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## **SECTION 20**

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**INSURANCE  
BAD FAITH**

## DAMAGES – CONTRACTUAL AND EXTRA-CONTRACTUAL

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Congratulations. Your client has prevailed on claims for breach of contract and breach of the implied covenant of good faith and fair dealing. This article will explain what damages your client may be entitled to and will set forth practical tips to consider when asserting your client's rights to these damages.

### A. Contractual Damages

After establishing that the insurer has breached the contract, the insured is entitled to contractual damages, and in very rare cases, prejudgment interest and attorney's fees.

How do you measure contractual damages? Look at the Policy. The amount of possible damages that will be paid for breaching the contract are defined in the insurance policy. "For the breach of an obligation arising from contract, the measure of damages, except where otherwise expressly provided by this code, in the amount which will compensate the party aggrieved for all the detriment proximately caused thereby, or which, in the ordinary course of things, would be likely to result therefrom." *Cal. Civ. Code* § 3300. Damages must be certain: "No damages can be recovered for breach of contract which are not clearly ascertainable in both their nature and their origin." *Cal. Civ. Code* § 3301.

What does this mean? The basic measure of contractual damages is the benefits due under the insurance policy, plus interest, from the date the benefits were due to the present. Examples of contractual damages include the following:

- In the context of a **health insurance** case: Contractual damages are the value of the services which the health insurer failed to provide. Watch out here for limited contractual damages. For example, if the health insurance company breached the insurance contract by failing to pay for an MRI which caused a delay in the diagnosis and treatment of cancer, and in turn caused missed work, a reduced life expectancy, and a difference in the treatment of the cancer and the survivability rate, for example, the value of the breach of contract claim is simply the cost of the MRI that the insurance company initially refused to pay for. The core of this case's value is in the extracontractual damages. Watch out for this when evaluating these types of cases.
- In the context of a **disability insurance** case: Contractual damages are the disability benefits that have accrued to date under the contract, plus interest. There is no recovery for future disability payments, as the right to future payments depends on a continued disability.
- In the context of a **property insurance** case: Contractual damages are the amount of the loss at the time of the loss, up to the policy's maximum amount. For example, if the home was purchased for 1 million and the house is insured for that 1 million, but it was worth 1.5 million at the time of loss, damages are the 1 million minus any applicable deductible under the Policy. Read the Policy carefully to see what is covered under the contract as certain items could be included, such as personal property and the loss of use as well as the dwelling and other structures.

Be sure to:

- Read the policy carefully to determine whether your client is entitled to additional damages. Prejudgment interest is only recoverable if provided for in the insurance contract (it is highly unusual for the insurance contract to provide for prejudgment interest).
- Note when attorney's fees are not recoverable for breach of contract unless expressly stated so in the contract. *Brandt v. Superior Court* 37 Cal.3d 813, 210 Cal.Rptr. 211 (1985).
- Advise your client on damages that are available should he prevail only on his claim for breach of contract and be sure to take into account any of the policy's provisions that may reduce or enhance those damages. If these provisions exist, determine whether any of those policy provisions are ambiguous and can be construed against the drafter – the insurance company.

### **B. Extracontractual Damages – “Bad Faith Damages”**

When a decision to purchase an insurance policy is made, the insured does “not seek to obtain a commercial advantage” but only “protection against calamity.” *Egan v. Mutual of Omaha Ins. Co.*, 24 Cal.3d 809, 818, 169 Cal.Rptr. 691, 695 (1979). The purpose of insurance is to afford peace of mind and security. Once a claim has been made, the insurance company stands in a greater position of power than the policyholder. The insurance company wrote the policy, the premiums have already been paid and it has unlimited resources to investigate and battle the claim. Extracontractual damages are permitted to balance these inequities. If the insurer is found to have acted in bad faith, i.e. in breach of the implied covenant of good faith and fair dealing, extracontractual damages can be awarded.

An insurer which is found to have breached the implied covenant of good faith and fair dealing can be liable for damages in excess of the policy limits that are proximately caused by the insured's failure to pay the insurance benefits. Damages are measured by the tort measure: “...the amount which will compensate for all the detriment proximately caused thereby, whether it could have been anticipated or not.” *Cal. Civ. Code* § 3333; *Crisci v. Security Ins. Co. of New Haven, Conn.* 66 Cal.2d. 425, 58 Cal.Rptr. 13 (1967); *see also* Crosky, Heesman, Ehrlich & Klee, *California Practice Guide: Insurance Litigation* (Rutter 2015) ¶ 13:69. In order to recover these damages, the plaintiff must show actual damage. *Sarchett v. Blue Shield of California* 43 Cal.3d 1, 16 (1987). Therefore, it is important to understand when claiming these damages, what impact it may have on discovery.

Compensatory damages include: (1) economic damages, (2) emotional distress damages, (3) attorney's fees, and (4) punitive damages.

#### **(1) Economic Damages**

Think of these damages as the economic tort damages. What economic losses did the insured suffer as a proximate result of the insurance company's breach of the insurance contract?

For example:

- Did the insured run up credit card debt for necessary items as a result of the failure to have the contractual benefit? Were hefty interest charges or late fees incurred?

- Did the loss of the benefit cause the insured to lapse on other bills? Did the failure to pay his bills negatively affect his credit? Was there resultant quantifiable damage caused from the negative credit?
- Was your client forced to dip into her retirement account to cover expenses as a result of the wrongful denial? What penalties did they pay as a result?
- Was your client forced to liquidate any assets that he or she would not have if it wasn't for the breach?

When evaluating what quantifiable financial stress the denial of the benefit caused, take a close look at your client's documents supporting these damages. Look at the timing of the losses. Confirm a connection to the actual denial of the insurance benefit as opposed to a loss caused by careless planning or a loss caused because the insured made poor business decisions. Verify that your client maintains credibility in asserting these damages.

The jury will not be sympathetic to a wealthy client who complains of financial devastation yet still is able to support his expensive Nordstrom habits or continue expensive dining. This would not be an example of causing the client financial stress. Is your client claiming that the denial of \$50,000 dollars in life insurance benefits caused him financial stress? If his net worth is over 10 million and he claims that he had to cut back on his expenses and it caused him stress, this will not hold any weight with the jury.

Be aware and consider that claims of this nature entitle the insurer to conduct discovery into the plaintiff's finances. Sensitive financial documents such as earnings records, credit card statements, and sometimes tax returns could potentially be at play. At the outset, discuss with your client his or her income versus expenses to gain an understanding of what economic losses are truly at issue.

Under a finding of bad faith, the plaintiff may also be entitled to the present value of a future contractual benefit. For example, in the disability insurance context, the plaintiff is entitled to future monthly disability benefits for the term of the contract. Look at the Policy to determine whether these benefits run to Age 65 or whether they are for life.

## (2) Emotional and Physical Stress

The insured may seek damages for mental and emotional distress suffered as a consequence of the insurance company's unreasonable withholding of policy benefits and any abusive or coercive conduct in doing so. *Jordan v. Allstate Ins. Co.*, 148 Cal.App.4th 1062, 56 Cal.Rptr.3d 312 (2007). The plaintiff may recover for his emotional and mental distress, injury to reputation and humiliation, inconvenience, and anxiety.

For example:

- Did the denial of the benefit cause *family problems* that did not exist before or greatly exacerbate them?
- Did the denial of the benefit and failure to provide cause a *lack of self-worth*?

- Was the insured *emotionally impacted* by not being able to provide for their family due to the non-payment of the benefit? Was there treatment with a counselor, religious leader or mental health professional?
- Was the insured *forced to borrow money* from a close family member or friend that they wouldn't have otherwise borrowed but-for the breach?

There is an important distinction here. Caution your client that the alleged emotional distress is not as a result of the loss of a loved one (in a life insurance case, for example) or the loss of their beloved family home or possessions (in a property insurance case, for example) or the loss of use of their arm and inability to practice in their profession (in a disability insurance case, for example).

Prepare the plaintiff that family members and close friends who were familiar with the insured's situation before and after can be identified as witnesses and can testify to the insured's emotional status before the claim, during the claim and after the denial. Your client's treating providers who witnessed what he or she experienced will likely testify about the emotional distress.

Watch out for peripheral issues. The insured cannot have already been under financial stress or on the brink of a divorce before the claim.

Did the denial of the benefit and the resultant emotional distress cause medical issues? Be aware that making this claim subjects the insured to discovery of medical and psychiatric records, if applicable. The medical issues complained of cannot have pre-existed the claim and must be caused by the failure to pay the benefit. Make sure to point out this important distinction to your client. The insured may have underlying physical issues that pre-dated the insurance claim or were the reason for making the insurance claim in the first instance. Gather your client's medical records and pharmacy records. Were new medications required once the claim was denied? What treatment occurred pre and post denial?

Caution. Since the jury is looking at all the evidence in determining the amount of extracontractual damages to award, be careful to avoid any evidence that points to the insured's bad faith. For example, minimize all of the following evidence if possible – did the insured fail to completely fill out relevant information on claim forms if that information would harm insured's chances of coverage? Did the insured misrepresent any relevant information during the pendency of the claim or fail to cooperate with the insurer?

In evaluating these damages be careful to explain to your client the critical distinction that these are not damages triggered by the actual event that caused the insurance claim to be filed, but damages caused by the actual failure to pay the benefit and any tortious, abusive or coercive conduct in handling the claim.

### **(3) Prejudgment Interest**

Prejudgment interest is recoverable on damages that are, "certain or capable of being made certain." *Cal. Civ. Code* § 3287. Prejudgment interest may also be awarded in the jury's discretion in every case of oppression, fraud or malice. *Cal. Civ. Code* § 3288(a).

### **(4) Attorney's Fees**

Attorney's fees incurred by an insured in obtaining policy benefits that an insurer has been held to have denied the insured in bad faith are recoverable and are known as *Brandt* fees. *Brandt v. Superior Court* 37 Cal. 3d 813, 817, 210 Cal.Rptr. 211, 213 (1985).

*Brandt v. Superior Court*, *supra* at 817 held that when an insurance company withholds policy benefits in bad faith, forcing the policyholder to bring a lawsuit to obtain those benefits, the policyholder can recover the attorney's fees he or she incurred to obtain the benefits that the insurer unreasonably withheld. "When an insurer's tortious conduct reasonably compels the insured to retain an attorney to obtain the benefits due under a policy, it follows that the insurer should be liable in a tort action for that expense." *Id.* But note the holding, only those attorney's fees incurred in establishing contract benefits are recoverable, "[f]ees attributable to obtaining any portion of the plaintiff's award which exceeds the amount due under the policy are not recoverable." *Id.* at 806-807. The plaintiff has the burden to prove that the entitlement to attorney's fees and the amount of the attorney's fees incurred to establish the contract benefits. *Cassim v. Allstate Ins. Co.* 33 Cal.4th 780, 16 Cal.Rptr.3d 374 (2006).

Those fees are treated as an element of the policyholder's compensatory damages or extracontractual damages. It is important to note that if you represent your client on a contingency fee agreement, you are not limited to the agreed-upon percentage of the benefits, for example, 40%. Nor is the amount of attorney's fees limited in any way to the contract benefits due under the policy. Rather, the amount of attorney's fees are intended to compensate for the attorney's efforts to obtain the contract benefits, regardless of the amount stated in the contingency fee agreement. Crosky, Heesman, Ehrlich & Klee, *California Practice Guide: Insurance Litigation* (Rutter 2015) ¶ 13:129.9.

*Brandt* fees can be awarded by a jury along with all the other available damages, or the parties can stipulate to allow the trial court to decide the issue of *Brandt* fees after a finding of bad faith.

### (5) Punitive Damages

The only type of case in which California allows punitive damages to be awarded based on the breach of a contract is an insurance case. The reason for this is that the relationship of insurer and insured is inherently unbalanced, and "the availability of punitive damages is thus compatible with recognition of insurers' underlying public obligations and reflects an attempt to restore balance in the contractual relationship." *20th Century Ins. Co. v. Superior Court*, 90 Cal.App.4th 1247, 1266, 109 Cal.Rptr.2d 611, 626 (2001). The purpose of punitive damages is to punish the defendant, to make an example, and thereby to deter others from similar conduct. Crosky, Heesman, Ehrlich & Klee, *California Practice Guide: Insurance Litigation* (Rutter 2015) ¶ 13:193; *Neal v. Farmers Ins. Exch.*, 21 Cal.3d 910, 928. 148 Cal.Rptr. 389, 399 (1978). The Due Process clause of the 14<sup>th</sup> Amendment limits the punitive damages.

Together, *State Farm Mut. Automobile Ins. Co. v. Campbell* (2003) 538 U.S. 408 and *BMW of North America, Inc. v. Gore* (1996) 517 U.S. 559 established three guideposts for determining whether a punitive damages award violates the Due Process Clause of the United States Constitution: (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. Regarding the disparity between the actual harm suffered and the punitive damages award, ratios as high as 10 to 1 have passed constitutional muster, but any ratio greater than 1 to 1 is likely to face a constitutional challenge.

In the context of insurance cases where the insurer has been found in breach of the implied covenant of good faith and fair dealing, *Brandt* fees are properly included as compensatory damages for purposes of calculating the punitive damages ratio when the fees are awarded by the jury, but excluded when the parties stipulate that the *Brandt* fee is to be determined by the trial court.

This year, the Supreme Court of California decided *Nickerson v. Stonebridge Life Ins. Co.*, 63 Cal.4th 363, 203 Cal.Rptr.3d 23 (2016) and was faced with the following issue: “Is an award of attorney fees under *Brandt v. Superior Court* (1985) 37 Cal.3d 813, properly included as compensatory damages where the fees are awarded by the jury, but excluded from compensatory damages when they are awarded by the trial court after the jury has rendered its verdict?”

The Supreme Court unanimously held that when reviewing a punitive damages award, *all* of the harm the policyholder suffered should be considered, “In determining whether a punitive damages award is unconstitutionally excessive, *Brandt* fees may be included in the calculation of the ratio of punitive to compensatory damages, regardless of whether the fees are awarded by the trier of fact as part of its verdict or are determined by the trial court after the verdict has been rendered.” *Id.* at 375. The court reasoned that, “to exclude the fees from consideration [of punitive damages] would mean overlooking a substantial and mutually acknowledged component of the insured's harm. The effect would be to skew the proper calculation of the punitive-compensatory ratio, and thus to impair reviewing courts' full consideration of whether, and to what extent, the punitive damages award exceeds constitutional bounds. *Id.* at 377.

Therefore, *Brandt* fees should be treated as compensatory damages when calculating the ratio of punitive to compensatory damages even when they are awarded by the trial court after the jury has returned its punitive damages award.

- In the *Nickerson* case, damages were as follows: \$31,500 in contractual damages and \$35,000 in extracontractual damages for emotional distress. The jury found \$19 million in punitive damages. The court awarded \$12,500 in attorney's fees under *Brandt*. The parties stipulated that the attorney's fees under *Brandt* were \$12,500. The jury awarded \$19 million in punitive damages. The trial court reduced the punitive damages award to a 10 to 1 ratio, to \$350,000, considering only the \$35,000 in extracontractual damages in determining the punitive damages award. The Supreme Court of California held that the \$12,500 in *Brandt* fees must be included in the 10 to 1 ratio calculation.

### C. Conclusion

It is important from the outset of the case to provide your client with a clear understanding of what damages are recoverable should they prevail on each cause of action and what will be required of them, and possibly their loved ones and treating providers, during the discovery process in order to prove that those damages are proximately caused by the actions of their insurance company.