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Pattern-and-practice evidence in bad-faith cases

How many times does it take to be *reprehensible*? Getting the goods in discovery

Insurance companies frequently rely on company-wide policies or practices that affect many policyholders when they deny insurance claims. Under California law, evidence demonstrating that the defendant insurance company has engaged in a widespread illegal practice or a practice that has been harmful to its insureds is directly relevant to not only proving bad faith, but also to establishing punitive-damages claims. 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.

Colonial Life

California's seminal case on "pattern and practice" discovery is *Colonial Life & Accident Ins. Co. v. Superior Court* (1982) 31 Cal.3d 785 [183 Cal.Rptr. 810]. In *Colonial Life*, the plaintiff brought a third-party bad-faith action arising out of Colonial Life's unreasonable refusal to settle her claim. Plaintiff had been injured and developed progressive gangrene that caused doctors to amputate her leg. Colonial Life employed a claims-adjusting company, Equifax, to adjust the claim. Equifax employed a claims adjuster, Sharkey. Colonial Life, through Equifax and Sharkey, claimed that the policy did not cover plaintiff's leg amputation, refused to tender the policy limits, and made a low settlement offer.

Plaintiff served Equifax with a request to produce all documents relating to claims that Sharkey handled for Equifax. Equifax objected that the request sought irrelevant documents and invaded the other policyholders' rights of privacy under California Insurance Code section 791.01. The trial court ordered Equifax to produce the names and addresses of the Colonial Life claimants.

Colonial Life filed a writ of mandate to stop plaintiff's counsel from obtaining the names and records of the claimants on the ground that the information was not relevant. The California Supreme Court rejected Colonial Life's argument as "patently meritless" and held that the requested discovery was directly relevant to the plaintiffs' claim for at least three reasons. First, because direct evidence demonstrating that a defendant knowingly harmed a plaintiff is often difficult to obtain, a plaintiff must often rely on circumstantial evidence that a defendant engaged in conduct with such a frequency so as to indicate a general business practice. Therefore, and because a plaintiff may establish a bad-faith claim by showing that the acts that harmed him were knowingly committed or engaged in with such frequency as to indicate a general business practice, discovery addressing the "frequency of alleged unfair settlement practices" is likely to produce relevant evidence.

Second, other instances of unfair practices are "highly relevant" to the plaintiff's claim for punitive damages. In California, to be liable for punitive damages a defendant must act with the intent to vex, injure or annoy or with a conscious disregard for a plaintiff's rights. A plaintiff may prove these elements directly or by implication. And a plaintiff can prove these elements through indirect evidence of a pattern of unfair practices. The Court cited *Neal v. Farmers Ins. Exchange* (1978) 21 Cal.3d 910, 922 [148 Cal.Rptr. 389] for the proposition that it previously affirmed a punitive damages award based on an insurer's failure to settle where the evidence showed that the failure to settle was part of a "conscious course of conduct, firmly grounded in established company policy."

Third, evidence regarding the claims adjuster's previous dealings were relevant to prove ratification or authorization by defendants of his unfair acts, which also supported plaintiff's claim for punitive damages.

To protect the policyholders' rights of privacy, the Court required plaintiff's counsel to send a letter to the other claimants to obtain their consent to release their records.

Subsequent decisions have upheld a plaintiff's right to obtain "pattern and practice" discovery in bad-faith actions. In *Moore v. American United Life Insurance Company* (1984) 150 Cal.App.3d 610 [197 Cal.Rptr. 878], plaintiff sued her disability insurer for wrongfully denying her claim. The definition of "total disability" in plaintiff's policy was narrower than the relevant definition of "total disability" for so-called "any occupation" disability policies under California law. Plaintiff claimed that American United engaged in a pattern and practice of obtaining misleading opinions from physicians by providing them with a definition of "total disability" that was narrower than the applicable definition under California law. Plaintiff also alleged that American United routinely misled its policyholders by including the narrower definition of total disability in their policies. Plaintiff contended that American United knew before it denied plaintiff's claim that its definition of total disability did not comply with California law.

Plaintiff introduced evidence at trial regarding two other American United disability claims to establish that American United engaged in a pattern and practice of improper claims handling and to show that American United knew that its definition of "total disability" was improper under California law.

The jury awarded plaintiff $30,000 for compensatory damages and $2.5 million in punitive damages. American United appealed on the ground that evidence regarding the other claims was not relevant to any disputed fact. Relying on *Colonial Life*, the Court found that the evidence was relevant to establishing a pattern and practice of unreasonable claims handling. American United also argued that evidence regarding the other claim was not relevant because it was not factually similar to plaintiff's claim as it involved a different definition of total disability. The Court rejected the argument and found that the policies were substantially similar. Finally, the Court rejected American United's argument that the danger of undue prejudice substantially outweighed any probative value of the evidence.

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American United also argued that the jury's punitive damages award was excessive. In upholding the award, the court evaluated the reprehensibility of American United's conduct. It reasoned that the plaintiff presented evidence of "fraudulent claims practices potentially affecting numerous insureds other than the plaintiff." The punitive damages award punished American United for engaging in a pattern and practice firmly grounded in established company policy that had the potential of defrauding numerous insureds other than the plaintiff. The court noted:

> The jury could conclude that defendant consciously pursued a practice or policy of cheating insureds out of benefits by obtaining incorrect opinions of total disability from treating physicians.

(*Moore v. American United Life Insurance Company, supra,* 150 Cal.App.3d at p. 640 [197 Cal.Rptr. at 897].)

In *Mock v. Michigan Millers Mut. Ins. Co.* (1992) 4 Cal.App.4th 306 [5 Cal.Rptr.2d 594], the court emphasized that pattern-and-practice evidence can be crucial to establishing punitive damages against an insurer. The court surveyed cases affirming an award of punitive damages against an insurer and noted that an established pattern and practice of bad-faith was a common element. Specifically, the court explained:

> [A] central theme common to those cases which have sustained punitive awards is the existence of *established policies or practices* in claims handling which are harmful to insureds. (See. e.g., *Moore v. American United Life Ins. Co.* (1984) 150 Cal.App.3d 610, 637 [197 Cal.Rptr. 878] [insurer had a practice 'firmly grounded in established company policy' of intentionally supplying physicians with the wrong definition of total disability]; *Downey Savings & Loan Ass'n. v. Ohio Casualty Ins. Co.* (1987) 189 Cal.App.3d 1072, 1098-1099 [234 Cal.Rptr. 835] [insurer was guilty of company-wide misconduct by instructing its claims adjusters to focus on ways to defeat claims]; *Hughes v. Blue Cross of Northern California* (1989) 215 Cal.App.3d 832, 847 [263 Cal.Rptr. 850] [insurer's objectionable claims handling practices were rooted in *established* company practice]; *Liberty Transport Inc. v. Harry W. Gorst Co.* supra, 229 Cal.App.3d 417, 436-437 [280 Cal.Rtpr. 159] [insurer had a *company policy* of never communicating directly with their insureds and despite knowledge of insured's ignorance of decision to deny claim did nothing to correct the error].) In *Patrick v. Maryland Casualty Co., supra.,* the court seemed to suggest that what was required was a 'consistent and unremedied pattern of egregious insurer practices.'

(217 Cal.App.3d at 1576 [267 Cal.Rptr. 24.]) (Emphasis in text.)

The importance of *Colonial Life* discovery to punitive-damages recovery after the U.S. Supreme Court's decision in *State Farm v. Campbell* and The California Supreme Court's decision in *Johnson v. Ford Motor Company*

Following *State Farm Mut. Auto. Ins. Co. v. Campbell, et. al.* (2003) 538 U.S. 408 [123 S.Ct. 1513], and the California Supreme Court's later decision in *Johnson v. Ford Motor Company* (2005) 35 Cal.4th 1191 [29 Cal.Rptr.3d 401], pattern-and-practice evidence is paramount in obtaining and keeping punitive-damage awards.

In *Campbell*, State Farm's insured, Campbell, was driving on a two-lane highway and attempted to pass six vans. Ospital was driving in the opposite direction. Ospital swerved to avoid Campbell and crashed into an automobile driven by Slusher. The accident killed Ospital and disabled Slusher. Ospital's successors and Slusher (collectively "accident victims") filed a tort and wrongful death action against Campbell and his wife. Although investigators determined that Campbell caused the crash, State Farm contested liability. State Farm then refused the accident victims' offer to settle the case for the $50,000 policy limit and took the case to trial. State Farm assured the Campbells that Campbell did not cause the accident, that the Campbells' assets were safe, and that the Campbells did not need separate counsel.

The jury determined that Campbell caused the accident and a judgment was entered for roughly $185,000. State Farm initially refused to cover the $135,000 liability above the $50,000 policy limit, and State Farm refused to post a bond to allow Campbell to appeal the judgment. While the case was on appeal, the Campbells settled with the accident victims. In exchange for the accident victims' agreement to not satisfy their judgment against the Campbells, the Campbells agreed to file a bad-faith action against State Farm and assign 90 percent of any recovery to the accident victims. After the Campbells lost the appeal, State Farm paid the entire judgment.

The Campbells then filed a bad-faith action against State Farm. At trial, the jury determined that State Farm's refusal to settle was unreasonable as there was a substantial likelihood of an excess verdict against the Campbells. The Campbells introduced evidence that State Farm took their case to trial as a result of a nationwide scheme to limit claims payments. The scheme involved State Farm's conduct in numerous states for more than 20 years. State Farm moved to exclude the evidence, but the trial court admitted the evidence on the ground that it was relevant to whether State Farm's conduct was sufficiently egregious to justify punitive damages.

The United States Supreme Court 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."

The Supreme Court emphasized that although "evidence of other acts [towards other insureds] need not be identical to have relevance in the calculation of punitive damages," it must have some nexus to plaintiffs' claims. In *Campbell*, instead of focusing on the type of conduct that

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damaged the Campbells, the Campbells introduced irrelevant evidence that bore no relation to their claim. For example, the Campbells introduced evidence that State Farm's policies generally corrupted its employees and that State Farm had investigated the personal life of one of its employees. This evidence was not relevant in the *Campbell* case and had no nexus to the Campbells' claim. The Court found that the Campbells used the case as a "platform to expose, and punish, the perceived deficiencies of State Farm's operations throughout the country" and that they introduced substantial "evidence pertaining to claims that had nothing to do with a third-party lawsuit." The Court indicated that a "defendant's dissimilar acts, independent from the acts upon which liability was premised," may not serve as the basis for punitive damages. The Campbells failed to show *any* conduct by State Farm that was similar to the conduct that damaged them. As a result, in reducing the punitive-damages award, the Supreme Court only considered State Farm's conduct towards the Campbells and did not consider State Farm's conduct towards any other insureds.

In *Johnson v. Ford Motor Co.*, the plaintiffs purchased a used Taurus from a Ford dealership. When asked about the previous ownership, the plaintiffs were told that the Taurus had been traded in for a newer model. When asked to see the car's repair history, they were shown a computer printout that indicated that there had been no significant repairs. In reality, the Taurus had suffered from repeated and serious transmission problems and the prior owner had requested that Ford repurchase the car as a "lemon." After the plaintiffs experienced repeated transmission problems, Ford replaced the transmission twice and, when plaintiffs again asked to see the car's repair history, they were finally shown the car's complete history, detailing the transmission problems experienced by the first owners.

Plaintiffs sued Ford for, among other things, intentional and negligent misrepresentation, violation of the Consumer Legal Remedies Act, and violation of Business & Professions Code section 17500's prohibition on false or misleading advertising. At trial, the plaintiffs introduced evidence that, in order to avoid the title branding and additional requirements involved in reselling a "lemon" automobile under California law, Ford managers employed a narrow concept of what constituted a repair attempt for purposes of applying the state lemon laws. In addition, when customers asked Ford to buy back their vehicles as lemons, Ford would instead offer them "owner appreciate certificates" ("OACs") that acted as credits on trade-ins for new Ford vehicles. This not only avoided having to brand the repurchased vehicles as "lemons," but also saved Ford thousands of dollars for each transaction. Plaintiffs presented further evidence that Ford's San Francisco and Los Angeles offices issued about 1,200 to 1,400 OAC's per year in the year of trial and the previous year (2000 and 2001). The average face amount of OAC's issued over the four previous years was between $2,700 and $3,200. Finally, testimony was given to the effect that the cost of reacquiring a vehicle as a lemon (i.e., the cost of repurchasing or replacing the vehicle less its resale or salvage value) was between $8,500 and $13,500, depending on the year and the method of reacquisition (refund or replacement).

Based on this evidence, the plaintiffs' attorney argued to the jury that Ford saved $6,000 to $10,000 on each OAC for a vehicle that would otherwise have had to be reacquired, and that approximately 1,000 such OAC's were issued per year to California customers (excluding some issued out of California offices to customers in other states). Counsel estimated Ford's savings in California from "this whole scheme of owner appreciation certificates" – that is, the practice of issuing OAC's for vehicles that should have been reacquired as lemons, and of failing to provide warranty buyback notices on all vehicles traded in with OAC's, thus concealing the vehicles' defects from subsequent buyers – to be $6 to $10 million per year for 2000 and 2001. He urged the jury, in order to deter Ford from continuing that conduct, to impose punitive damages in an amount that would, at least, take from Ford all those wrongful profits.

The jury found in plaintiffs' favor and awarded them $17,811.60 in compensatory damages, and $10 million in punitive damages. The Court of Appeal, holding Ford could constitutionally be punished only for its fraud on plaintiffs and not for its overall course of conduct, reduced the punitive damages award to $53,435, approximately three times the compensatory damages.

The Supreme Court reversed. The Supreme Court's decision was based on its holding that, although the Court of Appeal correctly rejected the aggregate disgorgement approach (because, among other things, it created an end-around the requirements of the class-action device by awarding damages based on profits earned from transactions with a large class of similar claimants without ever having to prove the specifics of those "hypothetical claims"), it did not properly consider the evidence of Ford's policies and practices, and their scale and profitability, in analyzing the reprehensibility of Ford's conduct. Although the Court of Appeal discussed Ford's policies in addressing reprehensibility – noting "it is reprehensible for a regulated manufacturer to implement a scheme that intentionally undermines the protections granted consumers by state law" – the court gave no express weight, in its assessment of the "constitutional maximum" permitted by the *State Farm* case, to the profitability of that scheme to Ford or the scale at which Ford pursued it.

According to the Supreme Court, although *State Farm* requires reasonably proportionality between punitive damages and actual or potential harm to the plaintiff, what is a reasonable ratio necessarily depends on the reprehensibility of the conduct, "the most important indicium of the reasonableness award," which, in turn, is influenced by the frequency and profitability of the defendant's prior or contemporaneous similar conduct.

Conducting pattern-and-practice discovery

Plaintiffs in bad-faith cases should conduct extensive discovery into an insurers' business practices to understand how a plaintiff's claim fits into the larger context of an insurer's pattern and practice of unfair claims handling. Developing

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evidence of a pattern and practice of unfair claims handling will help establish that what happened to the plaintiff was not an isolated "mistake" or problem, but rather the direct result of the insurer's intentional malice, oppression or deceit.

In order to bolster the relevance of similar instances of misconduct during discovery, plaintiffs often assert causes of action for unfair business practices alleging that the insurer is engaging in a pattern and practice of improper conduct. Policyholders can still state a cause of action against insurers for unfair, unlawful or fraudulent conduct in handling claims under California Business and Professions Code section 17200. (*State Farm Fire & Casualty Co. v. Superior Court* (*Allegro*) (1996) 45 Cal.App.4th 1093 [53 Cal.Rptr.2d 229], but see, *Textron Financial Corp. v. National Union Fire Ins. Co. of Pittsburgh* (2004) 118 Cal.App.4th 1061, 1072 [13 Cal.Rptr.3d 586], which suggests (erroneously in the author's view) that *Allegro* is no longer good law in light of *Cel-Tech Communications, Inc. v. Los Angeles Cellular Telephone Co.* (1999) 20 Cal.4th 163 [83 Cal.Rptr.2d 548].)

Plaintiffs should seek discovery regarding similar claims from policyholders, complaints to the insurer about similar issues, and other litigation against the company. Plaintiffs should also network with other counsel litigating similar actions against the company and use the other actions to develop pattern and practice evidence.

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 interesting 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.)

There is nothing in the Supreme Court decision that explains what evidence was in the record that supported these statements about the defendant's "larger pattern" of misconduct. However, that evidence is detailed in the decision of the West Virginia Supreme Court, in *TXO Production Corp. v. Alliance Resources Corp.* (1992) 187 W. Va. 457 [419 S.E.2d 870]. In that opinion, the court explains that the plaintiff's "pattern and practice" evidence consisted of the videotaped deposition testimony from four attorneys who had represented other oil producers who had dealt with the defendant and had been forced to file suit to obtain the royalties they thought they were owed.

Specifically, the plaintiff in *TXO* had accused the defendant of knowingly recording a false deed to create a cloud on plaintiff's title to oil and gas wells, and to use that cloud as a basis to reduce the royalty payments *TXO* had agreed to pay for the production on those wells. One of TXO's affirmative defenses at trial was good faith and lack of malice. To rebut this defense, the plaintiff introduced the testimony by the four attorneys, to establish a lack of good faith.

The first attorney testified that he represented an elderly, functionally-illiterate woman in Louisiana. TXO's employees had visited his client and tricked her into signing a lease by telling her that unless she signed "some papers" TXO could not continue to pay her neighbors any royalties for gas. They also told her that she did not need to speak to her attorney about their visit. TXO settled the suit. (419 S.E.2d at 881.) The second attorney testified that he owned oil wells in Texas and TXO had refused for over a year to pay him any royalties on the production from the wells, citing various excuses, including purported uncertainties about the title. TXO ultimately agreed to pay. (419 S.E.2d at 882.) The third attorney testified that he represented a group of well owners in a suit against TXO for its refusal to pay royalties, which TXO ultimately settled. (*Ibid.*) The fourth lawyer testified about ongoing litigation against TXO in Oklahoma. He explained that the suit alleged that TXO had misrepresented to a group of landowners that it had the right to drill on their land. As a result of its improper tactics, one landowner gave TXO permission to drill on his land. TXO then was able to use this permission to gain the right to drill under the entire tract. In essence, it was able to bootstrap its lie about its right to drill into permission to drill. (419 S.E.2d at 882, 883.)

The West Virginia Supreme Court found that this evidence was sufficient to disprove TXO's defense of good faith, "and to show that this case was but part of a pattern and practice of deception and chiseling by TXO." (419 S.E.2d at 883.) The court also found that this hearsay testimony was admissible under the "catchall" hearsay exceptions of the West Virginia Rules of Evidence, (which parallel the Federal Rules of Evidence.) Since TXO was represented by counsel in each deposition, and since it knew well in advance that plaintiff would be seeking to admit the deposition testimony, it had every opportunity to rebut or discredit the testimony. Hence, the testimony was deemed sufficiently credible and reliable to be admitted in evidence. (419 S.E.2d at 885, 886.)

Anticipating defendant insurers' objections to pattern-and-practice discovery

Insurers generally object to pattern and practice discovery on the ground that producing the information would be burdensome and oppressive and that it would violate third-party insureds' privacy rights. They routinely submit declarations indicating that it will cost hundreds of thousands of dollars to produce the information. For example, in *Mead Reinsurance Co. v. Sup. Ct. (City of Laguna Beach)* (1986) 188 Cal.App.3d 313, 317 [232 Cal.Rptr 752, 754], the court found pattern-and-practice discovery burdensome and oppressive where it would require production of over 13,000 claim files without allocating the costs of producing the files.

To preempt this problem, before you serve the discovery, depose the insurer's custodian of records and person most knowledgeable regarding information technologies to determine how the insurer maintains its files and data. Then you can craft your discovery requests to minimize the burden on the insurer. Of course, if you are willing to pay for the insurer's costs associated with the discovery courts are more inclined to allow the discovery.

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Insurers also object on the ground that the discovery would violate policyholders' right to privacy under Insurance Code section 791.01 and/or the Constitutional right to privacy. When you serve your discovery, you should send the insurer a form letter that it can send to its insureds to obtain their consent to produce their information. The letter should include a brief description of the bad-faith allegations and explain that the insureds' records may be relevant to the case. If relevant, also include a description of any unfair business-practice allegations. If insureds understand that they may be a victim of the insurer's bad faith or unfair business practices, they will be more likely to release their records. Importantly, the policyholder must date and sign the letter within one year of the production of the information. Alternately, at the time you propound document discovery, offer that all personally identifying information can be redacted from produced documents. Then, after reviewing the produced documents and if those documents support a claim that your client was injured by a pattern and practice of unreasonable or illegal claims-handling practices, you can request that a letter be sent to the insureds to obtain their consent to unredacted versions of the documents and/or their contact information.

If the insurer resists, and a motion is necessary, you can explain to the court that not only is the discovery sought relevant as substantive evidence to prove the truth of plaintiff's claims, but also it is relevant because these third-party insureds are actually potential witnesses to this case. Since those third-party insureds are victims of exactly the same unlawful behavior that is at issue in your case, they could potentially testify as to defendants' pattern and practice of claims handling. The discovery sought by the letter to third-party insureds would allow people whose cases are directly relevant to this case an opportunity to contribute to evidence supporting the argument that the insurer engages in a pattern and practice of this unreasonable and/or unlawful behavior.

Notably, in *Pioneer Electrics (USA), Inc. v. Superior Court* (2007) 40 Cal.4th 360 [53 Cal.Rptr.3d 513], which was decided after *Colonial Life*, the Supreme Court found that disclosure of such person's contact information is directly contemplated by the discovery statutes because these persons qualify as "percipient witnesses" to defendants' pattern and practice conduct. The Court also weighed the competing interests in a discovering third-parties' contact information and their rights to privacy. Specifically, the Supreme Court considered "the extent to which California's right to privacy provision (Cal. Const., art. I, § 1) protects [] purchasers from having their identifying information disclosed to the plaintiff during civil discovery proceedings in a consumers' rights class action against the seller." It held:

> [W]e think the trial court properly evaluated the alternatives, balanced the competing interests, and permitted disclosure of contact information regarding Pioneer's complaining customers unless, following proper notice to them, they registered a written objection. These customers had no reasonable expectation of any greater degree of privacy, and no serious invasion of their privacy interests would be threatened by requiring them affirmatively to object to disclosure.

Finally, in all trials jurors want to know why the parties acted the way that they did. If you can establish that the insurer engaged in the bad-faith conduct towards your client because of a systemic practice that damages other policyholders, the jurors will be eager to punish the insurer and deter similar conduct in the future.

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