No. 01-1289

IN THE

Supreme Court of the United States

STATE FARM MUTUAL AUTOMOBILE INSURANCE COMPANY,
Petitioner,

v.

CURTIS B. CAMPBELL and INEZ PREECE CAMPBELL,
Respondents.

On Writ of Certiorari to the Utah Supreme Court

BRIEF OF *AMICI CURIAE* ALLIANCE OF AMERICAN INSURERS, AMERICAN INSURANCE ASSOCIATION, NATIONAL ASSOCIATION OF INDEPENDENT INSURERS, AND NATIONAL ASSOCIATION OF MUTUAL INSURANCE COMPANIES IN SUPPORT OF PETITIONER

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WILSON-EPES PRINTING CO., INC. – (202) 789-0096 – WASHINGTON, D. C. 20001

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INTEREST OF THE *AMICI*[1]

Amici curiae Alliance of American Insurers, American Insurance Association, National Association of Independent Insurers, and National Association of Mutual Insurance Companies are the four largest national trade associations of property and casualty insurers in the United States. *Amici*'s member companies write every type of property and casualty insurance in every state.

Amici and their member companies have a substantial interest in the issues presented in this case. The decision of the Utah Supreme Court would allow a single jury in one state to award punitive damages based on an assessment of the lawfulness of an insurer's practices outside of that state, including practices that have no similarity whatsoever to the controversy before the jury. In essence, the role of the jury would be radically transformed from that of a factfinder in a particular dispute into a national insurance regulator.

Property and casualty insurers, however, already are subject to extensive systems of administrative regulation by state insurance departments in every jurisdiction—including all of the practices put into evidence before the Utah jury. As a result, a jury's determination that a particular practice was "unfair" or "deceptive" and a consequent award of punitive damages based on out-of-state conduct would subject insurers to conflicting legal standards governing their

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[1] Pursuant to Supreme Court Rule 37.6, *amici curiae* state that no counsel for any party to this dispute authored this brief in whole or in part and no person or entity, other than *amici curiae* and their member companies, made a monetary contribution to the preparation or submission of this brief. Petitioner is a member of one of the *amici* insurance industry trade associations.

All parties have given blanket consent to the filing of all *amicus* briefs in this case, in letters of consent filed with the Clerk of this Court.

business. Indeed, a jury could impose punitive damages for conduct deemed perfectly lawful by regulators in the state where the conduct occurred or conduct not previously determined by regulators to be unlawful.

Based on *amici's* familiarity with state regulation of the business of insurance, this brief demonstrates how jury consideration of out-of-state conduct could violate long established principles precluding states from engaging in extraterritorial regulation of insurance.

SUMMARY OF ARGUMENT

The Utah jury awarded punitive damages based on a nationwide spectrum of dissimilar "other act" evidence having no causal relationship to the plaintiffs' injury. In doing so, the jury was transformed from a factfinder in a particular case into a national regulator of insurance practices. The Utah courts have thus created a process that impermissibly infringes on the regulation of the business of insurance by the several states.

A state may not extend its insurance regulatory power extraterritorially to reach conduct occurring outside its boundaries. The Constitution imposes limits on extra-territorial regulation under the Commerce, Due Process, and Full Faith and Credit Clauses. Moreover, under the McCarran-Ferguson Act, the regulation of insurance is committed to the individual states, with each state regulating conduct within its own borders.

In exercising their insurance regulatory powers, states make individual and sometimes very different decisions as to what types of insurance practices should be prohibited or permitted and, if prohibited, the type and extent of sanctioning schemes, mechanisms of enforcement, and avenues for consumer redress that should be available. The Utah jury has superseded these state-by-state judgments by

conducting a national review of a wide variety of State Farm's underwriting, coverage, and claims handling practices, and then, without any instruction on the law of other jurisdictions, awarding punitive damages based on the jurors' disapproval of those practices, without any formal determination of their legality.

In fact, however, many of these practices were plainly lawful—indeed, encouraged—in the states where they occurred. The decision below should thus be overturned because it squarely conflicts with *BMW of North America, Inc. v. Gore*, 517 U.S. 559, 573 (1996), where this Court ruled that a jury awarding punitive damages may not punish the defendant "for conduct that was lawful where it occurred and that had no impact on [the forum state] or its residents."

The "other act" evidence considered by the Utah jury also included practices the legality of which had yet to be determined in other jurisdictions or which, although prohibited, did not give rise to a private cause of action or were not subject to punitive damages. This Court should prohibit jury consideration of these other categories of extraterritorial conduct based on the same "principles of state sovereignty and comity" that underlay the *BMW v. Gore* decision. *Id.* at 572. An award of punitive damages based on conduct that a state has not determined to be unlawful "would be infringing on the policy choices of other States" in determining whether a particular practice was consistent with public policy. *Id.* Similarly, awarding punitive damages for conduct not subject to a private right of action or to punitive damages in other states would infringe on the freedom of those states to determine how to penalize and deter conduct within their borders.

Moreover, the Utah jury was allowed to consider other acts of State Farm that, even if they had occurred in Utah, were so dissimilar to the acts that gave rise to plaintiffs' injuries as to violate all principles of evidence

governing the admission of "other act" evidence. This fundamentally altered the nature of the punitive damage proceeding from punishment of the defendant's conduct toward the plaintiffs into a general review of the defendant's business practices, subjecting the defendant to unforeseeable standards of conduct and grossly disproportionate punitive damages, all in violation of principles of due process.

The Utah courts' grant of authority to juries to conduct a nationwide compliance audit of business practices exceeds the institutional competence of the jury. Whatever respect may be due under the common law to juries considering disputes between the parties under a single body of law, the national, company-wide examination that the Utah Supreme Court condoned is the type of regulation that is properly left to state insurance regulators, who have the expertise and investigative tools to conduct such a comprehensive review.

For these reasons, this Court should bar a jury, in awarding punitive damages, from considering extraterritorial conduct of any variety and in-state conduct that is dissimilar to the practice being punished.

ARGUMENT

I. THE BUSINESS OF INSURANCE IS SUBJECT TO A UNIQUE SYSTEM OF STATE-BY-STATE REGULATION.

Constitutional principles arising under the Due Process Clause and Full Faith and Credit clause prohibit a state from regulating extraterritorially in a manner that ignores the law of the jurisdiction in which the conduct occurred. *See, e.g.*, *Phillips Petroleum Co. v. Shutts*, 472 U.S. 797, 815-23 (1985) (courts may not apply forum state's law to claims of out-of-state class members that have no relationship to the forum state); *Allstate Ins. Co. v. Hague*,

449 U.S. 302, 312-22 (1981) (to apply its law constitutionally, state must have significant contact or aggregation of contacts so as to render application not arbitrary or unfair); *cf. Amchem Prods. Inc. v. Windsor*, 521 U.S. 591, 624 (1997) (certification of a nationwide class precluded by conflict-of-law principles requiring application of the law of the state where the class member's claims arose).

These principles apply with particular force to the regulation of insurance. The system of insurance regulation in the United States is based on a federalist devolution of power to the several states as reflectors of local concerns and interests. Indeed, as a matter of national policy, the business of insurance is singular in the extent to which each state regulates insurance practices according to its own policies and judgments, whether by statute, administrative regulation, or common law jurisprudence.

Congress has determined that the regulation of the business of insurance should be reserved exclusively to the states. The McCarran-Ferguson Act provides that "[t]he business of insurance...shall be subject to the laws of the several States which relate to the regulation or taxation of such business." 15 U.S.C. § 1012(a) (1997). This policy of deference to state insurance regulation reflects Congress's judgment "that the continued regulation and taxation by the several States of the business of insurance is in the public interest." 15 U.S.C. § 1011 (1997); *see also U.S. Dep't of Treasury v. Fabe*, 508 U.S. 491, 500 (1993). The McCarran-Ferguson Act authorizes national regulation of insurance only if Congress creates a federal regulator pursuant to a statute that "specifically relates to the business of insurance." 15 U.S.C. § 1012(b) (1997). The National Conference of Insurance Legislators has aptly observed that, by virtue of

this statute, "insurance is the only major business in the United States that is primarily regulated by the states."[2]

The McCarran-Ferguson Act is not limited to a division of power between the federal and state levels of government. The Act also recognizes that the state regulation Congress intended to preserve is that of insurance practices occurring or having their impact within the regulating state. States thus are not entitled to regulate extraterritorially. In *FTC v. Travelers Health Association*, 362 U.S. 293 (1960), which addressed the extraterritorial application of a state unfair insurance trade practices law, this Court observed that "it is clear that Congress viewed state regulation of insurance solely in terms of regulation by the law of the State where occurred the activity sought to be regulated. There was no indication of any thought that a State could regulate activities carried on beyond its own borders." *Id.* at 300.

The legislative history of the McCarran-Ferguson Act confirms this interpretation of the statute: "One of the major arguments advanced by proponents of leaving regulation to the States was that the States were in close proximity to the people affected by the insurance business and, therefore, were in a better position to regulate that business than the Federal Government." *Id.* at 302. "Such a purpose would hardly be served by delegating to any one State sole legislative and administrative control of the practices of an insurance business affecting the residents of every other State in the Union." *Id.*

The McCarran-Ferguson Act thus reinforces constitutional principles forbidding extraterritorial regulation. Indeed, this Court's determination in *Travelers Health* that the Act was intended to preserve only regulation in the state where the practice occurred suggests that the Act did not lift

[2] National Conference of Insurance Legislators: History & Purpose, *at* http://www.ncoil.org/ncoilinfo/about.html.

the prohibitions of the dormant Commerce Clause where a state regulates conduct outside of its own boundaries. *Cf. Metro. Life Ins. Co. v. Ward*, 470 U.S. 869, 880 (1985) (McCarran-Ferguson Act precludes application of dormant Commerce Clause to taxation of foreign insurers doing business within the taxing state).

II. BY ITS CONSIDERATION OF CONDUCT IN OTHER STATES, THE UTAH JURY WAS TRANSFORMED INTO A NATIONAL REGULATOR OF INSURANCE PRACTICES.

In this case, the Utah jury assumed the role of a national insurance regulator in derogation of the constitutional prohibitions on extraterritorial insurance regulation.

Plaintiffs' central allegation is that State Farm, plaintiffs' auto insurer, unreasonably failed to settle a third-party liability claim that exposed plaintiffs to a judgment in excess of the insurance policy's limits. The jury was asked to consider, and award punitive damages based on, a broad range of out-of-state acts. As described in more detail below, the other acts (i) were nationwide in scope, occurring in numerous states other than Utah; (ii) covered a twenty-year period; and (iii) included acts that were wholly dissimilar to the alleged conduct that injured the Campbells and, indeed, often involved disparate lines of insurance.

The out-of-state practices had no nexus to Utah whatsoever. The insured property or person was not located in Utah, the policyholders were not residents of Utah, the claims were handled by State Farm offices outside of Utah, the practices were subject to the regulatory jurisdiction of insurance commissioners other than the Utah commissioner, and litigation involving the claims was filed outside Utah.

Plaintiffs' counsel expressly urged the jury to assume a regulatory role and assess State Farm's practices on a national basis. He told the jury in his opening statement that the case "transcends the Campbell file. It involves a nationwide practice. And you, here, are going to be evaluating and assessing, and hopefully requiring State Farm ***to stand accountable for what it's doing across the country, which is the purpose of punitive damages.***" JA 242a (emphasis added).

Indeed, the Campbells' counsel explicitly invited the jury to displace state regulators because they were not up to the task: "The only regulators of insurance companies are juries like you. You are the ones that hear, investigate and listen to the evidence and impartially make decisions regarding the actions of insurance companies.... Why were you important? ***Because you are the regulators.*** We do not have objective and effective regulators of the insurance industry." JA 3217a-3218a (emphasis added). Counsel similarly emphasized in his opening, "You are going to hear evidence that even the insurance commission in Utah ***and around the country*** are unwilling or inept at protecting people against abuses." JA 208a (emphasis added). The Campbells' witnesses also testified as to the purported inadequacy of state insurance regulators in California and other states. *See, e.g.*, JA 1089a-1090a.

With respect to the regulatory role urged on the Utah jury, *amici* recognize that an award of punitive damages always has some regulatory effect:

> As we noted in another context, "[state] regulation can be as effectively exerted through an award of damages as through some form of preventive relief. The obligation to pay compensation can be, indeed is designed to be, a potent method of governing conduct and controlling policy."

Cipollone v. Liggett Group Inc., 505 U.S. 504, 521 (1992) (quoting *San Diego Bldg. Trades Council v. Garmon*, 359 U.S. 236, 247 (1959)).

Amici do not mean to suggest that, as a result of this regulatory effect, a jury may never competently award punitive damages for a claim based on regulated insurance conduct. In the traditional setting, the jury's punishment and deterrence are aimed squarely at the specific conduct of the defendant that injured the plaintiff in that case. In that setting, the parties injured by the conduct to be punished are before the court, and the jury receives guidance on the legal principles by which to judge the conduct, including the effect of that state's regulatory law. Such traditional limitations are consistent with the institutional competence of the jury.

This case illustrates, however, how the regulatory character of the jury's function improperly dominates its particularized fact-finding role and, indeed, becomes all but exclusive once the jury moves from considering the evidence of acts that bore a causal relationship to the plaintiff's injury to considering "other act" evidence consisting of a wide variety of the commercial practices in which the defendant engages nationally, and which did not involve the party plaintiff in any manner. Moreover, in the Utah case no effort was made—or was possible—to instruct the jury on the regulatory and common law of other jurisdictions as to the lawfulness or allowable punishment for the conduct that took place within those states' respective borders.

This failure to take into account the laws and regulatory policies of other states cannot be justified through the rhetorical device of declaring that the jury is punishing only the acts involving the plaintiffs. If the jury is fixing the amount of damages based on out-of-state conduct, then the "other act" evidence forms at least part of the basis for the award and the unrelated conduct is being punished. This is particularly true in the case where, as here, (i) the plaintiff's

lawyer asks the jury to punish the insurer enough to force it to alter numerous practices everywhere; (ii) he also urges the jury to consider, as benchmarks for the amount of punitive damages, nationwide financial data; and (iii) the amount of the resulting award indicates that the jury was imposing punishment for out-of-state conduct.[3]

When the punitive damages case stops being about the harm done to a plaintiff and becomes an indictment of an insurer's nationwide practices involving insureds in other states, ***it essentially becomes a nationwide class action without the class and without the protections afforded to class members and defendants.*** A plaintiff arrogates to himself or herself the right to punish and deter conduct that he or she never experienced, but which directly affects non-residents whose voice is not heard. The jury is free to ignore the law of other jurisdictions and apply the law of the forum state nationally, even though that would not be permitted in a class action.

III. THE JURY'S EXERCISE OF A NATIONAL REGULATORY ROLE INFRINGED ON THE SOVEREIGNTY OF OTHER STATES.

In *BMW v. Gore*, this Court recognized that "[w]hile each State has ample power to protect its own consumers, none may use the punitive damages deterrent as a means of imposing its regulatory policies on the entire Nation." 517 U.S. at 585. The Court recognized that "the Constitution has a 'special concern...with the autonomy of the individual States within their respective spheres.'" *Id.* at 571 (citation omitted). Thus, the Court held that "it follows from these principles of state sovereignty and comity that a State may not impose economic sanctions on violators of its laws with

[3] *See* JA 3220a (counsel's argument for punitive damages based on State Farm's $55 billion in assets); JA 3237a-3238a (argument based on one month of surplus across the country).

the intent of changing the tortfeasors' ***lawful*** conduct in other States." *Id.* at 572 (emphasis added).

The Utah jury verdict in this case violated this precept by awarding punitive damages based on out-of-state conduct that was clearly lawful in other jurisdictions. Additionally, this case presents two issues not decided in *BMW v. Gore*: (i) whether punitive damages may be awarded based on extraterritorial conduct whose lawfulness is undetermined or unclear; and (ii) whether punitive damages may be awarded based on conduct that may be unlawful in other jurisdictions but subject to a specific regime of sanctions that exclude or limit punitive or any damages.

This Court should preclude a jury from awarding punitive damages based on these categories of extraterritorial conduct for the same reasons of "state sovereignty and comity" that the Court applied to lawful conduct in *BMW v. Gore*. 517 U.S. at 572. There, the Court emphasized the states' discretion in deciding how to prohibit unfair and deceptive trade practices:

> [T]he states need not, and in fact do not, provide such protection in a uniform manner. Some States rely on the judicial process to formulate and enforce an appropriate disclosure requirement by applying principles of contract and tort law. Other states have enacted various forms of legislation.... The result is a patchwork of rules representing the diverse policy judgments of lawmakers in 50 States.

517 U.S. at 569-70. The Court disallowed punitive damages based on extraterritorial conduct that was lawful in the state where it occurred because a punitive award would infringe on the freedom of other states to decide on the means of regulation most appropriate in light of local interests.

These considerations apply with equal force where (i) a punitive damages award may preempt a state's decision whether a particular practice should be declared lawful or unlawful or (ii) an award would be inconsistent with the state's judgment concerning the type and magnitude of penalties commensurate with the violation. As demonstrated below, the Utah jury's punitive damages award is in conflict with or would subvert the various states' differing insurance regulatory policies in numerous ways.

A. The Utah Jury Condemned Conduct Lawful in Other States.

Much of the purportedly "unfair" conduct laid before the Utah jury concerned practices that most or all states permit and that some endorse or even require. For example, all states permit the use of non-OEM parts (*i.e.*, replacement parts not made by the original equipment manufacturer) in automobile repairs. Use of such parts holds down the cost of automobile repairs by fostering competition between OEM and non-OEM manufacturers and thereby enhancing the affordability of insurance. Indeed, two states affirmatively ***require*** insurers to offer non-OEM parts in certain circumstances.[4] The Utah jury's decision thus undermines

[4] Massachusetts regulations provide that a non-OEM part shall be used unless the vehicle's operational safety might be impaired, an appropriate part cannot be located, a new part is available at the same or lower price, or the vehicle has been driven for fewer than 15,000 miles. Mass. Regs. Code tit. 211, § 133.04 (2002). Hawaii statutes provide that insurers "shall make available" to insureds a choice between OEM and non-OEM parts of like kind or quality and, if the insured or claimant opts for the OEM parts, the insured or claimant "shall pay the additional cost" of the OEM part unless the vehicle manufacturer's warranty requires use of OEM parts. Hawaii Rev. Stat. Ann. § 431:10C-313.6(a) (Michie 2001).

the near-universal judgment of state regulators that use of non-OEM parts is a lawful means of containing claims costs.

A number of other practices condemned by the Utah jury as unfair are also permitted in numerous jurisdictions. Many states allow insurers to make deductions from automobile claims payments for depreciation of parts in older cars or betterments (replacing old parts with new ones) if they are reflected in the claim file and itemized in writing with specific, appropriate dollar amounts.[5] Further, several states expressly have approved or even recommended methods for valuing total losses of damaged vehicles through the use of survey data or fair market value.[6] At least one has prohibited the use of the "blue book" values preferred by the Campbells' experts in the trial court below. *See* Cal. Ins. Bulletin No. 76 (Jan. 28, 1948).

Finally, most states permit insurers to require insureds to undergo independent medical examinations ("IMEs") by physicians selected by the insurers in order to determine causation and the nature and severity of injury.

[5] *See, e.g.*, Alaska Admin. Code tit. 3, § 26.080(e) (2002); Ariz. Admin. Code R20-6-801(H)(6) (2002); Ark. Ins. Dep't R. & Reg. 43, § 10(g) (2002); Cal. Code Regs. tit. 10, § 2695.8(k) (2002); Mo. Code Regs. Ann. tit. 20, § 100-1.050(2)(E) (2002); Neb. Admin. R. & Regs. 009.05 (2002); Nev. Admin. Code ch. 686A, § 680(6) (2002); N.J. Admin. Code tit. 11, § 2-17.10(a)(2) (2002); Okla. Stat. Ann. tit. 36, § 1250.8(G) (West 2002); Or. Admin. R. 836-080-0240(11) (2002); Pa. Code § 146.8(e) (2002); Va. Admin. Code tit. 14, § 5-400-80(E) (2002).

[6] *See, e.g.*, Alaska Admin. Code tit. 3, § 26.080(a)(1)(B) (2002); Ariz. Admin. Code R20-6-801(H)(1)(b) (2002); Cal. Code Regs. tit. 10, § 2695.8(b)(1) (2002); Nev. Admin. Code ch. 686A, § 680(1)(b) (2002); Ohio Admin. Code § 3901-1-54(H)(7) (2002); Or. Admin. R. 836-080-0240(3)(b) (2002); Wash. Admin. Code § 284-30-390(1)(b) (2002).

This is true by virtue of specific statutes[7] or, in the absence of such statutes, state-approved insurance policy provisions.[8]

As this Court recognized in *BMW v. Gore*, the award of punitive damages for conduct authorized or lawful in other states significantly subverts the power of those other states to set regulatory policy. This is even more true in the context of insurance regulation, where the historic prerogative of each state to regulate according to its own judgments about the public interest is protected by federal statute as well as constitutional mandate. Where punitive damages are awarded on an extraterritorial basis, the forum state's law provided in the jury instructions will effectively be used to assess the lawfulness of the insurer's conduct outside the state and thus override the judgments of other states that the particular practice is consistent with their regulatory policy. The threat of punitive damages thus will chill conduct considered by those other states to serve the public interest.

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[7] *See, e.g., Brito v. Liberty Mut. Ins. Co.*, 687 N.E.2d 1270, 1272 (Mass. App. Ct. 1997) (insurer may investigate instances of doubtful liability by requiring the claimant to undergo an IME under statute requiring claimants to "submit to physical examinations by physicians selected by the insurer as often as may be reasonably required"); *Hudson v. Omaha Indem. Co.*, 360 S.E.2d 406, 407-08 (Ga. Ct. App. 1987); *Neal v. State Farm Mut. Auto. Ins. Co.*, 529 N.W.2d 330, 333 (Minn. 1995).

[8] *See, e.g., Huntt v. State Farm Mut. Auto. Ins. Co.*, 527 A.2d 1333, 1335 (Md. Ct. Spec. App. 1987) (upholding insurer's requirement of an IME where policy provision, but not statute, authorized such examination); *Morris v. Aetna Life Ins. Co.*, 287 S.E.2d 388, 390 (Ga. Ct. App. 1981) (upholding insurance policy provision requiring no-fault additional insured to submit to an IME despite absence of statutory authorization); *see generally* 5 Rowland H. Long, *The Law of Liability Insurance* § 28.14, at 136 (2001) ("The insured may be required to submit to a medical examination as a prerequisite for the recovery of personal injury protection benefits.").

B. Jury Consideration of Extraterritorial Conduct that Is Unlawful or of Uncertain Legality Also Infringes on State Sovereignty.

The extraterritorial reach of a punitive damages award will also subvert state insurance regulation even where the conduct may not be lawful in the other states.

Where the lawfulness of a particular insurance trade practice has yet to be determined, the regulator's future decision whether to permit or prohibit the practice will be based on a variety of competing regulatory objectives. Although protection of consumers is one goal of insurance regulation, that objective must be weighed against two other important regulatory concerns: preservation of the solvency and financial condition of insurers and maximizing the availability and affordability of insurance coverage. A punitive damages award condemning a particular trade practice would preempt the regulator's authority to balance these competing objectives. Even where an insurance trade practice has been ruled unlawful by a state legislature or regulator, the extraterritorial reach of a punitive damages award may thwart state regulatory policy. ***How*** the state chooses to penalize a prohibited practice is itself a species of regulatory policy. The following are examples of the ways in which punitive damages awards with extraterritorial reach would constrict the state's freedom to determine the lawfulness of insurance trade practices and to fix appropriate punishment for unlawful behavior.

Virtually all states have unfair insurance trade practices or unfair claims settlement practice laws.[9] Except for a limited number of specifically defined unfair practices,

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[9] *See generally* Stephen S. Ashley, *Bad Faith Actions: Liability and Damages* § 9:02, at 9-5 (2d ed. 1997) (collecting citations).

the state insurance commissioner is responsible for determining what practices are unfair through rulemaking proceedings and case-by-case adjudications.[10] The goal is to establish a uniform standard of conduct for that state of which insurers have notice. The expert role of the state insurance department in determining unfairness would be undermined by punitive damage awards condemning practices before any administrative scrutiny.

The Utah jury also heard evidence of State Farm's underwriting practices, including cancellations. Most states regulate underwriting by prohibiting arbitrary or discriminatory cancellations or nonrenewals.[11] In applying these provisions, the state regulator must balance the objective of fairness to insureds against compelling insurers to take on unwanted risks that could jeopardize their financial condition or underwriting capacity. Out-of-state jury determinations that a particular underwriting practice was "unfair," such as requested by plaintiffs' counsel in this case, would effectively negate the authority of the state regulator to make this kind of careful judgment.

The states also make policy judgments concerning the type and extent of sanctions to impose for prohibited conduct. These include such questions as whether to rely

[10] *See, e.g.*, Ohio Rev. Code Ann. § 3901.21 (West 2002) (defining "unfair and deceptive practices in the business of insurance," and providing that "[t]he enumeration [in the statute] of specific unfair or deceptive acts or practices...is not exclusive or restrictive or intended to limit the powers of the superintendent of insurance to adopt rules to implement this section..."); Ohio Admin. Code § 3901-1-54 (2002) (establishing "uniform minimum standards for the investigation and disposition of property and casualty claims").

[11] *See, e.g.*, N.J. Admin. Code tit. 11, § 1:20-4 (2002); Wis. Admin. Code § 6.68 (2002); Wyo. R. & Regs. Dep't Ins. R. & Regs. ch. 33, § 3 (2002).

solely on administrative remedies or to establish a private cause of action; whether to require a certain level of misconduct before imposing sanctions; whether to recognize a cause of action only by insureds or by third-party claimants as well; whether to recognize a cause of action by insureds only in contract, or in tort as well; and whether to allow recovery of punitive damages and, if so, whether to cap or otherwise limit the amount. Punitive damages awards with extraterritorial scope would negate the flexibility of state legislatures and regulators to decide on the appropriate means and level of penalties.

For example, most states specify a number of factors for insurance regulators to consider in determining whether to penalize insurers for unfair practices. Such factors include the seriousness of the violation, the frequency of the conduct, the insurer's good faith, the complexity of the claims, the conduct of the claimant, the extent of consumer injury, the deleterious effect of the violation on the public and insurance industry, and the insurer's past history of violations.[12] Extraterritorial application of punitive damages awards would permit a jury to award damages without a finding of such frequency or other factors, and thereby punish conduct that the state legislature believed did not warrant sanctions or did not justify sanctions in such an amount.

Further, most states statutorily set penalties for unfair insurance trade practices. These penalties are far below the multi-million dollar level of the punitive damages award in this case.[13] Punitive damages awards thus can inflict a

[12] *See, e.g.*, Md. Regs. Code tit. 31, § 02.04.02 (2002); Cal. Code Regs. tit. 10, § 2695.12(b) (2002). *Cf.* Mont. Code Ann. § 33-18-201 (2002) (requiring unfair claim practice to have been committed "with such frequency as to indicate a general business practice"); Nev. Admin. Code ch. 679B, § 181 (2002) (same).

[13] *See, e.g.*, Mo. Ann. Stat. § 375.1012(1) (West 2002) (setting maximum penalty of $25,000 per flagrant violation and

double punishment vastly exceeding the levels thought appropriate by state legislatures.

The states also differ considerably in the extent to which they permit private rights of action under unfair practices and consumer protection statutes.[14] Some states expressly[15] or by judicial construction[16] recognize private causes of action under their unfair insurance trade or settlement practices acts, while other states expressly[17] or by judicial construction[18] bar private remedies. Some states recognize private causes of action against insurers under their general consumer protection statutes,[19] while others do not.[20]

aggregate of $250,000 per 12-month period); R.I. Gen. Laws § 27-9.1-6 (2001) (similar, with aggregate not to exceed $250,000 per hearing).

[14] *See generally* Stephen S. Ashley, *supra* note 9, § 9:16, at 9-65 to -66 ("Because these statutes vary so greatly, one cannot generalize about whether consumer protection statutes apply to insurance cases.").

[15] *See, e.g.*, N.M. Stat. Ann. § 59A-16-30 (Michie 2002).

[16] *See, e.g., Stewart Title Guar. Co. v. Sterling*, 772 S.W.2d 242, 244 (Tex. App. 1989), *rev'd on other grounds*, 822 S.W.2d 1 (Tex. 1991); *Berry v. Nationwide Mut. Fire Ins. Co.*, 381 S.E.2d 367, 371 (W. Va. 1989).

[17] *See, e.g.*, Ariz. Rev. Stat. Ann. § 20-461(D) (2002).

[18] *See, e.g., Moradi-Shalal v. Fireman's Fund Ins. Cos.*, 758 P.2d 58, 68 (Cal. 1988); *Mavroudis v. State Wide Ins. Co.*, 503 N.Y.S.2d 133, 133 (App. Div. 1986); *Strack v. Westfield Cos.*, 515 N.E.2d 1005, 1007-08 (Ohio Ct. App. 1986); *Greene v. Truck Ins. Exch.*, 753 P.2d 274, 279-80 (Idaho Ct. App. 1988).

[19] *See, e.g., Mead v. Burns*, 509 A.2d 11, 18 (Conn. 1986); *Bates v. Allied Mut. Ins. Co.*, 467 N.W.2d 255, 259 (Iowa 1991); *Hopkins v. Liberty Mut. Ins. Co.*, 750 N.E.2d 943, 949-50 (Mass. 2001); *Smith v. Global Life Ins. Co.*, 597 N.W.2d 28, 39 (Mich. 1999).

In some states, where the consumer protection or claim practices statute provides a remedy, a claimant does not a common law right of action against the insurer in tort or for tort damages.[21]

Third-party claimants often do not have the same standing to seek redress as insureds. For example, most states do not recognize bad faith claims by third-party claimants under the common law.[22] Some state statutes permit third-party claimants to bring a statutory cause of action,[23] while other states do not.[24] Some states hold that only the policyholder may sue under the consumer protection

[20] *See, e.g., Ferguson v. United Ins. Co.*, 293 S.E.2d 736, 737 (Ga. Ct. App. 1982); *Wilder v. Aetna Life & Cas. Ins. Co.*, 433 A.2d 309, 309 (Vt. 1981).

[21] *See, e.g., Spencer v. Aetna Life & Cas. Ins. Co.*, 611 P.2d 149, 158 (Kan 1980); *Farris v. U.S. Fidelity & Guar. Co.*, 587 P.2d 1015, 1018-22 (Or. 1978).

[22] *See, e.g., Ring v. State Farm Mut. Auto. Ins. Co.*, 708 P.2d 457, 460 (Ariz. Ct. App. 1985) (rule against third-party claims is followed by "the vast majority of the courts on this issue"); *Scroggins v. Allstate Ins. Co.*, 393 N.E.2d 718, 721 (Ill. App. Ct. 1979) ("Thus, the rule in...nearly all jurisdictions is that in the absence of statutory or contractual language sanctioning a direct action, an injured third party has no action against the insurer for breach of the duty to exercise good faith or due care by virtue of his standing as judgment creditor of the insured.").

[23] *See, e.g., O'Fallon v. Farmers Ins. Exch.*, 859 P.2d 1008, 1013 (Mont. 1993); *Aetna Cas. & Sur. Co. v. Marshall*, 724 S.W.2d 770, 772 (Tex. 1987).

[24] *See, e.g., O.K. Lumber Co. v. Providence Wash. Ins. Co.*, 759 P.2d 523, 527 (Alaska 1988); *Scroggins v. Allstate Ins. Co.*, 393 N.E.2d 718, 723 (Ill. App. Ct. 1979); *Patterson v. Globe Am. Cas. Co.*, 685 P.2d 396, 398 (N.M. Ct. App. 1984).

statute,[25] while others allow a beneficiary or additional insured under the policy to sue as well.[26]

All of these state policy judgments on the appropriate remedial scheme would become meaningless if out-of-state juries were permitted to award punitive damages irrespective of state-law limitations on causes of action and the right of recovery. Indeed, punitive damages could be awarded based on conduct as to which other states have expressly prohibited such awards.

Though the Campbells relied heavily on "other act" evidence concerning the handling of first-party claims, numerous states do not allow tort recovery in first-party cases, permitting only contract claims that do not allow punitive damages.[27] Thus, it is striking that the Campbells, in a third-party case, were permitted to introduce evidence of alleged mishandling of out-of-state, first-party claims as a basis for fixing the amount of punitive damages when a party actually asserting a first-party claim in those other states would not be permitted to recover any punitive damages.

The Utah jury's enormous award of punitive damages is particularly egregious because much of the underlying conduct took place in states that do not allow punitive damages for any cause of action or sharply restrict them. "State legislatures and courts have the power to restrict or

[25] *See, e.g., McCarter v. State Farm Mut. Auto. Ins. Co.*, 473 N.E.2d 1015, 1018 (Ill. App. Ct. 1985); *Bowe v. Eaton*, 565 P.2d 826, 830 (Wash. Ct. App. 1977).

[26] *See, e.g., Koral Indus. v. Security-Connecticut Life Ins. Co.*, 802 S.W.2d 650, 650 & n.1 (Tex. 1990).

[27] *See, e.g., Spencer*, 611 P.2d at 158; *Lawton v. Great S.W. Fire Ins. Co.*, 392 A.2d 576, 580 (N.H. 1978); *Pickett v. Lloyd's*, 621 A.2d 445, 452 (N.J. 1993); *N.Y. Univ. v. Continental Ins. Co.*, 662 N.E.2d 763, 768 (N.Y. 1995).

abolish the common-law practice of punitive damages, and in recent years have increasingly done so." *Pac. Mut. Life Ins. Co. v. Haslip*, 499 U.S. 1, 38 (1991) (Scalia, J., concurring in the judgment). Some states do not permit punitive damages at all unless expressly authorized by statute.[28] Alternatively, many states have enacted tort reforms that "cap" punitive damages, set higher standards of proof, or otherwise limit the award of punitive damages. For example, some states impose strict dollar-amount caps[29] or ratios to compensatory damages.[30] Other states limit punitive damages to the expense of litigation less taxable costs.[31] Others tie punitive damages to the adequacy of compensation.[32]

Beyond the amount or measure of punitive damages, states differ with respect to both procedural and substantive thresholds for such awards. Some states require only a showing by a preponderance of evidence, while others require a showing by clear and convincing evidence or even

[28] *See, e.g., Miller v. Kingsley*, 230 N.W.2d 472, 474 (Neb. 1975) (punitive damages unavailable); N.H. Rev. Stat. Ann. § 507:16 (2002) (punitive damages unavailable unless expressly authorized by statute); *Int'l Harvester Credit Corp. v. Seale*, 518 So. 2d 1039, 1041 (La. 1988) (same); *Santana v. Registrars of Voters*, 502 N.E.2d 132, 135 (Mass. 1986) (same); *Fisher Props., Inc. v. Arden-Mayfair, Inc.*, 726 P.2d 8, 23 (Wash. 1986) (same).

[29] *See, e.g.*, Va. Code Ann. § 8.01-38.1 (West 2002) (limiting punitive damages to $350,000).

[30] *See, e.g.*, Fla. Stat. Ann. § 768.73(1) (West 2002) (in certain classes of cases, limiting punitive damages to greater of thrice compensatory damages or $500,000 and, in more extreme cases, greater of four times compensatory damages or $2 million).

[31] *See, e.g., Berry v. Loiseau*, 614 A.2d 414, 434-35 (Conn. 1992).

[32] *See, e.g., Thompson v. Paasche*, 950 F.2d 306, 314 (6th Cir. 1991) (under Michigan law, punitive damages are unavailable if actual damages are sufficient to make the plaintiff whole).

proof beyond a reasonable doubt.[33] Substantive thresholds vary widely, ranging from evidence of gross negligence, to an "evil mind," to conduct that borders on criminal.[34]

These state policy judgments on the availability and extent of punitive damages would be overridden by out-of-state juries if they are allowed to award punitive damages irrespective of the specific limitations imposed by jurisdictions outside the forum state.

IV. THE JURY IMPROPERLY CONSIDERED A WIDE RANGE OF DISSIMILAR CONDUCT.

The problem of extraterritoriality discussed above is exacerbated by the dissimilarity of the "other act" evidence considered by the Utah jury.

This Court has recognized that, in appropriate cases, evidence of ***similar*** acts "may be relevant to the

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[33] *Compare Harwood v. Talbert*, 39 P.3d 612, 619 (Idaho 2001) (preponderance), *with Travelers Indem. Co. v. Armstrong*, 442 N.E.2d 349, 363 (Ind. 1982) (clear and convincing), *with* Colo. Rev. Stat. Ann. § 13-25-127(2) (West 2002) (beyond a reasonable doubt).

[34] *Compare Stroud v. Lints*, 760 N.E.2d 1176, 1179 (Ind. Ct. App. 2002) (requiring "malice, fraud, gross negligence or oppressiveness that was not the result of a mistake of fact or law, honest error of judgment, overzealousness, mere negligence, or other human failing"), *with* N.J. Stat. Ann. § 2A:15-5.12(a) (West 2002) (requiring "actual malice or...a wanton and willful disregard of persons who foreseeably might be harmed by those acts or omissions," but gross negligence insufficient), *with Rawlings v. Apodaca*, 726 P.2d 565, 578 (Ariz. 1986) ("plaintiff must prove that defendant's evil hand was guided by an evil mind"), *with Greater Providence Deposit Corp. v. Jenison*, 485 A.2d 1242, 1244 (R.I. 1984) ("punitive damages are proper only in situations in which defendant's actions are so willful, reckless, or wicked that they amount to criminality").

determination of the degree of reprehensibility of the defendant's conduct." *BMW v. Gore*, 517 U.S. at 574 n.20. Yet the "other act" evidence introduced in this case was so unrelated to the conduct at issue that it had no probative value on the reprehensibility issue.

American evidence law generally proscribes the admission of character evidence to prove action in conformity with that character. *See, e.g.*, Fed. R. Evid. 404(a); Utah R. Evid. 404(a). But it allows the introduction of "other act" evidence to prove aspects of the conduct toward the plaintiff, i.e., "proof of motive, opportunity, intent, preparation, plan, knowledge, identity, or absence of mistake or accident." Fed. R. Evid. 404(b); Utah R. Evid. 404(b). Such evidence has probative value on the question of reprehensibility; it is not a conduit for evidence of mere bad character.

At some point, however, the other acts become so distant from the gravamen of the lawsuit that their legitimate probative value decreases substantially, and the alleged motive or intent that they supposedly evince becomes very general. The evidence then transgresses the line between permissible "other act" evidence and impermissible character evidence, and indeed may be offered for the very purpose of bloodying the character of the defendant.

Courts and commentators have sought to draw the line between permissible and impermissible evidence as whether the other acts are substantially similar to the acts that gave rise to the complaint. Other act evidence should only be admissible if the other acts involved the "same 'gross features'—that is, all were committed by the 'same doer' and all involve the same type of act, although not necessarily the

same method of acting."[35] While "[t]he commission of similar wrongs by a party to a civil action may be admissible to show a fraudulent intent, plan, or scheme," the other acts "'must be similar in nature to those alleged in the complaint, and the transaction must be of substantially the same character.'"[36]

In this case, the Campbells did not limit the "other act" evidence to showing a pattern of mishandling third-party claims and thereby recklessly exposing insureds to excess judgments, or even to showing other alleged actions in "bad faith" by the same State Farm employees. To the contrary, much of the evidence was totally unrelated to the handling of third-party automobile insurance claims. Some of the other acts related to entirely different lines of insurance, such as homeowners insurance. Other evidence did not even relate to claims handling, such as that of underwriting practices.

When the evidence did relate to the handling of automobile insurance claims, almost all of it involved first-party claims (*i.e.*, those brought by insureds for recovery of direct benefits under the policy) rather than third-party claims of the type involved in the case (*i.e.*, those brought by tort victims or other third-party claimants against the adverse insured). Such claims are wholly distinct and involve a different constellation of interests, rights, and legal duties. Indeed, the Utah Supreme Court noted in a prior decision that

[35] *Lee v. Hodge*, 882 P.2d 408, 412 (Ariz. 1994) (quoting 2 John Henry Wigmore, *Evidence* § 304, at 251 (Chadbourne rev. 1979)).

[36] *Newman v. Bankers Fidelity Life Ins. Co.*, 628 So. 2d 439, 442 (Ala. 1993) (citation omitted); *see also Underwriters Life Ins. Co. v. Cobb*, 746 S.W.2d 810, 815 (Tex. App. 1988) (allowing admission of other routine denials of claims by same agent's customers, in same state, around the same time as plaintiffs' denial, and on same basis, to show general business practice because the other denials were "sufficiently similar").

"it is difficult to find a theoretically sound basis for analogizing the duty owed in a third-party context to that owed in a first-party context."[37]

First-party claims are brought by insureds, to whom the insurer owes contractual obligations. Whether the insurer has acted in bad faith in denying reimbursement of medical or property damage expenses or losses is determined "in the vast majority of jurisdictions" under the standard of whether the claim was "fairly debatable" as a matter of fact or law.[38]

Where the insured is sued by a third-party and seeks policy coverage not in the form of direct monetary benefits, but in the form of a defense or indemnification against the third-party claimant, the standard is different. For example, where a third-party claimant offers to settle the claim against the insured for an amount within policy limits, the insurer has a duty of "equal consideration" that varies among the states.[39]

Moreover, the insurer's obligations toward the "claimant" depend on whether it is a first- or third-party claim. A third-party claimant is not entitled to the same level of consideration as an insured. In most jurisdictions, the insurer stands in the shoes of the insured in dealing with the

[37] *Beck v. Farmers Ins. Exch.*, 701 P.2d 795, 800 (Utah 1985); *see also Clearwater v. State Farm Mut. Auto. Ins. Co.*, 792 P.2d 719, 722 (Ariz. 1990) (first- and third-party "actions involve different factual circumstances and distinct considerations for the insurer," and "the applicable standards of conduct differ").

[38] *Ellwein v. Hartford Accident & Indem. Co.*, 15 P.3d 640, 645 (Wash. 2001).

[39] Some states require the insurer to give equal or greater consideration to the concerns of the insured in avoiding an excess judgment; others require the insurer to give the insured only equal consideration; and others allow the insurer to give paramount consideration to its own interests. *Farmers Ins. Exch. v. Henderson*, 313 P.2d 404, 406 (Ariz. 1957) (collecting citations).

third-party claimant, and enjoys the same "right to require liability to be proven as a predicate for payment of the loss," including by securing a judgment and sustaining it on appeal.[40] "The insurer is not entrusted with protecting the third party's interests. To the contrary, the insurer and the third party stand in an adversarial relationship, the third party committed to separating the insured from his money and the insurer bound to do its best to prevent that result."[41] Because the insurer "has an adversarial relationship with a third-party claimant," the "tort victim, as a third-party claimant, cannot compel a tortfeasor's insurer to negotiate and settle a claim in good faith anymore than he could compel the tortfeasor to do so himself."[42] Thus, the insurer may carry out its duty to the insured by vigorously defending the insured against claims brought by third parties and indemnifying the insured from claims or judgments against him within policy limits.

In short, there are fundamental differences between first-party and third-party claims both in the legal standards governing the claims and the insurer's obligations to the claimant. Thus, evidence of the handling of one species of claim can have little if any relevance to the insurer's reprehensibility in handling the other species. In reality, allowing a jury to lump these disparate practices together amounts to introduction of "corporate character" evidence that would be inadmissible for purposes of proving liability. Allowing such evidence to be used to impose punitive damages significantly heightens the risk of awards that are disproportionate and excessive in relation to compensatory damages under the rules established by this Court. *See BMW v. Gore*, 517 U.S. at 568, 575; *Haslip*, 499 U.S. at 22.

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[40] *Long v. McAllister*, 319 N.W.2d 256, 262 (Iowa 1982) (citing *Kranzush v. Badger State Mut. Cas. Co.*, 307 N.W.2d 256, 265 (Wis. 1981)).

[41] Stephen S. Ashley, *supra* note 9, § 6:09, at 6-21.

[42] *Bates*, 467 N.W.2d at 258.

V. PARTICULARLY IN CONTRAST TO INSURANCE REGULATORS, JURIES ARE ILL-EQUIPPED TO ASSESS THE FAIRNESS OF A RANGE OF INSURER PRACTICES THAT DIFFER SIGNIFICANTLY AND ARE SUBJECT TO VARYING STATE REGULATION.

The discussion above demonstrates that (i) a jury's consideration of a broad range of out-of-state conduct violates the constitutional prohibitions on extraterritorial regulation, and (ii) a jury's consideration of a broad range of dissimilar conduct aggravates the risk of a disproportionate award of punitive damages. These threats to state sovereignty and proportionality are compounded by the jury's lack of institutional competence to conduct what is essentially a companywide compliance audit of insurers that historically has been the responsibility of state insurance regulators.

Juries can be very effective in finding facts in discrete, particularized controversies when adequately instructed as to the applicable substantive law. However, it is a fact of life that juries are lay people without expertise in the field of insurance. That may be acceptable where their findings are limited to the dispute between the parties, but it is unacceptable when they are charged with assessing the fairness of broad ranges of insurance trade practices. In such matters, state regulators are far better equipped.

State legislatures have delegated regulatory responsibility to state insurance departments for the precise purpose of creating a reservoir of expertise and array of investigative tools for reviewing insurer conduct on a companywide basis. In particular, state regulators have expertise in analyzing "pattern and practice" claims of the type alleged to justify punitive damages before the Utah jury. All state insurance departments are empowered to use "market conduct" examinations to take an overall look at insurer practices to determine whether there is a pattern of unfair conduct.

Beyond expertise, the jury faces operational limitations that render it incapable of conducting a comprehensive analysis of this type. Juries operate under intense constraints of time. That is exacerbated in the punitive damages phase of the trial because it is usually the tail of the dog and receives considerably less emphasis than the finding of liability or the awarding of compensatory damages. The factual predicates for the "other act" evidence, such as proof of unlawfulness, would require a minitrial that few if any trial courts are willing to provide.

Moreover, jurors have limited sources of information. They have no independent fact-finding authority and passively receive only the information offered by the parties. By contrast, regulators not only have substantial knowledge of industry practices but also the ability to gather and consider information from various sources, including informal inquiries, examinations, investigations, adjudicative proceedings, and rulemakings.

The jury is further handicapped by the quality of evidence brought before them. On critical issues, the jury is left to rely on the self-serving testimony of paid expert witnesses. Further, jurors often are allowed to consider allegations in pending cases that fall far short of a final adjudicative determination.

The jurors also are not given any meaningful guidance in the pertinent law to evaluate the lawfulness of broad-ranging "other act" evidence. Expert witnesses are, in most states, limited in their ability to testify as to the law. The jury is instructed in extraordinarily vague terms as to the standard for punitive damages. Even if these limitations are constitutionally tolerable in the case of the similar "other act" conduct assessed under a single state's law, they become intolerable when many different legal rules govern "other act" evidence of conduct in other states, or dissimilar conduct that is not subject to the same standards as the conduct that

injured the plaintiff. It would not be realistically feasible to instruct a jury on the law of all the jurisdictions involved in a national punitive damages inquiry, *see Amchem Prods.*, 521 U.S. at 624, particularly when the other jurisdiction's law is not that applicable under choice-of-law principles to the plaintiff's own cause of action.

Even if the jurors had adequate sources of information about the facts and the law of dissimilar conduct and out-of-state conduct, they are not required to take into account public policy factors and competing interests that state regulators are required to consider. As previously noted, the paramount goals of state insurance regulation are to preserve the solvency and financial condition of insurers while at the same time maximizing the availability and affordability of insurance coverage. Juries do not consider, and are not instructed to consider, any of these public policies. Instructions focus on general principles of intent or malice. Consequently, the jury's award of punitive damages is made on the basis of a uni-dimensional perspective that gives no weight whatsoever to insurance regulatory policy.

Both this Court and commentators have pointed to the risk inherent in the unconstrained nature of punitive damages awards, "that a jury will not follow those instructions [about punitive damages] and may return a lawless, biased, or arbitrary verdict." *Honda Motor Co. v. Oberg*, 512 U.S. 415, 433 (1994). "Compared to the analogous instructions and evidence presented on the issue of compensatory damages..., the punitive damages judgment is vastly underconstrained by instructions or by relevant experience." Cass R. Sunstein et al., *Punitive Damages: How Juries Decide* 213 (2002). "[J]uries use everyday habits for the assessment of blame, and...they often substitute those habits for the standards suggested by the legal system." *Id.* at 75.

These risks of standardless, arbitrary awards are heightened where juries are allowed to award punitive

damages based on assessment of out-of-state or dissimilar conduct. They may ignore the regulatory judgment of other states that the conduct is lawful. They are not constrained by whether or not the conduct is similar to the conduct of which the plaintiff specifically complained. They lack the time, resources, and experience to conduct what are essentially companywide "market conduct" examinations. They may ignore the fact that an insurer is exposed in other states and other cases to damages or sanctions for the same conduct that underlies their award.

In sum, to effectuate the constitutional prohibitions on extraterritorial regulation and disproportionate awards of punitive damages, this Court should prohibit a jury from awarding punitive damages based on out-of-state conduct or conduct that is not substantially similar to the specific practices under challenge.

CONCLUSION

For the reasons stated herein, the judgment of the Utah Supreme Court should be reversed.

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