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 *AMICUS CURIAE* OF CALIFORNIA CONSUMER HEALTH CARE COUNCIL, INC. IN SUPPORT OF RESPONDENTS

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TABLE OF CONTENTS

TABLE OF CONTENTS—Continued

TABLE OF AUTHORITIES

TABLE OF AUTHORITIES—Continued

TABLE OF AUTHORITIES—Continued

TABLE OF AUTHORITIES—Continued

MISCELLANEOUS

TABLE OF AUTHORITIES—Continued

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STATEMENT OF STANDING

Pursuant to Rule 37, a blanket letter of consent from the parties to this appeal has been filed with the Clerk of the Court permitting this brief on behalf of *amicus*.[1]

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[1] Pursuant to Rule 37.6, no counsel for either party has authored this brief in whole or in part and no person or entity has made a monetary contribution to the preparation or submission of this brief.

INTEREST OF *AMICUS*

Founded in April 1995 and incorporated as a California non-profit public benefit corporation in April 1996, the CCHCC is a grassroots, volunteer-governed and operated organization of individuals and groups concerned with protecting the interests of health care consumers throughout California. The CCHCC is committed to establishing and enhancing health care systems that work well for all Californians—systems that are safe, fair, accountable, and that promote quality, accessibility, and affordability, CCHCC is committed to serve all population groups including the insured, the uninsured, the under insured, and traditional under served groups.

A diverse range of policyholders, communicate on a regular basis with CCHCC regarding their insurance claims. Because CCHCC monitors both marketplace developments and policyholders' real life experiences, the organization is qualified to provide topical information to courts throughout the country via the submission of *amicus curiae* briefs in cases involving insurance principles that are likely to impact large segments of the public.

SUMMARY OF ARGUMENT

The insurance industry is unique in its financial structure and in its involvement in legal matters. Analogies cannot be drawn between the insurance industry and the automobile industry, for example. An insurance policy has nothing in common with a Ford car. The insurance industry spends over one billion dollars per year in legal fees in coverage disputes with its policyholders.[2] The insurance industry is far and away the largest user of the United States civil justice system.

[2] *See* Leslie Scism, *Tight-Fisted Insurers Fight Their Customers To Limit Big Awards*, Wall Street J., Oct. 15, 1996 at 1.

As consummate litigation experts, insurance companies have figured out ways to negate punitive damage awards. Insurance companies not only write-off payments of adverse punitive damage awards as ordinary and necessary business expenses on federal income tax returns, they *also* insure punitive damages. What an automobile manufacturer might call punitive damages the insurance industry calls "extra-contractual damages, damages in excess of policy limits or *extra-contractual cover*." The common wisdom that punitive damage awards are uninsurable does not apply to the insurance industry because the insurance industry does not see awards of extra-contractual damages as punitive damages.

Without juries and punitive damage awards, the insurance industry would escape needed regulation. State insurance commissioners do not have the power to effectively police bad faith or unfair insurance practices, as is attested to by their regulatory decisions to date. The *amicus* brief filed by the National Conference of Insurance Legislators ("NCOIL") supporting the insurance industry in this case is evidence of the lobbying impact of the industry. One must contrast this with the National Association of Insurance Commissioners ("NAIC") which is generally outspoken on matters affecting insurance regulation but has remained silent in this case.[3]

The activities of State Farm in this case are unlawful in all fifty states. Reversing the Utah Supreme Court would undermine state insurance regulations as well as the McCarran-Ferguson Act.

In sum, since "insurance is different" this is an inappropriate case to decide constitutional issues.

[3] *See* Brief of *Amici Curie* National Association of Insurance Commissioners (NAIC) Supporting Respondent, *Prometheus Funding Corp. v. Merchants Home Delivery Services, Inc.*, (U.S. filed Sept. 29, 1995). NAIC supported the RICO application to the business of insurance.

LEGAL ARGUMENT

I. EXTRA-CONTRACTUAL DAMAGES ARE ESSENTIAL TO POLICE THE INSURANCE INDUSTRY ACCORDING TO GENERALLY ACCEPTED TEXTS.

Punitive damage[4] awards are one of the effective ways of policing the insurance industry. Insurance companies have recognized the financial consequences of their anti-social and abusive bad faith conduct by the jury verdicts that have been rendered against them. Notably, in states that have strong insurance bad faith laws, the prospect of punitive damage awards has changed claims handling practices and procedures. For instance, Charles Soule, an insurance industry insider and former CEO of Paul Revere Life Insurance Company, has written in the standard text book on disability insurance that insurance companies must modify the way they do business in certain states because of punitive damage awards:

> Punitive damage awards, especially in California, affected product design, underwriting, and *claim handling*. The threat of severe punitive financial awards, running into multi-millions of dollars, raised the cost of doing business in California.

Charles E. Soule, *Disability Income Insurance: The Unique Risk*, 258 (5th ed. 1998) (emphasis added).[5] In other words,

[4] The insurance industry uses the terms "extra-contractual damages" or "damages in excess of policy limits" rather than punitive damages, therefore this terminology will be used inter-changeably with punitive damages throughout this brief.

[5] Published by the Insurance Institute of America ("IIA") which is an independent, nonprofit organization offering educational programs and professional certification to people in all segments of the property and liability insurance business. IIA responds to the educational needs of people in insurance and risk management to help them provide professional service to the public. More than 150,000 insurance practitioners around the world are involved in Institute programs. See, American

money talks in the insurance industry and punitive damage awards have forced insurance companies to pay attention to their claims handling procedures. Indeed, faced with the specter of jury verdicts, Richard Ellis, vice-president of claims at Mutual of Omaha Insurance Co., acknowledges that insurance companies are adjusting their strategies:

> We're somewhat in a posture of doctor practicing defensive medicine . . . we're finding insurance companies paying claims and large settlements simply because of their fear of punitive—damage awards.

Business Week, August 15, 1983, pp. 118, 119.

This Court should carefully note that a standard insurance industry textbook, used nationwide to teach tens of thousands of students of insurance each year, *explicitly* teaches that punitive damages in the insurance context are necessary:

> Recovery for breach of an insurance contract should not be limited to payment of the original claim.

James J. Markham, *The Claims Environment*, 277 Insurance Institute of America (1st ed. 1993).[6] In the absence of punitive measures, claims handlers have every incentive to deny claims. In fact, insurance companies often provide financial incentives to claims handlers with the lowest payment history. The threat of awards of extra-contractual damage is necessary.

Institute for Chartered Property Casualty Underwriters and the Insurance Institute of America, http//www.aicpcu.org/abovt.htm.

Mr. Soule's logic about punitive damages raising the cost of doing business is untested and suspect. Obviously an insurance policy that delivers what it promises should cost more than one that does not deliver what it promises. Richard E. Stewart, *The Loss of the Certainty Effect*, Risk Management and Insurance Review, Vol. 4, No. 2, 29-49 (2001).

[6] Layne S. Thompson, CPCU, one of co-authors of the Markham textbook, is a Senior Officer of the Petitioner, State Farm.

II. MONEY MAKES BEDFELLOWS STRANGE

Despite the gaping differences between the automobile and insurance industries, the Ford Motor Company has submitted an *amicus curaie* brief supporting State Farm in the present case. Not only do these industries have little in common regarding their protection against punitive damage awards, but State Farm and Ford also have a long and bitter history of antipathy that bodes to grow more intense in the future.[7]

The expected increase in antipathy between State Farm and Ford is based on two situations that bring the companies into direct conflict with each other. The first revolves around Ford's presence at the center of a public relations firestorm due to the rollover tendencies of Ford Explorers with Firestone tires on them. "Auto carriers whose insureds had been in rollover accidents are hot on the trail of subrogation where a tire or auto manufacturer appears to be at fault." Sallie Klaus, *When the Rubber Meets the Road—Tire Product Liability Claims*, GeneralCologne Re Insurance Issues (September 2001). State Farm has already been presenting accident claims to Firestone for several years and the potential exposure to Ford could reach into the hundreds of millions of dollars if State Farm makes good on its promise to continue bringing further subrogation actions. *Id.*

The second example of clear animosity between Ford and State Farm is demonstrated by the fact that each has served as a whistle blower with respect to the other's illegal practices, and this has led to significant judicial awards against both companies. Regarding the Ford rollovers, State

[7] *See, Hawkins v. Ford Motor Co.*, 566 S.E.2d 624 (W. Va. 2002); *McDowell (and State Farm) v. Don Bohn Ford, Inc. (and Ford Motor Company)*, 739 So. 2d 950 (La. Ct. App. 1999); *State Farm v. Ford Motor Company*, 592 N.W.2d 201 (Wis. 1999); *State Farm v. Ford Motor Company*, 736 So. 2d 384 (Miss. Ct. App. 1999); *State Farm v. Ford Motor Company*, 572 N.W.2d 321 (Minn. Ct. App. 1997).

Farm provided some of the first generally accepted evidence that there were dangerous problems with several models of SUVs, including the Ford Explorer. These problems included a higher center of gravity, making rollovers more likely, and unsafe recommendations by Ford to keep tires under-inflated. Some of this evidence was discovered through safety test programs run by State Farm to help determine the level of insurance premiums for certain vehicles. On its website, State Farm proudly relates how one of its researchers notified the National Highway Traffic Safety Administration (NHTSA) of a trend of increasing accidents among Ford Explorers with Firestone tires. *State Farm Researcher Lauded as Hero, at* http://www.statefarm.com/thenews/eyeofire.htm. State Farm additionally implicated Ford for being "up to its dirty old tricks" after an investigation determined that Ford had covered up the fact that it knowingly installed defective ignition switches in 26 million cars, starting in 1983. Suzie Larsen, *Safety Last*, The MoJo Wire *at* http://www.motherjones.com/mother_jones/SO77/larsen.html. State Farm is now suing Ford to recover millions of dollars based on these claims. *Id.*

Ford research demonstrated that State Farm was using non-original equipment manufactured (non-OEM) repair parts and deceiving its policyholders about the quality of these ersatz parts and the dangers associated with lesser-quality repair parts.[8] In a recent Illinois case, this evidence led to a judgment against State Farm in excess of $1.2 billion, $750 million of which were punitive damages. *Avery v. State Farm Mutual Automobile Ins. Co.*, 1999 WL 1022134 (Ill. Cir. 1999).

[8] Margaret Mannix, *Bumper stumper: real or generic? State farm verdict highlights failings of replacement car parts*, U.S. News and World Report 99 (October 18, 1999).

Ford's banding together in this case with its adversary demonstrates how little Ford knows about insurance and just how gullible purchasers of insurance can be.

III. INSURANCE IS DIFFERENT

The Supreme Court of Delaware declared in a somewhat different context that "[i]nsurance is different." *E.I. Du Pont de Nemours & Co. v. Pressman*, 679 A.2d 436, 447 (Del. 1996).

After a Ford is sold both the buyer and seller want it to work. After an insurance policy is sold the buyer wants it to work, but the seller does not.

An elementary economic analysis leads to the conclusion that insurance companies profit most by breaking their insurance policies:

> With regard to claims for small amounts of money, the insurance company has some incentive to refuse payment because little likelihood exists that claimant will pursue the claim. As for large claims, the insurance company may find it profitable to delay payment as long as possible to keep for itself the time value of the amount due.
>
> Opportunistic breaches are especially likely, and traditional damage rules do not sufficiently deter them.[9]

In fact, Richard A. Archer, deputy chairman of Jardine Insurance Brokers Inc. stated that: "I have never been involved in a loss in excess of $10 million where a lawsuit has not been filed." Richard A. Archer, *Preparing for a 'Mega-Loss'*, Business Insurance, Oct. 10, 1994 at 23, 24. It is for this reason that policyholders believe that they do not

[9] Pennington, *Punitive Damages for Breach of Contract: A Core Sample from the Decisions of the Last Ten Years*, 42 Ark. L. Rev. 31, 54 (1989).

buy insurance policies, they buy the right to sue their insurers for policy proceeds.

The huge sums spent by the insurance industry to litigate against policyholders pay off. Insurance companies unfairly profit by prolonging an insurance coverage dispute rather than paying a claim—even if they know the claim is valid. The insurance company has the use of the policyholder's money for the life of the dispute, earning investment income which in part funds the insurance company's defense. Unless an insurance company is faced with the prospect of damages well in excess of the policy limits, it will have no incentive to honor its obligations under the insurance policy:

> Unlike most other commercial actors fighting for supremacy in a world where possession is nine-tenths of the law, insurers always have the nine-tenths advantage: They hold the money. Consequently, insurers always get to "play the float" in any dispute.[10]

The uniqueness of insurance contracts virtually guarantees that policyholders will not recover the full amount of their claims. Insurance contracts are aleatory, meaning that the policyholder performs first, by paying premium while the insurance company performs later, but only if a loss occurs that arises out of a "fortuitous" event. Aleatory contracts differ from ordinary contracts, where both parties perform simultaneously, a difference that provides the insurance company with a future advantage, namely, economic leverage.

When one contracts for a Cadillac, and is tendered a Yugo, the would be purchaser can cancel his or her check and go to another car dealership. A policyholder, however, who is promised Cadillac insurance at the point of sale and receives Yugo insurance at the point of claim cannot "cover" by going

[10] Jeffrey W. Stempel, *Interpretation of Insurance Contracts: Law and Strategy for Insurers and Policyholders*, § 19.3, at 466-67 (1994).

back in time and purchasing alternative insurance. In fact, once a loss has occurred, the "event" is no longer insurable. Fortuity now becomes certainty.

When a loss occurs, a policyholder is at a distinct economic disadvantage. To begin with, the policyholder has already "lost" the premium, *i.e.*, the sum certain paid to insure against future losses. Typically, the very reason for purchasing insurance is to cover losses that a policyholder can not pay for out of its own resources. The plight of the policyholder is compounded when its claim is improperly denied. Its resources already depleted by premium payments and under financial pressure from the very catastrophe which led to the claim, it will have few resources to contest the denial. States other than New York have recognized that the peculiarities of aleatory insurance transactions require the specter of punitive damages to protect policyholders:

> Insurance is different. Once an insured files a claim, the insurer has a strong incentive to conserve its financial resources . . . .[11]

Generally, the non-breaching party to a contract can replace the performance of the breaching party by simply paying market price for substitute performance. However, with insurance this is not an option. The Ohio Supreme Court has recognized that:

> This feature of insurance contracts distinguishes them from other contracts and justifies the availability of punitive damages in limited circumstances.[12]

Further, insurance policies are not physical products, which can be inspected prior to sale and remain constant, but promises, expressed in words that are often uncertain and which can be subject to multiple interpretations. At the point

[11] *E.I. Du Pont de Nemours & Co. v. Pressman*, 679 A.2d 436, 447 (Del. 1996) (emphasis added).

[12] *Id.*

of sale, it is difficult to evaluate the quality of the insurance purchased; one cannot "kick the tires" of an insurance policy. Both the buyer and seller want a new Ford to work. After the sale the insurance company does not want its insurance policy to work. Rather, the quality of the promises in an insurance contract can be evaluated only by the insurance company's future performance. Richard E. Stewart, *The Loss of the Certainty Effect*, Risk Management and Insurance Review, Vol. 4, No, 2, 29-49 (2001).

Finally, as many policyholders discover the hard way, insurance company personnel who work in the claims department are a different breed than the ones who sold the policy. Claims personnel do not get rewarded for paying claims in full; in fact, it is an increasingly typical practice to reward adjusters for paying out less than is owed. Policyholder satisfaction is not a particularly important criteria for evaluating a claim adjuster's performance. The likelihood that a policyholder with a claim will have "self-selected" for cancellation or non-renewal is high. Accordingly, there is little business reason for most insurance company claims adjusters to refrain from taking coverage-minimizing positions.

IV. THE INSURANCE INDUSTRY DOES NOT TREAT PUNITIVE DAMAGES AS PUNISHMENT

A. Insurance Companies Pay Punitive Damages in the Ordinary Course.

If an insurance company fails to settle a claim within policy limits it may incur liability in excess of policy limits. These policy limits are not extra-contractual payments treated as punitive damages and, of course, these payments are not called punitive damages. These payments are not called punitive damages. The insurance industry rule seems to be that a rose by any other name would not smell the same.[13]

B. Insurance Companies Buy Insurance To Cover Punitive Damages, But Do Not Call It Punitive Damage Insurance.

The ECO provisions in reinsurance contracts are not reinsurance in the literal sense of the word because they operate as direct liability insurance running from the reinsurance company to the ceding insurance company for its liability in handling claims of its policyholders. *See Ott v. All-Star Ins. Co.*, 299 N.W.2d 839, 846 (Wis. 1981).

C. ECO Reinsurance Provisions Cover Punitive Damages Against Ceding Insurance Companies

Insurance companies regularly purchase punitive damage coverage for potential liability arising out of their own bad faith conduct. This is called extra contractual coverage ("ECO"). Extra-contractual coverage means payments beyond the insurance policy limits against the insurance company for bad faith conduct, but not called punitive damage.

Since the late 1950's, ceding insurance companies have demanded that reinsurance policies contain ECO provisions, in order to expand the scope of reinsurance policies. *See* 14 Eric Mills Holmes, *Holmes'' Appleman On Insurance 2d* Section 102.5 at 51 (2d ed. 2000). The widespread use of such coverage is because "'bad faith is to insurance companies what product liability is to manufacturers.' Accordingly, [] ECO coverages are in reality much like a

[13] "This situation typically arises when a liability insurer is guilty of 'bad faith' in refusing to settle a claim against its policyholder within its direct policy limits." 14 Eric Mills Holmes, *Holmes' Appleman On Insurance 2d* § 102.5(F)(1) at 49 (2d ed. 2000).

claims department errors and omissions insurance policy sold directly by the reinsurer to the ceding insurer." *Id.* at 53 (*citing* Robert J. Prahl, *Liability Claim Concepts and Practices 164* (1985) and *Ott*). The insurance industry is not inhibited by the common wisdom that punitive damages are not insurable.

A typical *and common* reinsurance provision covers a ceding insurance company's punitive damages and related expenses and defines loss as follows:

> (c)(2) equal to 100% of the amount paid by [MCCC] for punitive, exemplary, or compensatory damages awarded to the insured and arising out of the conduct of [MCCC] in the investigation, trial or settlement of any claim or failure to pay or delay in payment of any benefits under any policy if [ERC] has, in advance of any such conduct by [MCCC] counseled with [MCCC] and concurred in [MCCC's] course of conduct.

Employers Reinsurance Corp. v. Mid-Continental Casualty Co., 202 F. Supp. 2d 1221, 1226 (D. Kan. 2002).

ECO provisions were designed to deal with a loss incurred by a policyholder in excess of the policy limits and/or outside the scope of the underlying coverage. *Ott v. All-Star Ins. Co.*, 299 N.W.2d 839, 847 (Wis. 1981). Such common ECO clauses are intended to protect cedents from bad faith tort liability to their policyholders. *Id.* at 846. Appleman concurs that such losses generally include punitive damages assessed against the ceding insurance company for bad faith conduct against its policyholder. The scope of the provision was addressed in *Ott.*

> The Judgment in Excess of Policy Limits Clause is relatively widely used and provides the reinsurer will participate in such excess verdicts but not to exceed the reinsurance contract limits

> The Judgment in Excess of Policy Limits Clause is often the repository of specific extra-contractual, including punitive damage, exclusion language . . .

Ott, supra at 845-46.

A ceding insurance company's tortious conduct covered under an ECO clause includes the denial of a policyholder's claim based on an inadequate investigation; intentional misrepresentations of claims or policy terms; false accusations by the ceding insurance company against its policyholder; failure to disclose the policyholder's rights; unfair marketing practices; the ceding insurance company's unreasonable rejection of a settlement offer within policy limits in a case against the policyholder; agent misrepresentation or fraud; or other acts of bad faith that expose a policyholder to liability beyond its policy limits. Larry P. Schiffer & William Bodkin, *Caveat Reinsurer: Reinsuring Punitive Damages Under ECO Clauses,* 37 TORT & INS. L.J. 147, 159 (2001).

The scope of ECO reinsurance provisions effectively dilutes, if not completely eradicates, the intended punishment of a punitive damage award levied against an insurance company for bad faith conduct. The ability of insurance companies to pass along punitive damage liability illustrates the fundamental difference between a punitive damage award against an automobile manufacturer and an insurance company. Insurance companies may not only anticipate that an award could be levied against them for certain conduct, but may make risk shifting agreements for the payment of those punitive awards. In fact, the process the insurance company can deduct the reinsurance premium as an ordinary and necessary business expense.

D. Punitive Damage Awards Are Tax Deductible

"You know, so sue me, sue me, what can you do me?"—Frank Sinatra in *Guys and Dolls (*1955).

"Sue me" is the language of insurance. In fact, insurance companies take federal income tax deductions, for adverse punitive damage awards, as ordinary and necessary business expenses. The Internal Revenue Service ("IRS") considers punitive damage awards deductible by the defendant paying the judgment if the award resulted from conduct perpetrated in the normal course of the defendant's business. *See* Rev Rule 80-211, 1980-2 Cum Bull 57. Since denying insurance coverage, which is normal insurance conduct, can result in punitive damage awards, the insurance industry is able to deduct the awards as ordinary and necessary business expenses. Therefore, a punitive damage award against an insurance company is reduced by the tax benefit gained from the write-off. In sum, the tax deduction, greatly reduces the affect of a punitive damage judgment. The important point is that ordinary and necessary business expenses do not run afoul of the Fourteenth Amendment of the Constitution.

Insurance companies are arguing that large punitive damage awards violate the Constitution. However, such reasoning is contrary to the tax treatment afforded punitive damages as to the insurance industry. Punitive damages cannot be unconstitutional and still quality as tax deductions. The Supreme Court has explicitly stated that public policy should bar a tax deduction for legal expenses when: (1) there is a statutory fine or penalty, or (2) when expenses are incurred to exert undue influence over federal legislation. *See Commissioner v. Heininger*, 320 U.S. 467 (1943).

The insurance industry can not have it both ways. If punitive damage awards are unconstitutional, then *Heininger* prohibits them from being tax deductible.

V. INEFFECTIVE STATE REGULATION REQUIRES THAT STATE JUDICIAL SYSTEMS MUST BUTRESS REGULATION

A. State Regulators and the State Judiciary Are Fundamental to Insurance Regulation.

In 1946 the United States Congress passed the McCarran-Ferguson Act, giving the States plenary power over insurance law. *See* 15 U.S.C. § 1012(b). Clipping the wing of the state judiciary is inconsistent with the McCarran-Ferguson Act. The state judicial system is in place to punish insurance companies for wrongful conduct and provide relief for injured parties.

Here, the Utah Supreme Court has exercised its power over insurance law by authorizing a punitive damage award as a measure of punishment for wrongful conduct. Not only is the Utah Supreme Court entitled to make such a ruling, but sound judgment dictates such an outcome. If the States' rights to regulate insurance are to be curtailed, the remedy is for the industry to seek redress in the Congress that granted the States the right to regulate the business of insurance in the first instance. As previously discussed, "insurance is different" and punitive damage awards against insurance companies are to some extent an attempt to change claims handling behavior.

The use of punitive damages to alter claims handling practices is derived from the fact that money is the only way to get the attention of the insurance industry. Obviously, unlike a policyholder who commits insurance fraud, a corporate entity can not be thrown in jail. Without the threat of punitive damages, insurance companies would be free, fiscally, to routinely deny claims. After denying the claim and buying time to marshal its vast resources against the policyholder and building an argument against coverage, the insurance company could leverage settlement of the policy-

holder's claim. Economically distressed policyholders facing mounting litigation expenses mount at a time when they need the insurance proceeds the most, are more likely settle short of litigation for an amount less than what is owed under the contract. If these types of unfair trade practices did not to trigger huge punitive damage exposures against the insurance company, it would be a rational business plan for maximizing profits out of each policy.

Furthermore, insurance companies already have the advantage of time. Corporations are essentially immortal. Mr. Campbell is deceased, and this case is nearly a quarter century old. State Farm will undoubtedly outlive any of its victims. Therefore, there is no incentive for State Farm or any other insurance companies to obey the rules unless they are harshly punished for their wrongful acts. Their wrongful acts are economic in nature and the appropriate punishment is also economic.

In addition, no State insurance department can offer an injured policyholders relief for the bad faith conduct of their insurance companies. Insurance laws are the rules, that state insurance departments use as watchdogs attempting to police the execution of those rules. However, even if insurance regulators worked tirelessly to enforce compliance with insurance law, they would never preempt all insurance companies from violating the law and be able to compensate policyholders for their harm suffered. Insurance industry fraud can be national in scope and effect millions of policyholders.[14] Because the insurance regulatory system was

[14] For instance, the New Jersey Supreme Court held that the insurance industry misled the nation's insurance regulators in securing approval of a standard exclusion contained in standard form Comprehensive General Liability insurance policies sold to millions of policyholders. *See Morton Int'l, Inc. v. General Accident Ins. Co.*, 629 A.2d 831, 848-55 (N.J. 1993), *cert. denied sub nom*, *Ins. Co. of N. Am. v. Morton Int'l, Inc.*, 512 U.S. 1245 (1994). The Court refused to give effect to the industry's

never designed to be the only mechanism to fight against insurance company fraud, the use of common law remedies, including punitive damages, is fully consistent with coherent and consistent application of legal standards to insurance company practices. Accordingly, it is the province of the judiciary to right these wrongs and within the discretion of the state's highest court to affirm their right to do so.

State insurance regulators recognize that they have no power to require return of ill gotten gains, little or no power to deal firmly and comprehensibly with red lining and no effective power to stop race-based premiums.

B. The Insurance Industry has Chosen the State Court System Over State Insurance Commissioners to Regulate Insurance.

The insurance industry historically has sought to minimize the powers of the state insurance regulators. They have asserted that the existence of judicial civil remedies and criminal remedies, made unnecessary an expansion of the remedies that insurance commissioners could impose. Indeed, the insurance industry utilizes the full range of judicial remedies, including RICO treble damages and punitive damages, to address situations it believes involve policyholder fraud.

Generally, the Unfair Trade Practices Model Act (the "Model Act") developed by the National Association of Insurance Commissioners ("NAIC") is the basis for state insurance regulatory schemes. *See* Brief of *Amici Curiae* National Association of Insurance Commissioners Support-

judicial interpretation of the exclusion because to do so would require "ignoring the industries misleading presentation to regulators over twenty years ago, and overlooking the apparent unfairness that such an interpretation would impose on policyholders who were charged rates that did not reflect the radical diminution in coverage contemplated by the insurance industry." *Id.* at 873.

ing Respondent, *Prometheus Funding Corp. v. Merchants Home Delivery Services, Inc.*, No. 95-409 (U.S. filed Sept. 29, 1995) at 2; *Tweet v. Webster*, 614 F. Supp. 1190 (D. Nev. 1985).

In the early 1970s, the NAIC considered fundamental revisions to the Model Act. The NAIC appointed an insurance Industry Advisory Committee to review the proposed changes. *See, generally,* 1971-2 NAIC Proceedings 341. One proposed revision to the Model Act considered by the NAIC would have empowered insurance commissioners to award private damages:

> [T]he (Commissioner) may, at his discretion, order any one or more of the following:
>
> C. Such other relief as is reasonable and appropriate.

Report of the Industry Advisory Committee to the NAIC B-6 Subcommittee to Review the Model Unfair Trade Practices Act, November 29, 1979, 1972-1 NAIC Proceedings, 490, 498.

The Industry Advisory Committee "object[ed] strenuously" to the proposed extension of the commissioners' authority because it "tend[ed] to confer the powers of an equity court upon the Commissioner but without the limitations or safeguards that are proscribed for traditional proceedings." "[The Committee did] not believe a Commissioner should attempt to fill a role that is usually the province of a jury—that is, ascertain who may have been harmed and to what extent." *Id.* at 510.

The insurance industry argued that policyholders already could use *remedies at law* to combat unfair trade practices and that to empower the commissioner to award damages would sanction a double recovery. Robert S. Sieler, Chairman of the Industry Advisory Committee, explained in his testimony accompanying the Committee's report to the NAIC:

In the more serious cases, the public has the very real and effective capability of using remedies at law that now exist. This clause makes prosecutor, judge and jury out of the Commissioner and *still would subject the insurer and agent to the public's statutory and common law remedies.*

Statement by Robert S. Sieler, Chairman, Industry Advisory Committee, Unfair Trade Practices (B-6), Subcommittee to the NAIC Laws, Legislation and Regulation (B) Committee, 1972-1 NAIC Proceedings, 443, 446 (emphasis added).

The insurance industry having successfully convinced the NAIC not to empower insurance commissioners with comprehensive authority over insurance companies, now argues, through the Petitioner and the supporting *Amici* that represent insurance companies, that state insurance commissioners do, in fact, *comprehensively* regulate the insurance industry to the exclusion of private rights under other non-insurance statutes or the common law. The reality of the situation is otherwise.

Further, the insurance Industry Advisory Committee fully supported the Model Act knowing it would coexist with other non-insurance laws that provide private remedies to policyholders. In arguing against empowering state insurance commissioners, the Insurance Industry Advisory Committee stressed that persons injured by unfair trade practices "have an adequate remedy at law" and pointed to Section 9(d) in support of its argument. *See* 1972-1 NAIC Proceedings, at 509.

Section 9(d) provides, in its entirety, that:

(d) No order of the (Commissioner) under this Act or order of a court to enforce the same shall relieve or absolve any person affected by such Order from any liability under any other laws of the State.

Id. at 509.

This language, or substantially similar language, appears in virtually every state insurance code section that deals with insurance unfair trade practices.[15] Plainly, the Model Act and the state insurance codes are not designed to provide a comprehensive and balanced administrative system providing exclusive remedies for defrauded policyholders. Policyholders are free to utilize non-insurance statutory and common law, including federal law (*e.g.*, the federal civil rights statutes). Accordingly, this Court held that RICO is applicable to insurance companies. *Humana Inc. v. Forsyth*, 525 US 299, 311, 303, 314 (1999).[16]

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[15] *See* Ariz. Rev. Stat. § 20-456.C (1997); Ark. Code Ann. § 23-66-212(d) (1997); Cal. [Ins.] Code § 790.09 (Deering 1997); Conn. Gen. Stat. § 38a-817(d) (1997); Del. Code Ann. tit. 18, § 2308(g) (1997); Del. Code Ann. tit. 18, § 2309(e) (1997); Haw. Rev. Stat. § 431:13-202(b) (1997); Idaho Code § 41-1319(8) (1997); 215 Ill. Comp. Stat. 5/428 (3) (1998); Ind. Code Ann. § 27-4-1-10 (1998); Iowa Code § 507B.8 (1997); Ky. Rev. Stat. Ann. § 304, 12-120(4) (Michie 1996); Mich. Comp. Laws § 500.2049 (1997); Minn. Stat. § 72A.29 (1997); Mich. Stat. Ann. § 24.12049 (1997); Minn. Stat. § 72A.29 Subd. 1 (1997); Miss. Code Ann. § 83-5-43(4) (1997); Mont. Code Ann. § 33-18-1004(4) (1997); Neb. Rev. Stat. § 44-1530 (1997); N.J. Stat. Ann. § 17B:30-17 (1998); N.J. Stat. Ann. § 17:29B-8 (1998); N.M. Stat. Ann. § 59A-16-27.E (1998); N.C. Gen. Stat. § 58-63-35(d) (1997); N.Y. Ins. Law § 2409(b) (Consol. 1997); Okla. Stat. tit. 36, § 1208.D. (1997); Or. Rev. Stat. § 731.252(2) (1997); R.I. Gen. Laws § 27-29-7(d) (1997); Tenn. Code Ann. § 56-8-110(d) (1997); W. Va. Code § 33-11-6(c) (1998); and Wyo. Stat. Ann. § 26-13-115(d) (1997).

[16] Like the Model Act, RICO was not intended to displace remedies under other laws:

Nothing in this title shall supersede any provision of Federal, State, or other law imposing criminal penalties or affording civil remedies in addition to those provided for in this title.

Pub. L. No. 91-452, § 904(b), 84 Stat. 941, 947 (1970). *See also, Neibel v. Trans World Assurance Co.*, 108 F.3d 1123, 1130-31 (9th Cir. 1997) ("plaintiff may receive both treble damages under RICO and state law punitive damages for the same course of conduct").

C. Insurance Commissioners Do Not Have the Power To Properly Regulate Insurance Companies

Today, state insurance codes do not authorize insurance departments to award damages to individuals harmed by insurance company unfair trade practices and fraud. State insurance departments often have difficulty addressing even widespread patterns of insurance company fraud, let alone each individual policyholder's complaint of fraud.

Illustrative of the problem is the experience of fifty policyholders who filed complaints with the Indiana Insurance Department alleging that State Farm Insurance Company was low-balling their claims resulting from a chain of severe thunderstorms which damaged hundreds of thousands of homes on April 19, 1996. "In nearly identical complaints," these policyholders complained that State Farm offered to pay their claims at far less than the actual cost of repairs and "withheld payments until consumers agreed to settle." Scott J. Paltrow, *A Matter of Policy; How a State Becomes Popular with Insurers—But Not Consumers*, Wall St. J., Jan. 14, 1998, at 1. The Insurance Department sent State Farm fourteen notices that the Insurance Department "believe[s] that your company may have committed violations of the Unfair Claims Settlement Practices Statute." *Id.* The consumer services division asked the legal department to investigate but the legal department has not been able to do much. *Id.* When the legal department receives large numbers of consumer complaints about specific insurance companies, these complaints are referred to outside law firms for evaluation. Since 1991, none of these outside law firms, "often politically well-connected, and some [of which] derive their income from representing insurance companies as well, [has] produced an evaluation that has resulted in disciplinary action against an insurance company." *Id.*

According to the same Wall Street Journal article, state insurance regulators all across the country have "failed to detect widespread sales fraud by several of the nation's biggest life-insurance companies, *despite thousands of consumer complaints*." *Id.* (emphasis supplied).

State regulators took disciplinary action only after policyholders filed lawsuits and the press reported the abuses. *Id.* While the Wall Street Journal recognizes this as a failure of the state insurance regulatory system, the Insurance Industry *Amici*, for instance when they opposed application of RICO laws against insurance companies before this Court, herald this series of events as an unqualified success. United States Supreme Court Amicus Brief at 1998 WL 457677 *20; *Humana Inc. v. Forsyth*, 525 U.S. 299 (1999).

In 1996, the Colorado Insurance Department received over 7,000 consumer complaints against insurance companies. The Insurance Department imposed fines in only seven of these cases, one-tenth of one percent. The highest penalty imposed was $20,000.00. Scott J. Paltrow, *Insurance-Industry Lawyer Hired to Audit its Watchdog*, Wall St. J., June 11, 1998, at B2. In response to complaints, the Insurance Division hired a law firm to audit its enforcement activities. The law firm, Sonnenschein Nath & Rosenthal, represented many the insurance companies against which complaints had been filed, including: Prudential Insurance Company of America, which had 33 consumer complaints filed against it, the highest of any life insurance company; Allstate Insurance Company, which had 375 complaints, the third highest for an automobile insurance company; Travelers Group; Aetna; New York Life; and three of the insurance industry's largest trade groups. *See id.*

The Indiana Insurance Department regulates 1,800 insurance companies with a budget of only slightly over $4 million annually. Sally McCarthy, the Indiana Insurance

Commissioner, candidly admits that the Department has been unable to take action even against insurance companies "that repeatedly refuse to pay claims and that mislead customers." Scott J. Paltrow, *A Matter of Policy; How a State Becomes Popular with Insurers—But Not Consumers*, Wall St. J., Jan. 14, 1998, at 1.

These statistics confirm why the insurance industry craves that insurance company fraud be addressed solely under state administrative statutes—little or nothing is likely to happen. Based on experience, insurance companies know that state regulators consistently will be more lenient than will juries.

Such reprimands, resulting in paltry fines, expectedly have not stopped or even slowed the insurance industry practices that first gave rise to the claims the insurance regulators meant to address. Additional mechanisms for protecting policyholders are necessary. Juries have served and continue to serve that purpose and provide specific remedies, punitive when necessary, against unsavory and unlawful insurance company tactics.

VI. HYSTERIA WITHOUT FACTS A/K/A "CRYING WOLF"

It is completely disingenuous of large insurance companies to assert the position that large punitive damage awards would have a devastating impact on the industry. The net worth of the insurance industry is so great that for a punitive award to even garner notice it would have to be in the range of hundreds of millions of dollars. In 1997, world-wide insurance premiums totaled 2.13 trillion dollars, and that amount surely has risen over the past five years. Insurance Information Institute, The I.I.I. Fact Book 2000, v (1999). This figure includes property/casualty and life and health premiums. *Id.* In the United States alone, premiums totaled 636.8 billion dollars in 1998. *Id.* This figure was up 8.1

percent from 1997 and probably has increased at a similar rate over the past four years. *Id.* The tremendous size and scope of the insurance industry is one reason why it is laughable to believe that a 150 million dollar punitive award would lead to any disruption in the operations of a major insurance company. In fact, most major insurance companies could withstand ten such awards and barely suffer any effects at all.

The reasons punitive damages against insurance companies are constitutional have been already detailed. They include the facts that punitive damages are insured and that punitive damages are deductible as ordinary and necessary business expenses. However, the insurance industry insiders recognize that although threats of punitive damages or excess liability may be common, "the cases in which exposure to punitive damages or excess liability is real are few." James J. Markham, Kevin M. Quinley, & Layne S. Thompson, *The Claims Environment* 265 (1st ed. 1993). This recognition emphasizes the fact that the concern over punitive damage awards effect on the viability of the insurance industry is nothing more than a disingenuous attempt to create hysteria without facts.

CONCLUSION

Since "insurance is different" this is not an appropriate case to decide issues of constitutional dimension. Insurance is not an industrial product. Insurance companies do not treat punitive damage awards as punishment. The Congressional grant of authority to the States to oversee the business of insurance should remain unabridged.

Amicus respectfully suggests that the judgment of the Utah Supreme Court should be affirmed.

Respectfully submitted,

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