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**Commentary**

# *Developing Insurance Bad Faith Cases Post State Farm v. Campbell*

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The United State Supreme Court's recent decision in *State Farm v. Campbell*[1] will have a substantial impact on insurance bad faith litigation. This article addresses how plaintiffs' counsel in bad faith cases can utilize *Campbell* to develop evidence to justify substantial punitive damage awards.

## *The Facts Of State Farm v. Campbell*

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 $185,849. State Farm initially refused to cover the $135,849 liability above the $50,000 policy limit, and State Farm refused to post a bond to allow Campbell to appeal the judgment. State Farm's counsel told the Campbells that they should consider selling their house.

The Campbells retained their own counsel to appeal the verdict. 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% 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 nation-wide 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 jury awarded the Campbells $2.6 million in compensatory damages and $145 million in punitive damages. The trial court reduced the compensatory damages to $1 million and punitive damages to $25 million. But the Utah Supreme Court reinstated the $145 million punitive damages award based on the egregious nature of State Farm's conduct.

The United States Supreme Court held that the Due Process Clause of the Fourteenth Amendment prohibits grossly excessive or arbitrary punishments and found that the Utah Supreme Court erred in reinstating the $145 million punitive damages award. It reduced the punitive damages award to $1 million.

### *Framework For Analyzing Punitive Damages Awards*

As it previously outlined in *BMW v. Gore,*[2] the Supreme Court reaffirmed that courts reviewing punitive damages awards must consider three guideposts: the degree of reprehensibility of a defendant's misconduct, the disparity between the actual or potential harm suffered by the plaintiff and the punitive damages award, and the difference between the punitive damages award and the civil penalties authorized or imposed in similar cases.

The degree of reprehensibility of an insurer's conduct is the most crucial factor in evaluating a punitive damages award. 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.

### *Repeated Instances Of Misconduct And Intentional Malice, Trickery Or Deceit*

Repeated misconduct is more reprehensible than a single instance of misconduct as "a recidivist may be punished more severely than a first offender." In *Campbell*, instead of focusing on the type of conduct that 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 evaluating 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. As a result, State Farm's conduct was not highly reprehensible.

In bad faith litigation similar instances of misconduct are crucial to a reprehensibility analysis. Plaintiffs frequently seek to prove that an insurer's conduct towards the plaintiff is part of a pattern and practice of similar behavior towards other insureds to establish liability for bad faith. California law has long recognized that similar acts of misconduct are relevant in insurance bad faith actions.[3]

In *Colonial Life v. Superior Court,*[4] the California Supreme Court held that similar acts of misconduct are relevant in insurance bad faith actions. Plaintiff brought a bad faith action arising out of Colonial Life's unreasonable refusal to settle her claim. Plaintiff was 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 Sharkey as a claims adjuster. 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 documents that were not relevant and invaded the policyholders' rights of privacy under California Insurance Code §791.01. The trial court ordered Equifax to produce the names and addresses of Colonial Life claimants whose claims Sharkey handled.

Colonial Life filed a writ of mandate to stop plaintiff's counsel from obtaining the names and records of the other claimants on the ground that the information was not relevant. The California Supreme Court rejected Colonial Life's argument as "patently meritless." It reasoned that Insurance Code §790.03(h) precludes insurers from "knowingly committing or performing with such frequency as to indicate a general business practice a variety of unfair claim settlement practices." 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. And Plaintiff can prove that an insurer knowingly committed such acts through circumstantial evidence. Thus, discovery addressing the "frequency of alleged unfair settlement practices" is likely to produce directly relevant evidence.[5]

The Court also reasoned that other instances of unfair settlement practices may be highly relevant to plaintiff's punitive damages claim. 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 the plaintiff's rights. A plaintiff may prove these elements directly or by implication. Indirect evidence of the elements of punitive damages may be proved by a pattern of unfair practices.

The Court cited *Neal v. Farmers*[6] 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." The Court also noted that the evidence may be relevant to prove ratification by Colonial Life 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.

Similarly, in *Moore v. American United,*[7] 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 "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 broader than the applicable definition under California law. Plaintiff also alleged that American United routinely mislead its policyholders by including an improper 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 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.

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.[8]

In *Campbell*, the Supreme Court indicated that "evidence of other acts need not be identical to have relevance in the calculation of punitive damages." Plaintiffs must 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. Plaintiffs should seek discovery regarding similar claims from policyholder,[5] 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. Plaintiffs should develop evidence regarding other claims involving similarly situated policyholders.

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. In California policyholders can state a cause of action against insurers for unfair, unlawful or fraudulent conduct in handling claims under California Business and Professions Code §17200.[9]

Developing evidence of an insurer's pattern and practice of unfair claims handling will help establish that the harm resulted from the insurer's intentional malice, trickery or deceit and did not result from simply an accident.

### *Conduct That Causes Physical Harm Or Endangers Health Or Safety*

In evaluating reprehensibility, a court must also evaluate whether the harm caused was physical or economic, and whether the conduct reflected an indifference to or a reckless disregard of individual's heath or safety. Conduct that causes physical injuries or endangers health or safety is more reprehensible than conduct that just causes economic harm. The Supreme Court wrote that the Campbells' harm related only to an economic transaction and "not from some physical assault or trauma" as there were no physical injuries.

Bad faith cases involving primarily emotional distress damages from an insurer's delay in paying policy benefits is less reprehensible than cases where an insurer's conduct causes physical injuries or endangers health or safety. For example, an automobile insurer's delay in paying uninsured-motorist benefits would generally be less reprehensible than a health insurer's delay or denial of medical care that causes an insured to suffer physical injury — such as metastasis of cancer. Similarly, a liability insurer's unreasonable delay in settling a lawsuit against its insured is generally less reprehensible than a homeowners' insurer's failure to timely repair water damage that causes an insured to suffer mold-related illness.

A court must also consider whether the target of the conduct had financial vulnerability. Plaintiffs should examine the insured population that is being damaged by the bad faith conduct and determine whether it involves the elderly, poor or some other financially vulnerable group.

 

### *Disparity Between The Actual Or Potential Harm Suffered By The Plaintiff And The Punitive Damages Award*

In *Campbell*, the Court declined to impose a bright-line ratio that a punitive damages award cannot exceed. While the Court noted that single-digit multipliers are "more likely" to comply with due process than awards with ratios in the range of 500 to 1, it specified that *higher ratios than the Supreme Court previously has upheld* may comport with due process where an egregious act results in only a small amount of economic damage. As the Supreme Court upheld a ration of 526 to 1 in *TXO Production v. Alliance*,[10] the Court signaled that greater ratios can comply with due process. The Court generally indicated that few awards exceeding a single digit ratio between punitive and compensatory damages will satisfy due process. In *Campbell*, the Court declined to "impose a bright-line ratio which a punitive damages award cannot exceed." While the Court noted that single-digit multipliers are "more likely" to comply with due process than awards with ratios in the range of 500 to 1, it specified that *higher ratios than the Supreme Court previously has upheld* may comport with due process where an egregious act results in only a small amount of economic damage. As the Supreme Court upheld a ratio of 526 to 1 in *TXO Production*, the Supreme Court signaled that greater ratios can comply with due process.

*Campbell* reaffirmed the Supreme Court's holding in *BMW* that a court must consider both actual damages and *potential* damages when applying a ratio for punitive damages. In *TXO Production*, the Court indicated that in addition to the potential harm to the plaintiff, a court must consider the potential harm to other victims of the same practice. The Court noted:

> "It is appropriate to consider the magnitude of the *potential harm* that the defendants' conduct would have caused to its intended victim if the wrongful plan had succeeded, as well as the possible harm to other victims that might have resulted if similar future behavior were not deterred."[11]

The Court noted the example of a man that wildly fires a gun into a crowd and damages only a $10 pair of glasses. Thousands of dollars in punitive damages would be appropriate in order to teach a duty of care and to discourage the same conduct in the future. In sum, there must be a reasonable relationship between the punitive award and "the harm likely to result from the defendant's conduct as well as the harm that actually has occurred."

### *Civil Penalties*

A court must also address the difference between a punitive damages award and the civil penalties authorized or imposed in similar cases. But this will not be a critical issue in insurance bad faith cases.

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### *ENDNOTES*

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

2. *BMW of North America, Inc. v. Gore*, 517 U.S. 559, 116 S.Ct. 1589 (1996).

3. See *Colonial Life & Accident Ins. Co. v. Superior Court*, 31 Cal.3d 785, 183 Cal.Rptr. 810 (1982) and *Mead Reinsurance Co. v. Superior Court*, 188 Cal.App.3d 313, 232 Cal.Rptr. 752 (1986).

4. *Colonial Life & Accident Ins. Co. v. Superior Court*, 31 Cal.3d 785, 183 Cal.Rptr. 810 (1982).

 

5. *Colonial Life & Accident Ins. Co. v. Superior Court*, 31 Cal.3d at 790-792.

6. *Neal v. Farmers Ins. Exchange*, 21 Cal.3d 910, 922 (1978).

7. *Moore v. American United Life Insurance Company*, 150 Cal.App.3d 610, 197 Cal.Rptr. 878 (1984).

8. *Moore v. American United Life Insurance Company*, 150 Cal.App.3d at 640, 197 Cal.Rptr. at 897.

9. *State Farm Fire & Casualty Co. v. Superior Court (Allegro)*, 45 Cal.App.4th 1093, 53 Cal.Rptr.2d 229 (1996).

10. *TXO Production Corp. v. Alliance Resources Corp.*, 509 U.S. 443 (1993).

11. *TXO Production Corp. v. Alliance Resources Corp.*, 509 U.S. at 459-460. ■

 