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When Are Insurance Bad Faith Damage Awards Excessive?

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To evaluate the potential risks for insurance company clients sued for bad faith claim handling, defense counsel must understand the categories of potential damages that could be awarded and have a basis from which to assess their potential magnitude. Bad faith damages are case-specific, and they depend on the nature of the insurer's conduct and the insured's injury, among other factors. A particular damages award might be appropriate in one case, but excessive and even unconstitutional in another.

That said, courts have provided helpful guidance — including suggested ratios and mandatory ceilings — that can help lawyers determine their clients' likely and worst-case damages scenarios. This article focuses on the ratios and damages ceilings in first-party bad-faith insurance cases under California law.

The types of damages available in a bad faith insurance case fall into a number of different categories. In addition to recovering contract damages (which are generally the policy benefits due to the plaintiff), a plaintiff may also be able to recover a variety of tort damages, including damages for economic harm, noneconomic harm (which, in bad faith cases, often constitutes emotional distress damages), punitive damages, attorneys' fees and prejudgment interest.

Economic Harm

Beyond recovery of the policy benefits, the economic damages for bad faith breach could include other financial loss proximately caused by the breach.[1] For example, in Gruenberg v. Aetna Insurance Co., the California Supreme Court held that a plaintiff could recover the loss of future earnings and business profits if proximately caused by the insurer's tortious conduct.[2]

In other cases, courts have suggested that insureds could recover property loss (such as the equity in the insured's home), and even borrowing costs, if the bad faith breach caused the plaintiff to borrow money

to meet living expenses or to preserve assets from foreclosure.[3] In general, courts have not placed a cap on these extracontractual financial damages, but rather have permitted plaintiffs to recover any and all proximately caused financial loss from the bad-faith breach.

Emotional Distress Damages

Early cases generally held that juries had wide discretion to award emotional distress damages, which did not have to bear any relation to financial harm. For example, in 1970, the California Court of Appeal held in Fletcher v. Western National Life Insurance Co. that no fixed standard governed emotional distress damages, and that the only limiting factor was that the damages amount could not be "so large that the verdict shocks the moral sense and raises a presumption that it must have resulted from passion or prejudice."[4] This was consistent with the general principle under California law that noneconomic damages did not need to bear a reasonable relationship to economic damages.[5]

More recent cases, however, have held that emotional distress damages for bad-faith breach of contract must bear a reasonable relationship to economic harm. As the Court of Appeal held in Major v. Western Home Insurance Co., the bad-faith cause of action is primarily designed to remedy "financial loss."[6] Thus, "[i]n determining whether the noneconomic damages award is excessive, we compare the amount of that award to the economic damages award, to see if there is a reasonable relationship between the two."[7] In Major, the court upheld a 2:1 ratio between noneconomic and economic damages ($450,000 noneconomic damages to $220,359.55 in economic damages), holding that a 2:1 ratio was "not excessive."[8]

By contrast, in Merlo v. Standard Life & Accident. Insurance Co., the Court of Appeal held that a 33:1 ratio was excessive.[9] The court reversed the $250,000 noneconomic damages award because the plaintiff had been awarded only $7,470 in economic damages.[10]

Major and Merlo thus represent two ends of a very broad spectrum, leaving plenty of uncertainty for insurers. A recent Court of Appeal decision held that a 9:1 ratio was not excessive as a matter of law, rejecting a bright-line rule and holding that "[a]ssessing the reasonableness of that relationship requires a review of the evidence."[11]

The decision, however, was unpublished and thus provides only minimal guidance to insurers. In the absence of further published guidance, insurers should be prepared to argue that anything above a 2:1 ratio is excessive, citing Major's holding that the purpose of the bad-faith cause of action is to redress financial loss, and that noneconomic damages are excessive if they dwarf economic damages. At the same time, insurers should realize that noneconomic damages could potentially meet or exceed a 9:1 ratio.

A further issue is whether all of a plaintiff's noneconomic damages must be caused by financial loss (e.g., anxiety from unpaid medical bills), or whether a plaintiff who shows some financial loss can then seek all of his noneconomic damages. In Clayton v. U.S. Auto. Association, the Court of Appeal took the latter view, holding that "[o]nce economic loss is shown, … the plaintiff is entitled to recover for all emotional

distress proximately caused by the insurer's bad faith without proving any causal link between the emotional distress and the financial loss."[12]

More recently, the Court of Appeal rejected that view in Major, holding that Clayton was inconsistent with California law, which requires that all noneconomic damages be caused by financial loss. Citing the California Supreme Court's decision in Gourley v. State Farm Mut. Auto. Insurance Co., the court in Major explained that "once that threshold is met, the amount of emotional distress damages is still tied to the amount of economic damages. This is because … in the insurance bad faith setting, emotional distress is not recoverable as a separate cause of action, but only as 'an aggravation of the financial damages.'"[13]

Finally, insurers should note that, although noneconomic damages in a bad faith case are generally limited to emotional distress damages, they could also include damages for pain and suffering, invasions of a person's bodily integrity, disfigurement, disability, impaired enjoyment of life, susceptibility to future harm or injury, and shortened life expectancy.[14]

Punitive Damages

Insureds may seek punitive damages if the insurer acted with malice, oppression or fraud.[15] Due process sets a ceiling on the amount of punitive damages that a plaintiff can recover, and the punitive damages award must bear a reasonable relationship to the amount of compensatory damages. Three ratios have emerged as guideposts in evaluating the constitutionality of punitive damages in bad-faith cases: 1:1, 4:1 and 9:1.

The U.S. Supreme Court endorsed a 1:1 ratio in State Farm Mutual Auto. Insurance Co. v. Campbell, holding that punitive damages should not exceed compensatory damages if the reprehensibility of the defendant's conduct is low and/or compensatory damages are substantial.[16] In Roby v. McKesson Corp., the California Supreme Court similarly endorsed a 1:1 ratio, particularly when the verdict includes a sizable award for physical and emotional distress, which suggests that the jury's award already includes an element of punishment.[17] In Walker v. Farmers Insurance Exchange, the Court of Appeal held that a 1:1 ratio was appropriate because the compensatory damages were high and there appeared to be "a punitive element to [plaintiff's] recovery of compensatory damages."[18]

In other cases, courts have imposed a 4:1 ceiling on punitive damages. In State Farm, the Supreme Court noted that an "award of more than four times the amount of compensatory damages might be close to the line of constitutional impropriety."[19] Following State Farm, federal and state courts in California have regularly used a 4:1 ratio in assessing the reasonableness of punitive damages. In Planned Parenthood of Columbia/Willamette Inc. v. American Coalition of Life Activists, for example, the Ninth Circuit held that "[i]n cases where there are significant economic damages and punitive damages are warranted but behavior is not particularly egregious, a ratio of up to 4 to 1 serves as a good proxy for the limits of constitutionality."[20] And in Century Surety Co. v. Polisso, the California Court of Appeal noted that cases limiting punitive damages ratios to 4:1 are "instructive."[21]

Courts have permitted higher punitive damages ratios when the defendant's conduct is "highly reprehensible."[22] But courts have repeatedly warned that punitive-damages ratios should not exceed "single-digits" (i.e., 9:1), absent extraordinary circumstances and low compensatory damages.[23] In Nickerson v. Stonebridge Life Insurance Co., for example, the Court of Appeal affirmed a 10:1 punitive-damages ratio where the amount of compensatory damages was relatively low ($35,000), the defendant's reprehensibility was high (including "intentional deceit" and a pattern of misconduct), and the victim was particularly vulnerable.[24]

Brandt Fees

In a bad faith action, California law also permits plaintiffs to recover the attorney fees expended to recover policy benefits due — known as "Brandt fees."[25] The plaintiff may not recover fees expended to pursue bad faith liability or punitive damages, and it is the plaintiff's burden to apportion damages and prove which fees were expended to recover policy benefits.[26] Courts do not apply any particular ceiling or ratio on Brandt fees; rather, the plaintiff must show that the fees were reasonable.[27]

Ordinarily, Brandt fees are submitted to the jury for determination, but the parties may stipulate to having the court determine them.[28]

Prejudgment Interest

Finally, a plaintiff is sometimes permitted to recover prejudgment interest on its tort damages. First, a plaintiff is entitled to prejudgment interest as a matter of right if the damages are "certain or capable of being made certain" by computation.[29] Second, a plaintiff may recover prejudgment interest if the damages are not certain, but the plaintiff proves that the defendant acted with oppression, fraud or malice.[30] Absent a contrary statutory provision, the prejudgment interest rate on tort claims in California is 7 percent per year simple interest.[31]

With these guidelines in mind, a lawyer should be able to help his or her insurance client estimate likely and worst case damages scenarios in a bad faith lawsuit.

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[1] California Civil Code § 3333; see also Crisci v. Security Ins. Co. of New Haven, Conn., 66 Cal. 2d 425, 433 (1967).

[2] 9 Cal. 3d 566, 580 (1973); Shade Foods, Inc. v. Innovative Prod. Sales & Mktg., Inc., 78 Cal. App. 4th 847, 888 (2000).

[3] Merlo v. Standard Life & Acc. Ins. Co. of Cal., 59 Cal. App. 3d 5, 16 (1976); Little v. Stuyvesant Life Ins. Co., 67 Cal. App. 3d 451, 465 (1977).

[4] 10 Cal. App. 3d 376, 409 (1970).

[5] See, e.g., Sommer v. Gabor, 40 Cal. App. 4th 1455, 1470-71 (1995) ($2 million noneconomic damages for defamation with $0 economic damages).

[6] 169 Cal. App. 4th 1197, 1216 (2009).

[7] Id.

[8] Id.

[9] Supra, 59 Cal. App. 3d at 16-17.

[10] Id.

[11] Federici v. IDS Property Cas. Ins. Co., 2016 WL 5404719, at *8 (Cal. Ct. App. 2016) (unpub.).

[12] 54 Cal. App. 4th 1158, 1161 (1997).

[13] Major, 169 Cal. App. 4th at 1216.

[14] Bigler-Engler v. Breg, Inc., 7 Cal. App. 5th 276, 300 (2017).

[15] California Civil Code § 3294.

[16] 538 U.S. 408, 416–18 (2003).

[17] 47 Cal. 4th 686, 693 (2009).

[18] 153 Cal. App. 4th 965 (2007).

[19] 538 U.S. at 416.

[20] 422 F.3d 949, 962 (9th Cir. 2005); see also King v. GEICO Indem. Co., 712 F. App'x 649, 650 (9th Cir. 2017) (4:1 ratio).

[21] 139 Cal. App. 4th 922, 966 (2006).

[22] Pfeifer v. John Crane, Inc., 220 Cal. App. 4th 1270, 1314 (2013).

[23] State Farm, 538 U.S. at 425.

[24] 5 Cal. App. 5th 1 (2016).

[25] Brandt v. Super. Ct., 37 Cal. 3d 813 (1985).

[26] Cassim v. Allstate Ins. Co., 33 Cal. 4th 780, 813 (2004).

[27] See id.

[28] Id. at 805.

[29] California Civil Code § 3287(a).

[30] Id. § 3288.

[31] Michelson v. Hamada, 29 Cal. App. 4th 1566, 1586 (1994).