

Policy Benefits Should Be Included When Reviewing Damages

Law360, New York (July 11, 2016, 4:02 PM ET) --

In the face of a significant punitive damages award, insurers often argue that the award is excessive because of the disparity between the actual harm suffered by the insured and the punitive damages awarded by the jury. In support of this argument, insurers often assert that the policy benefits recovered by the insured should not be considered as part of the harm when reviewing that disparity. In most circumstances, however, this assertion is contrary to California law.



Michael S. Gehrt

The insurers' argument is premised on the United States Supreme Court's guidance that, "in practice, few awards exceeding a single-digit ratio between punitive and compensatory damages, to a significant degree, will satisfy due process." *State Farm Mutual Automotive Insurance Co. v. Campbell*, 538 U.S. 408, 425 (2003). In insurance cases, California courts have recognized that "a consideration of the disparity between compensatory and punitive damages awards must focus on the compensatory damages awarded on 'only [the] cause[s] of action providing a basis for punitive damages in this case.'" *Textron Financial Corp. v. National Union Fire Insurance Co. of Pittsburgh, PA*, 118 Cal. App. 4th 1061, 1084 (2004) (quoting *Diamond Woodworks Inc. v. Argonaut Insurance Co.*, 109 Cal. App. 4th 1020, 1056 n.35 (2003)). California Civil Code section 3294 allows the recovery of punitive damages "[i]n an action for the breach of an obligation not arising from contract, where it is proven ... the defendant has been guilty of oppression, fraud or malice. ..." Because punitive damages are not authorized in contract actions, insurers assert that policy benefits should not be considered in measuring the proportionality of a punitive damages award. This argument is based on misunderstood case law and fundamentally disregards the tort damages available to insureds.

The primary case insurers use to diminish punitive damages awards on the basis of proportionality is *Major v. Western Home Insurance Co.*, 169 Cal. App. 4th 1197 (2009). In *Major*, the insurer appealed from a jury verdict against it consisting of \$31,359.55 in personal property benefits, \$450,000 in emotional distress damages, \$189,000 in attorney fees and \$646,471.53 in punitive damages. The insurer asserted that a new trial was necessary because, among other reasons, the punitive damages award was excessive. The court reasoned that "because punitive damages are not authorized in contract actions under California law, where both contract and tort damages are awarded in insurance bad faith cases only the tort damages are considered in measuring the proportionality of a punitive damages award." According to the court, "contract damages are irrelevant to, and must be excluded from, the analysis of the ratio guidepost." After removing the contract damages, the court found that "the punitive damages award of \$646,471.53 is slightly more than a one-to-one ratio to the tort damages awarded by the jury (\$450,000 in emotional distress damages plus \$189,000 in Brandt fees equals \$639,000)."

The Major court's decision to exclude personal property benefits from the ratio is almost exclusively based on Textron, an earlier decision that is notable in its procedural peculiarities. The jury in Textron awarded punitive damages in addition to compensatory damages for breach of the implied covenant of good faith and fair dealing, fraud and breach of contract. The insurer attacked the constitutionality of the punitive damages award by arguing, in part, that "consideration of the proportionality of the punitive damages to compensatory damages must focus on the amount awarded for breach of the implied covenant of good faith and fair dealing and for fraud ... excluding the sum the plaintiff recovered on the contract claim." 118 Cal. App. 4th at 1084. The court found this argument persuasive, pointing out that "the parties held separate trials on the breach of contract count and the tort claims and the jury returned separate awards on them." Additionally, the court stated that "the jury's finding that defendant acted with oppression, fraud or malice applied solely to the latter two counts," i.e., the breach of good faith and fair dealing and fraud counts. The court, therefore, held that its "consideration of the disparity between the plaintiff's actual harm and the punitive damage award must be limited to its tort relief."

Read together, Major and Textron stand for the simple proposition that damages awarded specifically for breach of contract should not be included in the ratio because the punitive damages award does not flow from the breach of contract. The decisions do not, however, establish that policy benefits cannot be included in the ratio as tort damages.

Insurance contracts are unique to other contracts in that a breach of "the implied covenant of good faith and fair dealing will give rise to an action in tort by the insured, as well as one in contract, at the election of the insured." Archdale v. American International Specialty Lines Insurance Co., 154 Cal. App. 4th 449, 467 n.19 (2007). The "significant difference" between the two theories is "the available remedies." Id. As a general principle, "tort damages are awarded to [fully] compensate the victim for [all] injury suffered." Plut v. Fireman's Fund Insurance Co., 85 Cal. App. 4th 98, 108 (2000). "If the insured elects to proceed in tort, recovery is possible for not only *all unpaid policy benefits and other contract damages*, but also extracontractual damages such as those for emotional distress, punitive damages and attorney fees." Archdale, 154 Cal. App. 4th at 467-68 n.19 (emphasis added). Accordingly, policy benefits are available to an insured seeking recovery in contract as well as tort.

The Court of Appeal's decision in Amerigraphics Inc. v. Mercury Casualty Co., 182 Cal. App. 4th 1538 (2010), underscores this point. There, the insurer argued that a punitive damages award should be stricken "because the jury did not separately award damages for bad faith" and, therefore, "there was no predicate for an award of punitive damages." Although the court agreed that the jury made no finding on the verdict form as to bad faith damages, and that actual damages are a predicate for a punitive damages award, it held that "the special verdict form here did not *preclude* a finding of punitive damages." The special verdict form had separate questions for breach of contract, breach of the implied covenant and damages. The court held that:

... it is clear that the jury intended to find that Amerigraphics had been harmed by Mercury's bad faith in the same amount that it had been harmed by Mercury's breach of contract. In other words, Amerigraphics suffered damage in the amount of \$130,000, *which could have been awarded for either breach of contract or bad faith.* (emphasis added).

On that basis, the court included the policy benefits when analyzing the ratio of punitive damages to actual harm.

In sum, policy benefits should be included as compensatory damages when reviewing punitive damages

awards because they are recoverable as tort damages for breach of the implied covenant of good faith and fair dealing. This necessarily results in significantly higher punitive damages exposure for insurers that wrongfully deny coverage.

—By Michael S. Gehrt, Liner LLP

Michael Gehrt is a partner in Liner LLP's Los Angeles office.

The opinions expressed are those of the author(s) and do not necessarily reflect the views of the firm, its clients, or Portfolio Media Inc., or any of its or their respective affiliates. This article is for general information purposes and is not intended to be and should not be taken as legal advice.

All Content © 2003-2016, Portfolio Media, Inc.