Limitations on Punitive Damages Against Insurers Since State Farm v. Campbell: Lessons for Insurers

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Abstract: This article focuses on the limitations imposed on punitive damages awards by the United States Supreme Court, concentrating on how these limitations have been applied by lower courts in actions against insurance companies. The article begins by examining the Supreme Court's three "guideposts" for determining whether a punitive award complies with due process. The article focuses on the compensatory damages predicate for determining a punitive award pursuant to the second "guidepost" requiring trial courts to examine the ratio between actual and potential harm and the punitive award. The article examines what types of damages have been included in the predicate in bad-faith claims against insurers, and argues that under black-letter contract law, only the plaintiff's bad-faith tort damages should be included in the actual or potential harm side of the ratio. Finally, the article examines how the "reprehensibility" of insurers' conduct has affected punitive awards against insurers. [Key words: punitive damages, bad faith.]

INTRODUCTION

Insurance companies have long been a popular target for high punitive damages awards. This popularity has been largely due to the lack of well-defined limits on such awards. Until fairly recently, the few limits that did exist were nebulous at best. For example, the amount of a punitive award is limited by the rule that punitive damages must be proportional to the plaintiff's actual damages. However, in bad-faith actions against insurers it is not always clear which actual damages should be multiplied in determining whether a punitive award is excessive. This confusion is

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created by the conflation of contract damages with bad-faith tort damages. Black-letter contract law provides that punitive damages are not available for breach of contract. Rather, a plaintiff is only entitled to compensatory damages for breach of contract. Bad faith, on the other hand, is a tort for which punitive damages are available. Sometimes, however, in cases containing liability for both breach of contract and bad-faith, courts mistakenly include a plaintiff’s contract damages as part of its “actual damage” in determining whether a punitive award complies with due process. Because contract damages cannot support punitive damages, however, only the plaintiff’s bad-faith tort damages should be considered in the court’s proportionality inquiry.

Several recent Supreme Court decisions have restored certainty with regard to determining this ratio of compensatory damages to punitive damages. In BMW of North America, Inc. v. Gore and State Farm Mut. Auto Ins. Co. v. Campbell, the Court established that lower courts must examine the ratio between the actual or potential harm suffered by a plaintiff and the punitive damages awarded to that plaintiff in determining whether the punitive award violates due process. Determining which damages should be included in the “actual or potential harm” side of the ratio (a.k.a. the predicate), while seemingly simple, has proven surprisingly tricky for some courts in bad-faith cases where a portion of the insured’s overall compensatory damage award is for breach of contract. In light of traditional contract law principles barring punitive damages for breach of contract, this issue seems easily resolved: exclude contract damages from the predicate. However, not all courts have followed this line of reasoning.

The law of punitive damages is overflowing with policy considerations and other vague and subjective factors. However, the mathematical calculation of a punitive award should be a relatively straightforward and predictable exercise, given that it can be determined within the context of existing legal principles. In fact, Judge Posner, in an opinion discussing the purpose of punitive damages and the due process limitations placed upon them by the Supreme Court, stated that “punitive damages should be measured by standards or rules rather than in a completely ad hoc manner.” Unfortunately, because it remains unclear what types of

6Guirao and Carpenter (2003: 193) assert “(t)he issue itself involves many fundamentally differing points of view, not only liberal versus conservative or pro-business versus pro-consumer, but also a philosophical division of what punitive damages should accomplish, whether they exist only to punish the wrongdoer in a certain case, or alternatively, whether they exist as a public policy tool to eradicate a wrongdoer as an economic force.”
7Mathias v. Accor Econ. Lodging, Inc., 347 F.3d 672, 676 (7th Cir. 2003).
damages are subject to the predicate, the calculation is anything but straightforward and predictable.

The primary purpose of this article is to examine how courts have determined the predicate for punitive damages in bad-faith cases against insurers, and to advocate, based on basic contract law, for the exclusion of contract damages from that predicate. For contextual purposes, the article begins by examining the history of punitive damages and their relation to contract law and bad-faith tort law. The article also examines the Supreme Court's due process jurisprudence as it relates to punitive damages—specifically, the requirement that courts examine the ratio between the actual or potential harm suffered by a plaintiff and the punitive damages awarded to that plaintiff. Finally, the article examines cases where courts have excluded contract damages from the predicate, and it distinguishes and critiques cases where contract damages have been included in the predicate.

OVERVIEW OF PUNITIVE DAMAGES

History and Purpose of Punitive Damages

Punitive damages, of course, are monetary awards granted in addition to compensatory awards (Dobbs, 1993: § 3.11(1)). Punitive damages are intended to punish the defendant's conduct and to deter similar conduct by the defendant and others. Compensatory damages, on the other hand, are intended to redress the plaintiff's actual harm.³⁶

The law of punitive damages is rooted in the English common law (Rustad and Koenig, 2002: 54). Beginning in the 18th century, English courts began awarding plaintiffs exemplary damages as compensation for mental distress and other types of intangible loss (Dobbs, 1993: § 3.11(1)). Early on, punitive damages were awarded for dignatory torts that were "likely to provoke reactions of outrage" (Ellis, 1982: 15). Gradually, courts expanded the scope of punitive damages, making them available for traditional intentional torts that were committed with malice intent, such as assault and battery (Spitzer, 1982: 156; Rustad and Koenig, 2002: 57). Generally speaking, these awards were used to protect those without economic power or social status, and they "often constituted the only line

³⁶See Campbell, 538 U.S. 408, 416 (2003); St. Regis Paper Co. v. Watson, 428 So. 2d 243, 247 (Fla. 1983); American Law Institute (1981: § 355 cmt. a); Williston, Samuel (2002: § 65(2)).
³⁷See Campbell, 538 U.S., at 416.
³⁸See also Spitzer (1982: 156).
of defense against powerful individuals whose actions the criminal authorities failed to prosecute” (Rustad and Koenig, 2002: 57).

Punitive damages were well settled in American law by the mid-19th century (Orr, 2004: 1742). Until recently, the law of punitive damages has been the domain of state law. Today, most states adhere to the Restatement standard for punitive damages that requires a showing of “conduct that is outrageous, because of the defendant’s evil motive or his reckless indifference to the rights of others” (American Law Institute, 1979: § 908(2) (200)).11 Recently, however, punitive damages law has become more federalized, with the Supreme Court constitutionalizing the law with a series of “complex procedural and substantive limits on recovery” (Rustad and Koenig, 2002: 54, 60).12

**Punitive Damages, Breach of Contract, and Bad Faith**

Generally, punitive damages are not available for breach of contract (Dobbs, 1993: § 3.11(1)).13 Rather, recovery for breach of contract is limited to the amount of money necessary to restore the injured party to the position he or she would have been in had the contract been performed.14

Punitive damages may be available, however, for any tort accompanying the breach of contract.15 According to the American Law Institute (1981: § 355) “(P)unitive damages are not recoverable for a breach of contract unless the conduct constituting the breach is also a tort for which punitive damages are available.” Until relatively recently, breach of an insurance contract was not considered a tort that gives rise to punitive damages. In fact, breach of an insurance contract was not treated any differently than the breach of any other contract.16 Thus, punitive damages were not available for breaches of insurance contracts, just as they were not available for breaches of other contracts. Eventually, however, the unique and prominent role insurance contracts play in American society led courts

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11See also Rustad and Koenig (2002: 60).
12See infra, Due Process Limitations on Punitive Damages.
13See also Safeco Ins. Co. of Amer. v. Campbell, 433 So. 2d 25 (Fla. Dist. Ct. App. 1983) [reiterating that plaintiff must allege a tort separate and distinct from breach of contract to recover punitive damages].
14See Maxfly Aviation, Inc. v. Gill, 650 So. 2d 1297, 1300 (Fla. Dist. Ct. App. 1992); American Law Institute (1981: § 369); Williston, Samuel (2002: § 65(2)).
15See, e.g., Allstate Ins. Co. v. Kelley, 481 So. 2d 989, 990 (Fla. Dist. Ct. App. 1986) [denying punitive damages for breach of contract where plaintiff did not sufficiently allege and separate and distinct tort].
16Henderson (1992: 5–8, 11–12, and 21–26) provides the basis for our discussion here of historic legislative and judicial intent pertaining to the societal role of insurance contracts and related implied good faith insurer duties.
and legislatures to treat insurance contracts differently. Early in the 20th century, some state legislatures enacted statutes allowing insureds to recover attorney’s fees and penalties from insurers when they failed to provide benefits under the insurance policy. In the latter half of the century, courts began to develop a common-law cause of action for an insurer’s breach of its implied duty of good faith. Early on, an insurer’s breach of this implied covenant gave rise to an action sounding in both contract and tort (Henderson, 1992: 25). However, courts quickly began to recognize the claim as solely a tort claim. By labeling the claim a tort, courts opened the door to all tort damages being available to the insureds, including punitive damages. Many states now have codified the tort of bad faith.

The availability of punitive damages for bad faith often creates confusion when combined with contract damages. For example, when an insured sues its insurer for bad faith and for breach of contract for failing to perform an obligation under the insurance policy, the insured is entitled both to contract damages and tort damages, including, potentially, punitive damages. Sometimes, however, courts commingle the insured’s contract and tort damages when determining the availability and amount of punitive damages. Further, courts sometimes combine the contract and tort damages, label them collectively as “compensatory damages,” and then use that sum as the actual damages basis for a punitive award. This sum of compensatory damages also then serves as the predicate for determining the appropriate amount of punitive damages in accordance with due process standards. Of course, as discussed above, using contract damages as the basis for, or in the calculation of punitive damages, violates longstanding fundamental rules of contract law.

In addition, until recently, the size of punitive damage awards has gone largely unchecked. This has led to insurers’ being held liable for huge punitive awards. These awards have become increasingly excessive in recent years, leading some to call for limitations on punitive awards (e.g., Lovett, 2003: 1125). A closely related issue is the unpredictability that accompanies these awards. Absent some limit on the amount of punitive damages, it is difficult for insurers to calculate and assess their potential liability. This uncertainty creates serious business concerns for the insurance industry. Although legal reforms may have been necessary to protect

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17 *Id. at 25; Norman’s Heritage Real Estate Co. v. AETNA Cas. & Sur. Co., 727 F.2d 911, 915 (10th Cir. 1984); Keeton and Widiss (1988: § 7.10(a)).
18 *See, e.g., Fla. Stat. § 624.155.
19 *See *infra*, The Predicate: What Can Be Multiplied?
20 *Henderson* (1992: 60) asserts “(o)nsurers must carry large financial reserves to protect against unexpected, as well as expected, losses if they are to remain solvent.” *Sud* (2005: 67) asserts that excessive punitive awards have caused many defendants to go bankrupt.
insureds, (Henderson 1992: 31–32) notes “it now appears that the balance may have been tipped too far in their favor by unduly exposing insurers to extra-contractual damages,” adding that the tort and large punitive damages awards have become “too oppressive on an industry whose financial vitality and efficiency are essential to the social well-being.” Although recent developments have provided some small degree of certainty and predictability, these problems still remain.

Due Process Limitations on Punitive Damages

Scholars have recognized that the primary source of whatever certainty exists regarding punitive damages comes from the Due Process Clause of the Fourteenth Amendment (see Viscusi, 2004). The United States Supreme Court has established that due process limits the amount of punitive damages that can be imposed on a liable party. In BMW and Campbell, the Court established that grossly excessive punitive damage awards violate due process.21 Such awards serve no legitimate purpose, constitute an arbitrary deprivation of property, and violate notions of fairness by depriving persons of fair notice of the severity of the penalty that may be imposed upon them for their conduct.22

In Campbell, the United States Supreme Court emphasized certain limits on punitive damages awards, especially in their relationship with compensatory damages. Specifically, the Court ruled, "[w]hen compensatory damages are substantial, then a lesser ratio, perhaps only equal to compensatory damages, can reach the outermost limit of the due process guarantee."23 Even more specifically, the Court has repeatedly suggested a punitive award greater than “four times the amount of compensatory damages might be close to the line of constitutional impropriety.”24 Although the court refused to set a maximum multiplier, it concluded: “in practice, few awards exceeding a single-digit ratio between punitive and compensatory damages, to a significant degree, will satisfy due process.”25

21Campbell, 538 U.S. at 416; Gore, 517 U.S. at 562. More recently, the Supreme Court addressed the due process limitations on punitive damages in Philip Morris USA v. Williams, 127 S.Ct. 1057 (2007). In Williams, the Court held that punitive damages may not be used to punish a defendant for harm to nonparties. Although the Court affirmed the Gore/Campbell “guideposts,” it explicitly refused to address whether the $79.5 million punitive award was reasonably related to the plaintiff's $821,000 in compensatory damages.

22See Campbell, 538 U.S. at 417.

23Id. at 425 (emphasis added).


25Id. at 410 (emphasis added).
Clearly, these numerical guidelines have provided potential defendants—including insurance companies—with more certainty. A recent academic examination of the effect of various tort reform attempts to limit punitive awards asserts the Supreme Court’s due process limitations were “the most forceful reform effort,” and specifies “imposing a ratio limit that the punitive award cannot be more than nine times the value of the compensatory damages award has a significant restraining effect” (Viscusi, 2004: 15–16).

However, some courts have found ways to lessen this restraining effect, sometimes through exceptions specifically provided by the Supreme Court, and sometimes through fuzzy math and sleight of hand. This article will examine post-Campbell decisions that have awarded and affirmed punitive damages awards against insurers that exceeded Campbell’s limitations.

**THE GORE/CAMPBELL MULTIPLIER GUIDEPOSTS**

In *BMW of N. Am., Inc. v. Gore*, the Supreme Court announced three “guideposts” for the evaluation of the constitutionality of punitive damages awards:

1. the degree of reprehensibility of the defendant’s misconduct;
2. the disparity between the actual or potential harm suffered by the plaintiff and the punitive damages award; and
3. the difference between the punitive damages awarded by the jury and the civil penalties authorized or imposed in comparable cases.

The Supreme Court discussed and refined the standards relevant to each of these guideposts in *Campbell*. In *Campbell*, the insurer was found liable for bad faith in defending one of its insureds in a wrongful death lawsuit. The state court awarded the insureds $1 million in compensatory damages for the 18 months of emotional distress they suffered as a result of the insurer’s conduct. In addition, the state court awarded the insureds $145 million in punitive damages largely on the basis of evidence that the insurer had engaged in unethical and oppressive conduct with respect to other insureds and its own employees. In characterizing the reprehensibility of the insurer’s conduct, the Court stated:

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27 *Id.* at 575.
Applying these factors in the instant case, we must acknowledge that State Farm’s handling of the claims against the Campbells merits no praise. The trial court found that State Farm’s employees altered the company’s records to make Campbell 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 Campbells their assets would be safe from any verdict and by later telling them, postjudgment, to put a for sale sign on their house. While we do not suggest there was error in awarding punitive damages based upon State Farm’s conduct toward the Campbells, a more modest punishment for this reprehensible conduct could have satisfied the State’s legitimate objectives, and the Utah courts should have gone no further.28

In addition to the numerical guidelines quoted above, the Court held that (1) a state may not punish a defendant for its out-of-state acts unless those acts have a “nexus” to the harm suffered by the plaintiff and are used to establish that a defendant has engaged in a common plan or scheme that affected the plaintiff; and (2) a defendant’s conduct dissimilar to that which harmed the plaintiff is not admissible to establish punitive damages.29

“Reprehensibility”—What Conduct Can Affect the Multiplier?

In Campbell, the Court reaffirmed that reprehensibility is the “most important indicium of the reasonableness of a punitive damages award.”30 Further, the Court set forth five factors to measure the reprehensibility of a defendant’s conduct:

(1) whether “the harm caused was physical as opposed to economic”;  
(2) whether “the tortious conduct evinced an indifference to or a reckless disregard of the health or safety of others”;  
(3) whether “the target of the conduct had financial vulnerability”;  
(4) whether “the conduct involved repeated actions or was an isolated incident”; and

28Campbell, 538 U.S. at 419–420.  
29Id. at 422.  
30Id. at 419.
(5) whether "the harm was the result of intentional malice, trickery, or deceit, or mere accident."\textsuperscript{31}

These factors were mentioned in \textit{Gore}, but in \textit{Campbell} the Court mandated that lower courts must use them "to determine the reprehensibility of a defendant."\textsuperscript{32} Although these factors may appear straightforward on their face, Barnes (2007: 27) observed that "[h]ow this determination of reprehensibility ultimately translates into a ratio to compensatory damages is somewhat of a mystery for defendants faced with punitive damage awards." Following her review of recent cases applying the reprehensibility guidepost, Barnes (2007: 32) concluded as follows:

As presented in the foregoing cases, while the factors for determining the "degree of reprehensibility" are presumably the same, the ultimate justification for the ratio to compensatory damages appears purely subjective. The only factor that appears with any repetition is the relationship of the number of Campbell "degree of reprehensibility" factors to the finding of a higher level of reprehensibility. What punitive damage ratio ultimately results from the "higher level of reprehensibility" is anyone's guess.

This article will discuss the latter two factors, which have special significance to commercial liability insurance.\textsuperscript{33}

"Repeated Actions"—Pattern and Practice

Courts are more likely to impose punitive damages awards exceeding the "four times" or "single-digit" ratios where there is evidence the defendant is a "recidivist." The two most common issues relevant to this factor are (1) what actions are "similar" enough to be relevant; and (2) what out-of-state conduct is relevant to this analysis.

Similar and Dissimilar Acts

In \textit{Campbell}, the Court put new constraints on the type of evidence admissible to establish a defendant's reprehensibility by holding that a "defendant's dissimilar acts, independent from the acts upon which liability was premised, may not serve as a basis for punitive damages."\textsuperscript{34} In previous proceedings, the Utah Supreme Court affirmed an excessive

\textsuperscript{31}Id.
\textsuperscript{32}Id.
\textsuperscript{33}The third factor (the target's financial vulnerability) has always been a constant, it has not played a significant role in recent case law developments.
\textsuperscript{34}\textit{Campbell}, 538 U.S. at 422.
punitive damage award in part because of State Farm’s fraudulent anticompetitive behavior:

In the present case, State Farm’s conduct seriously affected the Campbells, as indicated previously, as well as many others. In particular, State Farm’s conduct corrupted its employees by forcing them to engage in deceptive practices or lose their jobs. Moreover, State Farm’s continuing illicit practice created market disadvantages for other honest insurance companies because these practices increased profits. As plaintiffs’ expert witnesses established, such wrongfully obtained competitive advantages have the potential to pressure other companies to adopt similar fraudulent tactics, or to force them out of business. Thus, such actions cause distortions throughout the insurance market and ultimately hurt all consumers. Because State Farm’s actions have such potentially widespread effects, this factor supports a high punitive damages award.35

The U.S. Supreme Court rejected this finding as a basis of reprehensibility:

For the reasons already stated, this argument is unconvincing. The reprehensibility guidepost does not permit courts to expand the scope of the case so that a defendant may be punished for any malfeasance, which in this case extended for a 20-year period. In this case, because the Campbells have shown no conduct by State Farm similar to that which harmed them, the conduct that harmed them is the only conduct relevant to the reprehensibility analysis.36

Therefore, “a defendant’s dissimilar acts, independent from the acts upon which liability was premised, may not serve as the basis for punitive damages.” 37

Critical to the Campbell court’s decision to disregard “market disadvantages for other honest insurance companies” was the plaintiffs’ use of previous first-party claims against State Farm as evidence of its reprehensibility with regard to a third-party claim. The Court found the first-party claim history “dissimilar” because it was not the same “common scheme” that injured the plaintiff. However, the Court did not specify that due process requires “similar acts” evidence to be identical to those that harmed the plaintiff to have relevance in the calculation of punitive damages.

In a subsequent decision in the Campbell case, the Supreme Court of Utah applied a 9–1 multiplier to the punitive damages award against State

36Campbell, 538 U.S. at 424.
37Id.
In "Campbell II," the Utah Supreme Court conceded that it was bound by the U.S. Supreme Court's finding that State Farm was not a "recidivist," but nevertheless declared that the "absence of prior bad acts does not mean that State Farm has forsown the conduct that caused the Campbells' injury and that the citizens of Utah therefore have no reason to deter State Farm's future conduct." The court concluded that "State Farm's obdurate insistence that its treatment of the Campbells was proper clearly calls out for vigorous deterrence."

The Ninth Circuit recently followed Campbell in reversing punitive damages award in Merrick v. Paul Revere Life Ins. Co. Merrick sued Paul Revere for the improper denial of a disability claim. The trial judge allowed the jury to hear evidence of a "history of improper behavior" with regard to "victims other than Merrick." This included a practice of secret "round-table meetings" held to plan denials of claims (although no such meeting was alleged in Merrick's claim) and the use of biased independent medical examiners (although there was no claim of bias in Merrick's case). The judge also allowed into evidence the practices of Unum Provident, a separate insurance company that bought Paul Revere after Merrick bought his policy, although those practices were wholly unrelated to Paul Revere's treatment of Merrick's claim. To compound his error, the trial judge disallowed a jury charge that stated, "you may not punish Defendants for conduct or practices that did not affect Plaintiff," and allowed a watered-down version merely asking whether Paul Revere "acted with oppression, fraud or malice [sic], express or implied, in its dealings with plaintiff, such to justify an award of punitive damages." The Ninth Circuit found this to be in error because the charge addressed only the availability of punitive damages and not the amount:

More important, the instructions given did not provide the jury with clear direction regarding the proper and improper uses of Merrick's "bad company" evidence. As noted above, the jury was permitted to consider this evidence when determining the reprehensibility of the insurers' actions toward Merrick, but it could not directly punish the defendants for harm to victims other than Merrick.

39Id. at 416.
40Id.
41500 F.3d 1007 (9th Cir. 2007).
42Id. at 1017.
In another recent decision, the Montana Supreme Court reduced a punitive damages award with a ratio to compensatory damage of 26–1 to one of 9–1.\textsuperscript{43} The court reduced the award because (1) "there is no evidence that [defendant’s] misconduct was driven by ‘any significant profit motive’"; (2) the wrongdoing at issue was "a single episode of damaging misconduct, rather than repeated instances"; and (3) "there is no evidence that [defendant] has previously engaged in such misconduct."\textsuperscript{44}

The California Supreme Court has held that a defendant’s recidivism may be relevant to the reprehensibility issue. In Johnson v. Ford Motor Co.,\textsuperscript{45} a trial court awarded the plaintiff $17,811.60 in compensatory damages and $10,000,000 in punitive damages (a 600–1 ratio) on the basis of evidence that “[Ford’s] entire customer response program was structured precisely to short-circuit lemon law claims whenever defendant plausibly could.” The appellate court reduced the punitive damages award to $53,435 (a 3–1 ratio) because “[p]unitive damages designed to punish and deter defendant’s overall course of conduct” are not constitutional.\textsuperscript{46} However, the California Supreme Court reversed, finding that “the lower court appears not to have properly considered the evidence of Ford’s policies and practices, and their scale and profitability.”\textsuperscript{47} Further:

[The] defendant’s recidivism is relevant to the reprehensibility of its conduct. To the extent the evidence shows the defendant had a practice of engaging in, and profiting from, wrongful conduct similar to that which injured the plaintiff, such evidence may be considered on the question of how large a punitive damages award due process permits.\textsuperscript{48}

Therefore, the court remanded the case, noting only that the $10,000,000 punitive damages award “may” have been excessive:

We agree with the Court of Appeal that the $10 million punitive damages award may not, under the circumstances of this case, constitutionally be justified on the basis of disgorgement of profits earned by Ford through its entire course of wrongful conduct toward other consumers. In reducing the punitives to a small multiple of the relatively modest compensatory damages award, however, the Court of Appeal apparently failed to adequately consider that Ford’s fraud was more

\textsuperscript{43}Seltzer v. Morton, 154 P.3d 561 (Mont. 2007).
\textsuperscript{44}Id. at 44.
\textsuperscript{45}35 Cal. 4th 1191, 113 P.3d 82 (Cal. 2005), at 88.
\textsuperscript{46}Id.
\textsuperscript{47}Id.
\textsuperscript{48}Id. at 97.
reprehensible because it was part of a repeated corporate practice rather than an isolated incident. For this reason, we reverse the Court of Appeal’s judgment and remand for that court to conduct again the independent due process review required.\textsuperscript{49}

The California Supreme Court allowed the trial court to determine punitive damages anew, under its guidelines; subsequent proceedings were not published.

In another California case, \textit{Diamond Woodworks, Inc. v. Argonaut Ins. Co.},\textsuperscript{50} the California Court of Appeals found that the fact that the insurer had persisted in its denial of a defense to Diamond and its denial of coverage for a period of 18 months precluded any finding that this conduct was an “isolated incident.” The California Court of Appeal refused to consider evidence that Diamond had presented in the Superior Court that Argonaut had lied to government officials and insurance regulators, had violated state insurance laws, and had denied other policyholders’ claims. Because the constitutional inquiry into the award was limited to the insurer’s conduct towards one insured in this case, the court reduced a punitive damages award with a 14–1 ratio to compensatory damages to one with a ratio of just below 4–1 to compensatory damages.

In a very recent case, the U.S. Supreme Court reversed a punitive damages award with a 100–1 ratio to compensatory damages in \textit{Philip Morris USA v. Williams}.\textsuperscript{51} The Oregon Supreme Court had affirmed the award, distinguishing the “guideposts” specified in \textit{Campbell}:

\[T\]he guideposts are only that—guideposts… Single-digit ratios may mark the boundary in ordinary cases, but the absence of bright-line rules necessarily suggests that the other two guideposts—reprehensibility and comparable sanctions—can provide a basis for overriding the concern that may arise from a double-digit ratio.\textsuperscript{52}

While the court rejected the amount of the punitive damages award, it essentially approved the Oregon Supreme Court’s rationale for affirming a high ratio. Clarifying the “similar acts” factor, the Court ruled: “a jury may not punish for the harm caused others” but “conduct that risks harm to many is likely more reprehensible than conduct that risks harm to only a few [and] a jury consequently may take this fact into account in determining reprehensibility.”\textsuperscript{53}

\textsuperscript{49}Id. at 85.

\textsuperscript{50}109 Cal. App. 4th 1020 (2003).


\textsuperscript{52}Williams v. Philip Morris, Inc., 127 P.3d 1165, 1181 (Or. 2006).

\textsuperscript{53}Philip Morris USA, 127 S. Ct. at 1065.
Out-of-State Conduct

One well-known principle iterated by the *Campbell* court is that reprehensibility must be viewed with an eye towards the insurer’s conduct to the particular plaintiff, not its conduct “towards the world at large.” Accordingly, the Court found that the *Campbell* jury should not have been allowed to hear evidence with respect to State Farm’s national claims practices or injuries occurring outside of Utah since a state “cannot punish a defendant for conduct that may have been lawful where it occurred, nor did Utah have a legitimate concern, nor, as a general rule, does the state have a legitimate concern in imposing punitive damages to punish a defendant for unlawful acts committed outside the state’s jurisdiction.”

An insurer successfully limited a punitive damages award against it in *Goddard v. Farmers Ins. Co. of Oregon*. The lower court found that the insurer’s conduct involved “stonewalling” and “low-ballling” in negotiating a settlement on behalf of its insureds under automobile liability policies, and that this was typical of how the insurer did business on a nationwide basis, and that such unethical conduct justified a significant punitive damages award. Nevertheless, the punitive damages award of $20,718,576 was unconstitutionally excessive, and should have been limited to a maximum of three times the compensatory damages award of $863,274.

However, a federal court in Pennsylvania allowed discovery into an insurer’s nationwide pattern and practice, in a bad-faith case context, in *Saldi v. Paul Revere Life Ins. Co.* In *Saldi*, the court required the insurer to disclose evidence with respect to its general business practices, procedures and policies, including documents obtained through similar litigation against the defendant by other policyholders, as evidence of its alleged bad faith with respect to the handling of the insured’s long-term disability policy.

[W]e conclude that courts have consistently held that when a bad faith policy or practice of an insurance company is applied to the specific plaintiff, the plaintiff is entitled to discover and ultimately present evidence of that policy or practice at trial in order to prove that the insurer intentionally injured the plaintiff and to show the insurer’s reprehensibility and recidivism in order to assist the jury in calculating appropriate punitive damages.

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54*Campbell*, 538 U.S. at 421.
56*Id.* at 116–117.
58*Id.* at 176.
The court concluded that, "evidence of lawful out-of-state conduct of the defendant may be probative when it demonstrates the deliberateness and culpability of the defendant’s action in the state where it is tortious." Therefore, there is no bright-line rule that protects insurers from discovery of their nationwide practices as evidence relevant to punitive damages.

**Intentional Trickery or Deceit**

Trickery is another basis on which a court could justify exceeding the 4–1 or single-digit ratio. For example, in *Setzer*, *supra*, the court found a 26–1 ratio was too high but justified a 9–1 ratio because of evidence of the defendant’s intentional trickery.60

In *Hollock v. Erie Ins. Exchange*,61 the Pennsylvania Superior Court sustained a greater than 10–1 ratio against an insurance company that was found to have acted with "deliberate indifference and, in some cases, blatant dishonesty, exhibited by Erie and its employees.” The Court cited the critical findings of the lower court that supported the award:

The court determined that Erie misrepresented the amount of Hollock’s coverage, established an arbitrary reserve with “absolutely no relationship” to available loss documentation, discounted Hollock’s projected wage loss projections without supporting medical or vocational evidence, refused to contact Hollock’s employer to determine the extent of her inability to complete assigned tasks, and refused to pay Hollock’s claim for UIM benefits although it had previously accepted and paid her first-party claims arising from the same accident.... Ultimately, the court characterized Erie as “a company run [amok],” whose supervisory personnel “sanction[ed] deceit” in the service of a “corporate belief that it is acceptable to tell a little lie so long as no one really gets hurt.”62

Thus the court found “no basis to disturb” an award of $2,800,000 based on compensatory damages of $278,825.90.63

Similarly, in *Wilcox Inn, Inc. v. Public Serv. Mut. Ins. Co.*,64 an insurance sued its insurer for bad faith for undervaluing a property damage loss after a tornado. The insurer eventually paid the balance of the loss ($42,000) after an appraisal, but refused to pay the $2,000 “proof of loss preparation”

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60 Id. at 176.
63 Id. at 419–420.
64 Id. at 422.
65 599 F.3d 224 (3d Cir. 2005) (Pa. law).
coverage. The insured sued for the additional $2,000 payment and won, incurring $128,075 and $7,372 in attorney fees and costs, respectively, and winning punitive damages of $150,000. The Third Circuit Court of Appeals justified the large ratio (75–1) of punitive damages to compensatory damages on the grounds, among others, that the insurer had engaged in "purposefully indifferent inaction and intentionally dilatory action" by repeatedly asking for unnecessary documentation, freezing the appraisal process, and low-ball ing the insured.\footnote{Id. at 228.}

Likewise, in \textit{Aon Risk Services v. Mickles},\footnote{242 S.W.3d 286 (Ark. App. 2006).} an insurance agent was held liable for deceit and bad faith after misrepresenting to its insured, when selling the policy, that she would receive double benefits upon the death of her child. The lower court awarded $29,900 in compensatory damages and $2,000,000 in punitive damages (a 66–1 ratio). The appellate court found this excessive but lowered the punitive damages award to $750,000, a 25–1 ratio. The court relied on the defendant's conduct being "highly reprehensible in its dishonesty and outright fraud" to justify the ratio, writing:

Our review of a punitive-damage award is not an exact science but a fluid analysis based on the particular facts of each case. While we believe that Aon’s conduct in this case justifies the imposition of an award that exceeds the single-digit rule expressed in \textit{State Farm v. Campbell}, \textit{supra}, we likewise believe that the circumstances of the case as a whole require a reduction of the award to a less breath-taking ratio of approximately 25-to-1 or less.\footnote{Id. at 400.}

Immediately following \textit{Campbell}, a federal court in Iowa reduced a jury’s punitive damages award of $17,000,000 to $10,000,000 in \textit{Eden Elec., Ltd. v. Amaco Co.}\footnote{258 F. Supp. 2d 958 (N.D. Iowa 2003).} The defendant in \textit{Eden} was found liable for defrauding a company that purchased outdated inventory from it. Noting that the lower award was still slightly higher than the 4–1 ratio to the compensatory damages of $2,400,000, the court found the defendant’s fraud warranted a penalty exceeding quadruple damages, because it fell "at the more reprehensible end of the business fraud category," although the plaintiff suffered only economic damages, because it was "the result of 'intentional malice, trickery, or deceit.'"\footnote{Id. at 971. See also \textit{Bogle v. McClure}, 332 F.3d 1347 (11th Cir. 2003) [upholding punitive damages award of $13,300,000, a 4–1 ratio over compensatory damages, in employment discrimination claim because of the defendants’ trickery and deceit in covering up its activities].}
The Predicate: *What* Can Be Multiplied?

The ratio that can be applied to a plaintiff’s compensatory damages is but one factor in the computation of punitive damages. The other factor is the predicate of the multiplier: exactly what amount(s) count as “compensatory damages” that can be multiplied? Courts have applied very different standards, especially in lawsuits against insurers.

Of course, allowing the compensatory damages for breach of the policy to serve as the predicate for punitive damages directly contradicts the black-letter law disallowing punitive damages for breaches of contract. Recently, a number of courts have applied this principle and have excluded contract damages from the predicate for punitive damages. In *Textron Financial Corp. v. National Union Fire Ins. Co.*,\(^{70}\) the California Court of Appeals adopted the position that the breach of contract portion of bad-faith damages cannot be the basis for punitive damages. In *Textron*, the plaintiff sued an insurer for breach of contract, breach of implied covenant of good faith and fair dealing (bad faith), and fraud. The trial court awarded the plaintiff $165,414.40 in compensatory damages, $75,670.40 of which was for breach of the insurance contract, and $1.7 million in punitive damages. As a result, the court reduced the punitive damages award to $360,000, about four times the amount of compensatory damages awarded on the plaintiff’s bad-faith and fraud claims. The Tenth Circuit Court of Appeals in *Haberman, supra*, also excluded the plaintiff’s contract damages from the compensatory damages predicate. There, the plaintiff was awarded $548,000 on her breach of contract claim, $5,000 in actual damages for her bad-faith claim, and $100,000 in punitive damages. In determining whether the punitive damages award violated due process, the court included only the $5,000 bad-faith damages in its analysis of the ratio.

Pennsylvania courts have been inconsistent in how they apply the predicate. In *Willow Inn, supra*, an insured sued its insurer under Pennsylvania’s bad-faith statute after the insurer paid its contractual damages of $117,000. In the bad-faith case, the district court awarded the insured $2,000 in compensatory damages on the breach of contract claim, plus $128,075 in attorney fees, $7,372 in costs, and $150,000 in punitive damages on the bad-faith claim. The district court used the amount of the insured’s claim under the policy as the predicate in determining that the punitive damage award was not excessive. The Third Circuit Court of Appeals disagreed, holding that the insured’s costs and attorney fees should constitute the predicate:

As Willow Inn’s main insurance claim had been settled before this case was brought, and because the $2,000 award on the contract claim was only incidental to the bad faith thrust of this litigation, we conclude that the attorney fees and costs awarded as part of the [statutory bad faith] claim is the proper term to compare to the punitive damages award for ratio purposes. These awards totaled $135,000, resulting in approximately a 1–1 ratio, which is indicative of constitutionality under Gore and Campbell.\textsuperscript{71}

However, in Gallatin Fuels, Inc. v. Westchester Fire Ins. Co.,\textsuperscript{72} where the insurer was sued in contract and bad faith, the trial court implied that contract damages can be included in the predicate. In Gallatin, although the court never actually concluded which damages should be included in the predicate, it did reduce the punitive damage award to establish an acceptable ratio based solely on the contract award.

Florida courts have not yet discussed the Campbell guideposts with regard to insurer bad faith. In Ferguson Transp. Inc. v. North American Van Lines, Inc.,\textsuperscript{73} the Supreme Court of Florida affirmed a lower court’s denial of punitive damages where there was no tort liability to sustain such an award. The plaintiff in the case sued for breach of contract and tortious interference with a business relationship. The jury found for the plaintiff and granted it $1,300,000 in compensatory damages in addition to a punitive award. The District Court of Appeals overturned the tort claim for lack of evidence and, accordingly, reversed the punitive award as well. The Supreme Court affirmed, holding that punitive damages were not recoverable absent tort liability. Conversely, in Scott v. Progressive Express Ins. Co.,\textsuperscript{74} a plaintiff was not precluded from bringing a bad faith claim for punitive damages by the fact that compensatory damages were already paid in settlement of a motorist’s previous action against insurer.

One unusual case of note is Trinity Evangelical Church v. Tower Ins. Co.,\textsuperscript{75} where the Wisconsin Supreme Court sustained a $3.5 million punitive damage award based on its perception of the potential loss that an insured faced, despite the fact that the insured’s actual out-of-pocket loss was only $17,570. After initially denying coverage for auto claims involving a church school teacher’s personal vehicle, Tower had eventually agreed to reform its policy to include non-owned vehicle coverage and paid $500,000 to settle the underlying auto claim. As a result, Trinity’s actual loss was

\textsuperscript{71}Willow Inn, 399 F. 3d at 232.
\textsuperscript{72}2006 U.S. Dist. LEXIS 13577 (W.D. Pa. 2006).
\textsuperscript{73}687 So. 2d 821 (Fla. 1996).
\textsuperscript{74}932 So. 2d 475 (Fla. 4th DCA 2006).
\textsuperscript{75}661 N.W.2d 789 (Wis. 2003).
limited to $17,570 in attorney’s fees that it had incurred to litigate the coverage case up until Tower had agreed to reform its policy. Tower argued on appeal that the ratio of nearly 200 to 1 was constitutionally excessive. Trinity responded, however, that as it had cost a half million dollars to settle the underlying liability claim, that sum reflected the risk of actual damages attributable to Tower’s bad faith. The Wisconsin Supreme Court agreed. Noting that Campbell had declared that there were no “rigid benchmarks” with respect to the ratio of punitive to compensatory damages and that such ratios might be affected by the relative egregiousness of the defendant’s acts, the court ruled that $500,000 was an appropriate measure of the insured’s actual damages and therefore held that a ratio of 7 to 1 was well within the due process parameters addressed by the U.S. Supreme Court. Writing in dissent, Justice Sykes (joined by Justice Prosser) argued that the majority had engaged in sleight of hand in manipulating the insured’s “actual damages” so as to bring the ratio of punitive to compensatory awards within a permissible range. She argued that the amount for which the underlying case was settled “has no bearing on the actual or even potential compensatory damages in the bad faith claim” inasmuch as Trinity Evangelical Church was never at risk for this amount since it was going to be paid either by Tower or, if coverage was unavailable, through the Errors and Omissions carrier for the insurance agent that had negligently failed to confirm this coverage.

Unfortunately, the Supreme Court cases examining the ratio of compensatory damages to punitive damages have not addressed the issue of what damages can serve as the predicate to be multiplied. Absent the Court’s intervention, it is likely that lower courts will continue to vary on whether to include contract damages in the predicate.

“Disparity”—Exceeding the Single-Digit Multiplier

The U.S. Supreme Court has enumerated three situations in which a multiplier higher than a single digit might be constitutional: “[1] a particular egregious act has resulted in only a small amount of economic damages . . . [2] the injury is hard to detect, or [3] the monetary value of non-economic harm might have been difficult to determine.”76 Of these three factors, the second factor is most relevant to commercial liability insurance.

The Seventh Circuit Court of Appeals affirmed a $186,000 punitive damages award, where there was a $5,000 compensatory damages award (a 37–1 ratio) in Mathias v. Accor Economy Lodging, Inc.77 The court approved

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76Gore, 517 U.S. at 582, quoted in Campbell, 538 U.S. at 425.
77347 F.3d 672 (7th Cir. 2003) (Ill. law).
the higher multiplier because it served the purpose of "limiting the defendant's ability to profit from its fraud by escaping detection and (private) prosecution."\textsuperscript{78}

Some courts have allowed punitive damages awards against insurance companies that maximized or exceed the single-digit multiplier limit. Such awards were enforced against insurance companies in \textit{Hollock}\textsuperscript{50} (upholding a 10–1 ratio for insurance bad-faith case due to insurer's "reprehensible conduct, its significant wealth and the limited compensatory award") and \textit{Haberman v. The Hartford Ins. Group}\textsuperscript{80} (affirming punitive damages award with 20–1 ratio, where insurer refused to fairly pay UM claim, in part because insurer's behavior was hard to detect).

Where none of the three bases for allowing double-digit multipliers apply, however, the Supreme Court has enforced the restrictions mandated in \textit{Gore} and \textit{Campbell}. By overturning unconstitutionally excessive punitive damages awards in four cases subsequent to \textit{Campbell}, the Supreme Court has shown that it is serious that awards "four times the amount of compensatory damages might be close to the line of constitutional impropriety."\textsuperscript{81}

In \textit{Philip Morris USA Inc. v. Williams, supra}, the Court of Appeals of Oregon reinstated a $79,500,000 punitive damages award where a jury had awarded only $800,000 in compensatory damages (a 97–1 ratio). That court cited a long-term fraudulent "business strategy" to profit from a product that was known to be unsafe. Nevertheless, the Supreme Court vacated the award. It continued to do so in three product liability cases against auto manufacturers with essentially similar allegations of fraudulent long-term business practices to profit from products known to be unsafe.\textsuperscript{82}

\textsuperscript{78}\textit{Id.} at 677. See also \textit{Collins Entertainment Corp. v. Coats & Coats Rental Anusement, 584 S.E.2d 120} (S.C. App. 2003) [upholding 10:1 ratio for interference with contractual relations]; \textit{Southern Union Co. v. Southwest Gas Corp., 281 F. Supp. 2d 1090} (D. Ariz. 2003) [imposing punitive damages of $60,000,000 (a 135–1 ratio) on state corporation commissioner found to have interfered with proposed merger involving local corporation, because of evidence he attempted cover-up his activities]; \textit{Willow Inn, 399 F.3d 224} [upholding 75–1 ratio in first-party bad-faith action in part because the conduct was hard to detect—valid claimants who were less diligent than Willow Inn in pressing their claims, when confronted with similar behavior by PSM, would have abandoned their claims in frustration."].

\textsuperscript{79}442 A.2d 409 (Pa. Super. 2004).

\textsuperscript{80}443 F.3d 1257 (10th Cir. 2006) (Ok. law).

\textsuperscript{81}\textit{Campbell, 538 U.S.} at 425.

\textsuperscript{82}\textit{Ford Motor Co. v. Estate of Smith, 538 U.S. 1028} (2003) [overturning a Kentucky court's punitive damages award of $15,000,000, five times the compensatory damages]; \textit{Ford Motor Co. v. Roma, 538 U.S. 1028} (2003) [reversing a $290,000,000 punitive damages award, a 48–1 ratio to compensatory damages]; \textit{Chrysler Corp. v. Clark, 540 U.S. 801} (2003) [overturning federal court's award of $3,000,000 in punitive damages, more than fourteen times compensatory damages].
As shown in the cases cited above, conduct that is "hard to detect" (evidence that is seemingly easy for a jury to find in the bad-faith context) has been cited in post-\textit{Campbell} decisions to avoid the constitutional basis of single-digit multipliers on punitive damages awards.

\textbf{Comparable Civil Penalties}

The third guidepost mandated in \textit{BMW} is "the difference between the punitive damages awarded by the jury and the civil penalties authorized or imposed in comparable cases." To clarify, the court noted that "[a] reviewing court should accord substantial deference to legislative judgment concerning appropriate sanctions for the conduct at issue."\textsuperscript{83} However, it appears that few courts have relied on this prong to a significant extent. In \textit{Campbell}, the Supreme Court of Utah relied in part on this guidepost when affirming the extensive punitive damages award, noting that criminal penalties could possibly be imposed to punish State Farm's conduct. However, the U.S. Supreme Court disregarded this basis for a higher multiplier, noting that the "broad fraudulent scheme" State Farm had been accused of was based in part on out-of-state and dissimilar conduct.\textsuperscript{84} Likewise, in \textit{Nancy v. Kentucky Nat. Ins. Co.},\textsuperscript{85} the court dismissed this guidepost with regard to a statutory bad-faith claim against an insurer.

Finally, the last \textit{BMW} factor—the difference between the punitive damages awarded by the jury and the civil penalties authorized or imposed in comparable cases—does not offer much guidance one way or the other. If West Virginia's Commissioner of Insurance finds that an insurer committed or performed unfair claims settlement practices with such frequency as to indicate a general business practice, the maximum civil penalty that can be imposed under the West Virginia Unfair Claim Settlement Practices Act is $250,000 (see West Virginia Code § 33-11-6(c)). However, such a penalty does not take into consideration Kentucky National's malice as found by the jury in its handling of Nance's claim. Neither party has pointed to any other civil-penalty schemes for our comparison.\textsuperscript{86}

Where there is no bad-faith statute, it follows that this prong is inapplicable.\textsuperscript{87} However, at least one court has cited this guidepost to uphold a

\textsuperscript{83}\textit{Gore}, 517 U.S. at 583.
\textsuperscript{84}\textit{Campbell}, 538 U.S. at 428.
\textsuperscript{85}240 Fed. Appx. 539 (4th Cir. 2007) (W. Va. law).
\textsuperscript{86}\textit{Id.} at 530. See also \textit{Burns v. Prudential Securities, Inc.}, 167 Ohio App. 3d 809, 857 N.E.2d 621 (Ohio App. 3 Dist. (2006) [finding award of $250,000,000 to be excessive where "The maximum penalty authorized by the Ohio legislature for securities violations is $20,000"]).
\textsuperscript{87}\textit{International Union of Operating Engineers, Local 150 v. Lowe}, 870 N.E. 2d 303, 323 (III. 2006) ["As the legislature has not spoken on this issue, it is not necessary for us to further consider this guidepost"].
punitive damages award by comparing it to potential statutory bad-faith penalties. In Thomas v. Grange Mut. Cas. Co., the court found “that the punitive damages award of $15,000.00 is reasonable in light of the civil penalty of $10,000.00 per violation as authorized by Kentucky law.”

CONCLUSION

In Campbell, the Supreme Court placed significant limitations on punitive damages awards that may be awarded against insurance companies. However, some significant exceptions remain. Factors that allow courts to exceed the 4:1 ratio recommended in Campbell include: (1) whether the reprehensible conduct was a “repeated corporate practice” before the plaintiff was harmed; (2) evidence that the defendant continued the same bad practices after harming the plaintiff, rather than having “foresworn the conduct”; (3) whether the conduct was driven by “profit motive”; (4) evidence of “intentional trickery”; and (5) “conduct that risks harm to many.” Conduct that is “hard to detect”—including the misrepresentation of the extent of coverage when marketing a policy—can support even higher punitive damages awards. Further, an insurer’s “pattern and practice” with regard to similar claims (i.e., the same type of coverage) can be relevant to a punitive damages award against it; while an insurer cannot be punished for out-of-state actions under Campbell, those actions can be relevant to its reprehensibility.

The result is more clarity, but not complete clarity. There remain multiple bases for a court to award or affirm punitive damages well in excess of a single-digit multiplier in a bad-faith claim. If an insurer is found to have committed one or more of the acts committed by the insurer in the cases cited above (e.g., used intentional trickery that was hard to detect, to misrepresent the coverage afforded by its policies, in a common scheme against multiple policyholders in a given state, in order to achieve market dominance over other insurers), a court could award or affirm punitive damages above a single-digit multiplier and not violate the mandate of Campbell.

REFERENCES


LIMITATIONS ON PUNITIVE DAMAGES


