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"*How to Avoid Punitive Damages Awards*"

I. The Legal Framework

A hodgepodge of standards. In some jurisdictions, punitive damages are available in instances of bad faith denial of claims. E.g., Gulf Atl. Life Ins. Co. v. Barnes, 405 So. 2d 916, 925 (Ala. 1981) ("Because the violation of the duty of good faith and fair dealing is tortious in nature, punitive damages as well as compensatory damages are recoverable in the proper case"); State Farm Fire & Cas. Co. v. Nicholson, 777 P.2d 1152, 1158 (Alaska 1989); Silberg v. California Life Ins. Co. (1974) 11 Cal.3d 452, 462 (1974); Neal v. Farmers Ins. Exchange 21 Cal.3d 910, 923 (1978);. Cal. Civ. Code, § 3294 [punitive damages available "in actions not arising out of contract"]; Surdyka v. DeWitt, 784 P.2d 819, 822 (Colo. App. 1989) (affirming punitive damages for bad faith tort); Pickett v. Lloyd's, 131 N.J. 457, 470 (1993)[acknowledging that punitive damages can be awarded in bad faith cases in "egregious circumstances"]; 42 Pa. Cons. Stat. § 8371 [expressly allowing punitive damages in bad faith cases, subject to clear and convincing burden of proof]; W.V. Realty, Inc. v. N. Ins. Co., 334 F.3d 306, 318 (3d Cir. 2003) (applying Pennsylvania law; standard for punitive damages in bad faith case same as for any other punitive damages claim); Zimmerman v. Harleysville Mut. Ins. Co., 860 A.2d 167, 174 (Pa. Super. Ct. 2004) ("that a finding of bad faith permits an award of punitive damages 'without additional proof, subject to the trial court's exercise of discretion"); O'Neill v. Gallant Ins. Co., 329 Ill. App. 3d 1166, 1176 (2002) (punitive damages for third-party bad faith failure to settle); Campbell v. Gov't Emps. Ins. Co., 306 So.2d 525 (Fla.1974); Campbell v. State Farm Mut. Auto. Ins. Co. 98 P.3d 409 (Utah 2004); Trinity Evangelical Lutheran Church & Sch.-Freistadt v. Tower Ins. Co., 261 Wis. 2d 333, 351–52 (2003)

Other jurisdictions do not allow punitive damages for bad faith absent some additional independent traditional tort (e.g., fraud). (E.g., Cramer v. Ins. Exch. Agency, 174 Ill. 2d 513, 526 (1996) (no first-party bad faith tort; plaintiff's may seek punitive

damages only under independent tort theory); Rocanova v. Equitable Life Assur. Socy. of U.S., 83 N.Y.2d 603, 612 N.Y.S.2d 339, 634 N.E.2d 940 (1994) [requiring independent tort; violation of unfair claims statute does not suffice; even then there must be conduct that may be characterized as "gross" and "morally reprehensible," and of "such wanton dishonesty as to imply a criminal indifference to civil obligations" and a pattern of misconduct directed at the public generally); New York Univ. v. Continental Ins. Co., 87 N.Y.2d 308, 639 N.Y.S.2d 283, 662 N.E.2d 763 (1995) (bad faith failure by an insurer to pay a claim, without more, cannot justify a punitive damages award]; Colford v. Chubb Life Ins. Co. of America, 687 A.2d 609, 616 (Me. 1996) ("In order to secure … punitive damages in this action, [plaintiff] must demonstrate that [carrier] committed independently tortious conduct beyond the denial of [the] disability claim"); Marquis v. Farm Family Mut. Ins. Co. 628 A.2d 644, 652 (Me. 1993) (remedies for bad faith limited to contract remedies plus statutory late payment, interest and attorney fee recoveries); Kewin v. Massachusetts Mut. Life Ins. Co., 409 Mich. 401, 422–423, 295 N.W.2d 50 (1980) (no tort bad faith cause of action).

And yet others fall in between. E.g,, Capstone Bldg. Corp. v. Am. Motorists Ins. Co., 308 Conn. 760, 802 n. 40 (2013) (allowing recovery of plaintiff's attorney fees as punitive damages: "Insurers who fail to defend or to indemnify in bad faith may face liability in addition to the policy's benefits, … [i]n the appropriate case, punitive damages for attorney's fees may be awarded," emphasis added.)

See generally Insurer's liability for consequential or punitive damages for wrongful delay or refusal to make payments due under contracts, 47 A.L.R.3d 314.

Thus, assuming a true conflict between competing jurisdictions, choice of laws can be crucial. See Allegheny Plant Servs., Inc. v. Carolina Cas. Ins. Co., No. CV 14-4265 (KM), 2016 WL 1070671, at *5 (D.N.J. Mar. 17, 2016) (examining, and deferring decision, whether true conflict exists between New Jersey and Pennsylvania punitive damages for bad faith rules). Various states apply various choice of law rules from where the insured risk is or accident takes place to where the contract was entered into.

In addition, a number of states (e.g., Maine, Illinois, Pennsylvania) have statutory schemes with statutory remedies (e.g., penalty amounts, interest, attorney fees) for bad faith conduct or even improper denials.

Lesson: Be sure to check jurisdiction and conflicts of laws

A. Bad Faith Typically Is Not Enough; Fraud, Malice, Conscious Disregard, Evil Mind Generally Required.

E.g., Trinity Evangelical Lutheran Church & Sch. Freistadt v. Tower Ins. Co., 261 Wis. 2d 333, 351–52 (2003) (bad faith not enough; requiring (1) evil intent deserving of punishment or of something in the nature of special ill-will; or (2) wanton disregard of duty; or (3) gross or outrageous conduct); requires that "the injury complained of [be] attended by circumstances of fraud, malice, or willful and wanton conduct); Surdyka v. DeWitt, 784 P.2d 819, 822 (Colo. App. 1989) (of punitive damages requires that "the injury complained of [be] attended by circumstances of fraud, malice, or willful and wanton conduct."); Colo. Rev. Stat. Ann. § 13-21-102 (West); O'Neill v. Gallant Ins. Co., 329 Ill. App. 3d 1166, 1177 (2002) ("where the insurer's conduct exceeds mere negligence and, like here, demonstrates to a jury's satisfaction that the refusal to settle within policy limits was engaged in with utter indifference and reckless disregard for its policyholder's financial welfare, punitive damages can be awarded"); State Farm Fire & Cas. Co. v. Nicholson, 777 P.2d 1152, 1158 (Alaska 1989) (conduct must be "outrageous, such as acts done with malice or bad motives or reckless indifference to the interests of another"); Gulf Atl. Life Ins. Co. v. Barnes, 405 So. 2d 916, 925 (Ala. 1981) ("A distinction must be drawn, however, between that conduct which gives rise to tort liability in the first instance and conduct that justifies imposition of punitive damages"; punitive damages require "malice, willfulness, or wanton and reckless disregard of the rights of others"); see Cal. Civ. Code, § 3294 (requiring clear and convincing evidence of malice, oppression or fraud amounting to "despicable" conduct).

Two California cases illustrate the distinction well. In Shade Foods, Inc. v. Innovative Products Sales & Marketing, Inc., 78 Cal.App.4th 847 (2000), the California Court of Appeal found that two carriers acted in bad faith in denying a claim arising out of wood splinters that had been introduced nuts the insured had commercially processed. The appellate court held "[t]he record fully supports the finding of bad faith in Northbrook's denial of first-party coverage" and "that the record as a whole discloses a reasonable basis for the jury's finding that Royal breached its implied obligation of good faith and fair dealing toward [the insured]." Id. at 881, 909. Nonetheless, multimillion dollar punitive awards against the two carriers could not be sustained:

- The record reveals that, when initially presented with the claim, Northbrook unreasonably failed to assess first-party coverage and greatly overestimated the strength of its defenses to the point of concluding that there was no potential for coverage. In the course of the negotiations following its denial of coverage, it never took any meaningful action to reassess its ill-advised denial of first-party coverage; and after the complaint was filed, it waited a full year to offer to pay the defense costs of IPS.

- Underlying Northbrook's conduct, the jury could reasonably perceive a careless disregard for the rights of its insured and an obstinate persistence in an ill-advised initial position. We think that this conduct might conceivably support a finding that the insurer acted “with a willful and conscious disregard of the rights ... of others” within the definition of “malice” or that the insurer “subject[ed] a person [IPS] to cruel and unjust hardship in conscious disregard of that person's rights” within the definition of “oppression.” (Civ.Code, § 3294, subd. (c).)

- [W]e still must take into account the extreme complexity of the coverage issues and the purely economic character of the losses in assessing the level of opprobrium that it merits. In our opinion, the record falls well short of establishing by clear and convincing evidence the sort of contemptible conduct that could be described by the term “despicable.” Unreasonable and negligent as it may have been, Northbrook's conduct falls within the common experience of human affairs, both with respect to its careless initial evaluation and its stubborn persistence in error.

Shade Foods, Inc., supra, 78 Cal.App.4th at p. at p. 892, emphasis added.

The same was true with respect to the second carrier:

- Royal unquestionably misled Shade for a time as to its willingness to indemnify the General Mills claim, but it made its position clear in January 1995—eight months after receiving notice of the claim and only three months after issuing the particularly misleading coverage letter. Though unfair to Shade, this conduct falls far short of subjecting Shade to “cruel and unjust hardship in conscious disregard of [its] rights” or displaying a “willful and conscious disregard of the rights ... of others.” Again, Royal lacked any reasonable justification for failing to adequately assess Shade's exposure to liability and invoking the other-insurance clause as a defense to its indemnity obligation, but, in light of the complexity of the coverage and liability issues and the purely economic character of the losses, we do not think its conduct can reasonably be regarded as meriting the degree of opprobrium associated with the term “despicable.”

Shade followed Tomaselli v. Transamerica Ins. Co., 25 Cal. App. 4th 1269, 1287–88 (1994). Again, in Tomaselli, the appellate court found bad faith, but it rejected punitive damages:

- It is notable that punitive damages have been assessed against insurance companies most commonly where a showing has been made of a continuous policy of nonpayment of claims. Cases illustrating an established practice of claims stonewalling are collected in Mock v. Michigan Millers Mutual Ins. Co. (1992) 4 Cal.App.4th 306 at p. 329, 5 Cal.Rptr.2d 594, where the court suggested approval of an earlier inference to the effect that " 'a consistent and unremedied pattern of egregious insurer practices' [is required] in order for the insurer's 'bad faith' conduct to rise to the level of malicious disregard of the insured's rights so as to warrant the imposition of punitive damages." (Citing Patrick v. Maryland Casualty Co. (1990) 217 Cal.App.3d 1566, 1576, 267 Cal.Rptr. 24.)

- [T]here was no showing that the inadequacy of appellant's claims administration was part of a course of conduct. No evidence was introduced as to appellant's handling of other claims. This is not a case, therefore, in which punitive damages are warranted to punish for the maintenance of evil policies which damage the public in general.

- Surely the retention of outside legal counsel to investigate a questionable case cannot be deemed malicious—even admitting that the counsel so retained had a reputation for digging up reasons to deny coverage. The taking of the EUO is a recognized and acceptable practice in claims investigation, and if done in an inappropriate case amounts to nothing more than overzealousness.

- Plaintiffs complain that the appellant did not follow up its representations that it had never received the insurance endorsement on which appellant relied. Again, such conduct evidences only negligence or slipshod investigation. … [C]laims handling that is "witless and infected with symptoms of bureaucratic inertia and inefficiency" does not add up to malice or oppression.

See Food Pro Int. v. Farmers Ins. Exchange, 169 CalApp.4th 976, 993, (2008) (Evidence that is merely consistent with hypothesis of malice, fraud, gross negligence, or oppressiveness does not suffice for punitive damages; some evidence is required that is inconsistent with alternative hypothesis "that tortious conduct was the result of a mistake of law or fact, honest error of judgment, over-zealousness, mere negligence, or other such noniniquitous human failing").

Contra: Zimmerman v. Harleysville Mut. Ins. Co., 860 A.2d 167, 174 (Pa. Super. Ct. 2004) (the trial court's prior finding of bad faith was sufficient to permit it to award punitive damages, within its sound discretion); Hollock v. Erie Ins. Exchange, 842 A.2d 409 (Pa.Super.2004) (en banc) (same)

Lesson: Ineptness Does Not Suffice For Punitive Damages

II. Practical: What Really Makes A Difference

A. Discourtesy, rudeness, callousness, meanness, disrespect

B. Long delays, especially unexplained delays, in responding

C. Not explaining what's going on or what is needed or addressing policyholder concerns concerns – allowing an inference of nefarious motive. Lack of transparency and lack of communication are problematic, as is failure to completely explain what policy benefits are available and how they will be dispensed, as well as what items of damage are either not covered at all, limited by a sub-limit of available coverage, and explaining step by step how the claim will be processed and how the insured is to go about receiving the policy benefits.

D. Prejudging. Going through the motions of investigating even if carrier doesn't think it will make a difference

E. Being unrepentant

F. Treating the insured or their representatives as an adversary

III. Some Exemplars

A. Campbell v. State Farm Mut. Auto. Ins. Co. (Utah 2004) 98 P.3d 409; State Farm Mut. Auto Ins. Co. v. Campbell, 538 U.S. 408 (2003):

This was an auto accident/wrongful death claim in which the insured had a $25,000 policy. The insured initially protested that he was not at fault. Although early investigations supported differing fault conclusions, "a consensus was reached early on by the investigators and witnesses that Mr. Campbell's unsafe pass had indeed caused the crash." State Farm, nonetheless decided to contest liability and declined to settle the claims for the policy limit of $50,000 ($25,000 per claimant). State Farm also ignored the advice of one of its own investigators and took the case to trial, assuring the Campbells that "their assets were safe, that they had no liability for the accident, that

[State Farm] would represent their interests, and that they did not need to procure separate counsel." A jury determined that the insured was 100 percent at fault, and returned a verdict for $185,849.

State Farm refused to cover the $135,849 in excess liability. Its counsel made this clear to the Campbells: "You may want to put for sale signs on your property to get things moving." Nor was State Farm willing to post a supersedeas bond to allow the insured to appeal the judgment against him. The insured obtained his own counsel to appeal the verdict, settling on appeal by assigning his claims against State Farm.

The trial court found that State Farm's employees altered the company's records to make the insured appear less culpable. State Farm disregarded the overwhelming likelihood of liability and the near-certain probability that, by taking the case to trial, a judgment in excess of the policy limits would be awarded. State Farm amplified the harm by at first assuring the insured that his assets would be safe from any verdict and by later telling him, postjudgment, to put a for-sale sign on his house.

"'State Farm argued during phase II that its decision to take the case to trial was an 'honest mistake' that did not warrant punitive damages. In contrast, the Campbells introduced evidence that State Farm's decision to take the case to trial was a result of a national scheme to meet corporate fiscal goals by capping payouts on claims company wide. This scheme was referred to as State Farm's 'Performance, Planning and Review,' or PP & R, policy. To prove the existence of this scheme, the trial court allowed the Campbells to introduce extensive expert testimony regarding fraudulent practices by State Farm in its nation-wide operations. Although State Farm moved prior to phase II of the trial for the exclusion of such evidence and continued to object to it at trial, the trial court ruled that such evidence was admissible to determine whether State Farm's conduct in the Campbell case was indeed intentional and sufficiently egregious to warrant punitive damages.'" State Farm Mut. Auto. Ins. Co. v. Campbell, 538 U.S. 408, 414–15 (2003) quoting Campbell v. State Farm Mut. Auto. Ins. Co., 65 P.3d 1134, 1143 (Utah 2001)

B. Major v. W. Home Ins. Co., 169 Cal. App. 4th 1197.

The insureds' home burned in a wildfire. The carrier used a third party claims adjusting service. At the outset, the supervisor agreed "[t]ime was of the essence" because the insureds' home was gone. In October 2003 the file was assigned to an adjuster. The first payment on the dwelling was not made until February 2004. The carrier failed to mortgage payments on time. The adjuster also refused to provide the insureds with a copy of the policy, despite several requests.

In May 2004 the file was reassigned to a new adjuster, who had not received training required by California law in fair claims settlement practices. Although the supervisor knew that requiring an adjuster to process anything more than 75 to 100 claims was "way too many to handle," the newly assigned adjuster handled over 200 other claims. At the time he took over the file, the carrier was two months behind on payment of mortgage benefits and behind in payments for the trailer the insureds were living in on their property.

The insureds sent the carrier a 77–page inventory of personal property for payment along with other repair invoices. The adjuster did not respond. The insureds followed up with phone calls on May 25, 28 and June 1. On June 2, the adjuster called back and told the insureds that he had not reviewed the claims file and would call them back on June 7. He did not do so. The insureds called him on June 9. At that time, he again said he had not reviewed the file and told them their claim was "third in his stack." He told the insureds on at least three occasions their claim was not his top priority. On June 15, 2004, the insureds contacted adjuster again and he told them that two adjusters had quit, he had been given additional files to manage, and he had not yet read the claims file. On June 25, 2004, the Majors again contacted Western regarding the issues raised in the May 14 letter. Anderson said he had "glanced over [the letter] but ha[d]n't had time to go over it yet." The adjuster reviewed the insureds' May 14 property submission on or about July 12. He told the insureds they were not entitled to recover the cost of replacing their pool because it fell within the coverage for the dwelling, and the policy limit for the dwelling had already been met and stated that he did not know what coverage the spa fell under. He had not read the personal property inventory. By August 30, 2004, he admitted that he had still not reviewed the personal property inventory and told the Majors it would be a "nightmare" to have to do so. If he had reviewed the file, there should have been notations reflecting that fact in the file. There were no such notations. On September 16, the carrier again failed to pay mortgage benefits. The insureds eventually hired counsel and the carrier paid all benefits owed.

C. Trinity Evangelical Lutheran Church & Sch. Freistadt v. Tower Ins. Co., 261 Wis. 2d 333, 351–52 (2003).

An insurer's sales agent inadvertently failed to check the box for hired and non-owned auto coverage in obtaining a policy for a church. The policy was issued without such coverage. After an auto accident the agent realized the error and asked the carrier to extend coverage effective from the initial policy date. The carrier's vice president and director of operations refused, said that the agent should contact his errors and

omissions carrier and observed that he was not going to "back date and add uncertainty as to possible exposure. We could be facing big dollars due to liability." The carrier was asked on several occasions to reconsider, including by the agent's errors and omissions carrier. The errors and omissions carrier cited the carrier to a Wisconsin Supreme Court case from 1969, involving the same carrier, which held that a policy had to be reformed for just such a mistake. The vice president did not read the case and the carrier did not change its position. During discovery, the underwriter who had dealt with the agent confirmed that at the time the policy was requested the agent had asked for hired and non-owned auto coverage. The carrier then immediately agreed to reform the policy.

IV. Defending Cases

A. Attack whether there is something beyond arguable improper claims handling that can go to a jury.

B. Show the company's culture of being careful and timely with insureds' claims (how adjusters are reviewed, official guidelines/policies)

C. Admit lapses, don't attempt to dissuade a trier of fact of the obvious

D. Emphasize unique, complex nature of circumstance. No pattern of similar conduct. Claims adjuster mismatched against an insured represented by counsel

E. Address Problems:

The curmudgeon claims rep.

The disaffected employee/former employee

The unrepentant coverage analysist/outside counsel

-- Demonstrate the inherent reasonableness of the totality of the carrier's conduct utilizing the best possible spokesperson given the venue, even if they have to be introduced to the claim after the fact to demonstrate the company's reasonable approach to the processing of claims

-- Vigorously prepare witnesses with mock cross examination and documents from claim, leave no stone unturned

-- Be prepared to address such issues as performance planning and review processes, scorecards, individual reviews, issues in personnel files, average indemnity goals, and other institutional issues as well as marketing materials and slogans.