, which included a substantial award of non-economic damages" a 1:1 ratio of compensatory to punitive damages was the maximum constitutionally permissible punitive damages award.)

(1) <u>Pattern and Practice</u>

For insurance cases, California, at least, already has a well-developed body of law that permits discovery of, and submission of evidence on, pattern and practice of improper insurance claims handling. (See, e.g., *Colonial Life Ins. Co. V. Superior Court,* 31 Cal.3d 785, 183 Cal.Rptr. 810 (1982); *Moore v. American United Ins. Co.,* 150 Cal.App.3d 610, 197 (1984).) But even apart from that, the court's decisions in *TXO Production Corp. v. Alliance Resources Corp.*, 509 U.S. 443 (1993), *BMW* and *State*

---

penalties authorized or imposed in comparable cases. Crosky, Heesman Popik & Imre, *California Practice Guide: Insurance Litigation* (Rutter 2011) ¶ 13:219.

Farm make clear that pattern and practice is relevant to the reprehensibility analysis. So, you should be sure to get discovery on:

- Other similar claims and the defendant's response to them;
- Defendants' written policies and practices
- Defendants' unwritten policies and practices

(2) <u>Recidivism</u>

The U.S. Supreme court has repeatedly stated that a recidivist defendant deserves to be punished more harshly. That means you should get discovery on:

- Other compensatory or punitive damages awards against the defendant regarding the same conduct with respect to the claim you have;
- Other compensatory or punitive damage awards against the defendant even with respect to ***other*** policies or ***other*** type of claims. This may seem anti-intuitive in light of the court's decision in *State Farm* - but remember, we are talking about ***fair notice***. Irrespective of the specific type of claim involved, if the defendant was "dinged" before for substantially similar conduct, even in a different context, it had fair notice of the type of conduct that would get it in trouble and the level of punishment that could be involved. Plus, if there have been other actions against the defendant and it did not change its ways before injuring your insured, it is a recidivist and needs to be punished more severely.
- Look for civil penalties or government or regulatory action. If an insurer has been fined anywhere for conduct similar to that in issue in your case, and hasn't changed its conduct - it is a recidivist. And, again, the evidence goes to fair notice. Look for such fines or regulatory action with other state insurance departments and the FTC (re advertising issues).

(3) <u>Scale of profitability</u>

In *Johnson*, the California Supreme Court held that evidence gained from the defendant's wrongful conduct cannot be recovered as mere disgorgement. But, the court held, the amount of money made by the defendant as the result of engaging in the unfair conduct is admissible as part of the reprehensibility analysis.

(4) <u>Profit motivation</u>

A recent case under federal common law looked to profit motivation as a factor in determining the reprehensibility of a defendant's conduct. In *Exon Shipping Co. v. Baker*, 554 U.S. 471, 494 (2008), the court held "[a]ction taken or omitted in order to augment profit represents an enhanced degree of culpability."

(5) <u>State's interest</u>

This is a particularly new and novel approach, and is only worth pursuing in really significant cases, but if it applies, it might turn out to be a very powerful weapon.

The analysis here starts with language from *State Farm* which was expanded upon in the Utah Supreme Court's decision after remand from the U.S. Supreme Court. Essentially, the analysis is based on the fact that each individual state has an interest in imposing punitive damages in order to protect its own interest and the interests of its citizens. The impact the defendant's conduct has on the state and its citizens as a whole is an assessment that the jury can properly consider in determining reprehensibility.

There is a three-step process for the analysis:

(a) Define the scope of the legitimate state interests the punitive damages award is intended to further;

(b) Discovery the potential impact of the defendants' conduct on that interest;

(c) Calculate the financial impact on the state.

As an example, the scope of a state's interest in the context of an insurance claim is to assure the financial security and independence of its citizens and/or to provide protection to assets. A state is always interested in assuring that competition is protected because if the marketplace is not trustworthy, the economic impact will be disastrous. So do discovery on the impact the defendant's conduct is likely to have in the marketplace. Find out how many of the same or similar types of policies have been sold by defendant in the state and what is its share of the market. Find out how many claims are associated with that policy type, by both the defendant and, to the extent you can, competitors. Also dig out information about the frequency of claims denied for the same or similar reasons on the same or similar kinds of policies. Once you have that kind of economic information, get a forensic economist to do a calculation of the harm to competitors and the harm to economy that has, or would, result if the defendant were allowed to continue the conduct.

There is one important thing to note here. As discussed in the next section on harm to others, you must be sure to tell the jury, through argument and instructions, that it may not award an amount of punitive damages that will reimburse the state for these losses. They can ***only*** consider the evidence in determining the reprehensibility of the defendant's conduct. But since the instructions should also - consistent with the Supreme Court's jurisprudence - tell the jury that the reprehensibility factor is ***the*** most important one, it may well have a profound effect on the jury's perspective.

(5) <u>Harm to others</u>

The most important thing that came out of the *Williams* case was the line it drew. It held that a jury's award of punitive damages could not include an amount for harm to others, but that the evidence of harm to others could be included in the jury's assessment of the reprehensibility of the defendant's conduct (which is, again, ***the*** most important factor in determining whether the punitive damages are constitutionally acceptable).

This is conceptually hard to understand, I know. In fact, Justice Stevens in his concurring and dissenting opinion said that "the nuance escapes me." But be that as it may, what it means is that you can get the evidence before the jury, so long as you are careful to

instruct the jury that it may only consider the evidence for purposes of reprehensibility and may not award an amount that actually represents the harm to others.

C. Jury instructions

Because of these nuances, the jury instructions in a punitive damages case take on much more importance. There is no point trying to dance around the issues. Take them head on and tell the jury they cannot award any amount of punitive damages to reimburse the state or others who have been harmed. But also tell them that they can take these issues into consideration in deciding the reprehensibility of the conduct and that reprehensibility is the most important factor.

If you think you have a good shot at getting to the punitive damages, you should also be sure to instruct the jury that non-economic damages should ***not*** include any punitive aspect, in order to avoid the problems on that issue from the *State Farm* decision.

Look at the proposed jury instructions quoted in the footnotes in the *Exxon Valdez* decision. They were developed by the court before *State Farm* was decided, but the anticipated many of the issues.

Good luck.

---

[i] *State Farm Mut. Auto. Ins. Co. v. Campbell, et. al.*, 123 S.Ct. 1513 (2003)