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Internet Resources

- ◆ www.zreclaim.com/badfaith/newchart.asp (50 state survey of bad faith law)
- ◆ www.badfaithinsurance.org (non-profit group committed to fighting bad faith practices of insurers)
- ◆ www.irmi.com/expert/articles/black_006.asp (from insurer perspective, how claims files may aid policyholders in bad faith cases)
- ◆ http://library.lp.findlaw.com/insurance-law_1_223_1.html (compilation of bad faith articles)
- ◆ www.expertwitness.com/form/list_by_cat.phtml?categoryId=234 (listing of insurance bad faith experts)

INSURER BAD FAITH LITIGATION REMAINS ALIVE AND WELL IN PENNSYLVANIA

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By Linda Karpel

In a critical blow to the insurance industry, a Pennsylvania appellate court recently upheld a substantial bad faith verdict. See Hollock v. Erie Insurance Exchange, No. 298 MDA 2002, 2004 WL 100468 (Pa. Super. Jan. 22, 2004) (“Hollock”). Among other things, the Hollock court affirmed a punitive damages award of nearly \$3 million and confirmed that post-litigation conduct by insurers, specifically discovery abuse, may support a finding of bad faith. In so ruling, the Hollock court also clarified the standard governing a policyholder’s recovery of punitive damages in a bad faith action.

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Prior to the Hollock decision, courts in Pennsylvania had recognized that an insurer’s conduct during litigation could provide the grounds for a bad faith claim, but had largely concluded that insurer discovery abuse during litigation did not constitute bad faith. Those courts reasoned that Pennsylvania’s bad faith statute was intended to provide a remedy for bad faith conduct by an insurer in its role as an insurer and not as a legal adversary. Slater v. Liberty Mut. Ins. Co., Civ. A. No. 98-1711, 1999 WL 178367 at *2 (E.D. Pa. Mar. 30, 1999); see also Shoemaker v. State Farm Mut. Auto. Ins. Ass’n, No. 44998 S 1990, 119 Dauph. Co. 193 (Pa. C.P. Ct. 1998). One court went so far as to suggest that other procedural rules provide the policyholder with an adequate remedy for discovery abuse by insurers. O’Donnell v.

Allstate Ins. Co., 734 A.2d 901, 909 (Pa. Super. 1999).

In Hollock, however, the court held that the discovery abuse by an insurer was properly considered as evidence of the insurer’s bad faith. There, the policyholder sued her insurer for bad faith, based on its failure to investigate, process and pay an underinsured motorist claim within a reasonable period of time. In appealing the bad faith verdict entered in the policyholder’s favor, the insurer challenged whether its litigation conduct during discovery could be properly considered as evidence of bad faith.

In upholding the trial court’s finding of bad faith, the Hollock court conceded

that it had previously “expressed skepticism concerning the degree to which discovery practices . . . could support [a] claim for [insurer] bad faith,” Hollock, 2004 WL 100468 at *4. The insurer’s discovery misconduct in Hollock, however, “far exceeded mere discovery matters” and evidenced dishonest purpose since the insurer intentionally tried to conceal or cover-up the improper conduct of its employees. Id. at *5. The Hollock court concluded that when an insurer engages in such “a blatant attempt to undermine the truth finding process,” a bad faith action is appropriate because the rules of court provide the policyholder with no other remedy. Id.

The Hollock opinion also provided significant guidance with respect to the award of punitive damages in bad faith actions. First, the Hollock court clarified that, once a

Insurer Bad Faith cont. from page 1

policyholder submits evidence sufficient to prove its insurer's bad faith, the trial court has the discretion to award punitive damages against the insurer. In so ruling, the Hollock court rejected the insurer's argument that the award of punitive damages for bad faith required additional proof of malice or "wanton disregard" on the part of the insurer. According to the Hollock court, the Pennsylvania bad faith statute contains no preconditions for the award of punitive damages in favor of the policyholder, other than a finding of bad faith. Id. at *8.

Second, the Hollock court reviewed the trial court's award of punitive damages in light of the recent decision of the United States Supreme Court in State Farm v. Campbell, 538 U.S. 408, 123 S. Ct. 1513 (2003). In Campbell, the Supreme Court reexamined the limits that constitutional due process may place on the award of punitive damages, striking down a \$145 million dollar punitive damage award against an insurer in a bad faith case.

The most important factor identified by the Supreme Court in Campbell for evaluating the reasonableness of a punitive damages award in the bad faith context is the reprehensibility of the conduct of the insurer toward the policyholder. Campbell, 123 S. Ct. at 1521. The Hollock court relied on the trial court's extensive findings concerning the reprehensible conduct of the insurer to fulfill this requirement.

The two other factors identified in Campbell for evaluating the reasonableness of a punitive damage award were (1) the difference between "the actual or potential harm suffered by the [policyholder] and the punitive damages award," and (2) the difference between the award of the punitive damages "and the civil penalties authorized or imposed in comparable cases." Id. at 1520. With respect to the difference between the actual or potential harm to the policyholder and the punitive damages award, the Hollock court recognized that, while the Supreme Court had held that "in practice few awards exceeding a single-digit ratio [of punitive damages to compensatory damages] will satisfy due process," id. at 1524, the Supreme Court had also refused to set a "bright line" for an acceptable ratio between an award of compensatory damages and an award of punitive damages in the same case.

In upholding the 10 to 1 ratio between the punitive and compensatory damages awarded to the policyholder in Hollock for the insurer's bad faith, the court stressed that the 10 to 1 ratio was very close to the "single-digit

ratio" limit referenced by the Supreme Court. The Hollock court also noted that where, as in that case, the damages actually suffered by the policyholder were relatively small in contrast to the magnitude of the insurer's misconduct, larger punitive damage awards to policyholders may be appropriate in order to deter further insurer bad faith and prevent the insurer from profiting from its misconduct. Hollock, 2004 WL 100468 at * 11.

Finally, with respect to the difference between the punitive damage award in Hollock and any civil penalties imposed for that misconduct, the Hollock court noted that, while the trial court had not expressly pronounced the insurer guilty of violating state insurance statutes, it had identified statutes that were potentially violated and would have subjected the insurer to monetary and other penalties, including the suspension or revocation of the insurer's license to do business. When compared against a suspended or revoked license, the punitive damages award in Hollock was found to be reasonable and in accord with the requirements of due process. Id. at *12.

Although the Hollock decision will almost certainly be appealed to the Pennsylvania Supreme Court, it confirms for now that insurer bad faith litigation is alive and well in Pennsylvania. When an insurer acts in bad faith, either before or after the commencement of litigation, the law of Pennsylvania continues to provide the policyholder with a remedy in the form of compensatory and punitive damages.



Questions or comments?
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DISCOVERY IN BAD FAITH CASES

To support an action for insurer bad faith, policyholders should pursue discovery of the following information.

I. CLAIMS FILE AND CLAIMS ACTIVITY LOG

- Permits the policyholder to ascertain the facts surrounding the handling of its claim
- Serves as a potential source of admissions by the insurer's claims employees that its coverage position is not reasonable
- Serves as a potential source of admissions by claims employees concerning the meaning, scope or application of particular insurance policy language
- Reveals what the insurer knew about the claim and coverage and when the insurer knew it
- Production should not be resisted by the insurer on the basis of the work-product doctrine because it is the routine duty of insurers to process, investigate and assess claims.

II. COMPLETE INSURANCE POLICIES

- Including all declarations, endorsements, riders, amendments and binders
- The parties may dispute which documents constitute the policy at issue
- If the insurer made its claim decision utilizing an incorrect set of policy forms, that fact may be relevant to the policyholder's bad faith claim

III. CLAIMS MANUALS AND GUIDELINES

- Serves as a potential source of admissions concerning the meaning, scope or application of particular policy language
- Supports a bad faith claim if insurer acted or resolved claim in manner contrary to its manuals, policies or guidelines

- May show that insurer encouraged unethical practices rather than reasonable claim evaluations
- Trade secret objections by insurer can be cured by policyholder's offer to enter into a stipulation of confidentiality

IV. UNDERWRITING MANUALS AND GUIDELINES

- May reveal admissions concerning meaning, scope or application of insurance policy language
- May show that insurance company's actions were based on pure financial motives, rather than the merit of the claim
- Trade secret objections by insurer can be cured by policyholder's offer to enter into a stipulation of confidentiality

V. INTERNAL NOTES & COVERAGE OPINIONS

- Permits the insured to ascertain the facts surrounding the handling of its claim
- Serves as a potential source of admissions by the insurer that its coverage position is not reasonable
- Serves as a potential source of admissions concerning the meaning, scope or application of particular insurance policy language
- Production should not be resisted by insurer on the basis of work-product doctrine because it is the routine duty of insurers to process, investigate and assess claims
- Some courts even permit discovery of opinions by legal counsel that do not reveal client confidences

VI. DRAFTING HISTORY OF POLICY PROVISIONS

- Standardized policy provisions form the basis of most insurance policies

Discovery in Bad Faith cont. from page 3

- Drafting history information may provide evidence of industry or trade usage of material policy terms that is contrary to the interpretation accorded by insurer
- Drafting history information is especially powerful if insurer at issue participated in drafting committees or groups

VII. RESERVES AND REINSURANCE

- May provide evidence that insurer thought claim was covered, or worth more than it offered on claim
- Associated documents may contain admissions concerning coverage

VIII. PERSONNEL FILES & COMPENSATION POLICIES AND EVALUATIONS OF EMPLOYEES OF INSURER

- May reveal that insurer's employee bonus system, incentive payments, or other compensation scheme rewards high number of claim denials
- May reveal that employee(s) handling claim at issue had poor performance evaluations

IX. CLAIMS FILES OF THE INSURER'S OTHER POLICYHOLDERS

- May provide evidence of a pattern or practice of bad faith by insurer (However, use of such pattern or practice evidence to support punitive damages was limited to some extent by recent Supreme Court opinion in State Farm Mut. Auto. Ins. Co. v. Campbell, 123 S. Ct. 1513, 1521-23 (2003).)
- May reveal that insurer interpreted policy language inconsistently when handling other, indistinguishable claims

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