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 NATIONAL CONFERENCE OF INSURANCE LEGISLATORS AS *AMICUS CURIAE* IN SUPPORT OF PETITIONER

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TABLE OF CONTENTS

TABLE OF AUTHORITIES

Page(s)

CASES

TABLE OF AUTHORITIES (continued)

Page(s)

TABLE OF AUTHORITIES
(continued)

Page(s)

TABLE OF AUTHORITIES
(continued)

Page(s)

CONSTITUTIONAL PROVISIONS

STATUTES

TABLE OF AUTHORITIES
(continued)

TABLE OF AUTHORITIES
(continued)

TABLE OF AUTHORITIES (continued)

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This brief is filed on behalf of the National Conference of Insurance Legislators as *amicus curiae* in support of petitioner, with the written consent of the parties.[1]

[1] Pursuant to Supreme Court Rule 37.6, *amicus* states that no counsel for a party authored this brief in whole or in part, and no person or entity other than the National Conference of Insurance Legislators, its members, or its counsel has made a monetary contribution to the preparation or submission of this brief. Letters of consent are filed with this brief.

INTEREST OF *AMICUS CURIAE*

The National Conference of Insurance Legislators ("NCOIL") is an organization of state legislators whose main area of public policy concern is insurance legislation and regulation. Many legislators active in NCOIL either chair or are members of the committees responsible for insurance legislation in their respective statehouses across the country. The purpose of NCOIL is to help legislators make informed decisions on insurance issues that affect their constituents and to oppose encroachment by the federal government or other states on each state's rightful authority to regulate the business of insurance within its own borders.

Insurance is the only major business in the United States that is primarily regulated by the states. The McCarran-Ferguson Act of 1945 authorized the states to regulate "the business of insurance" under the oversight of Congress. NCOIL works to educate state legislators on current and ongoing insurance issues; to promote cooperation among state legislators from different states; to improve the quality of insurance regulation; to assert the prerogative of state legislators and other officials to determine the policies their states will follow with respect to insurance matters; and to speak out against encroachment on state primacy in regulating the business of insurance.

The judgment below infringes the considered policy choices of Utah's sister states. It will have a profoundly adverse impact on consumers and insurance policyholders nationwide. As the persons directly responsible to their constituents for shaping insurance policy in their states, the members of NCOIL have a vital stake in preventing the detrimental impact that the decision below will have on the ability of state legislatures to regulate the business of insurance within their respective state borders.

SUMMARY OF ARGUMENT

The legislatures of the fifty states have primary responsibility for regulating the business of insurance pursuant to the McCarran-Ferguson Act of 1945. *See* 15 U.S.C. § 1011 *et seq.* Each state legislature is faced with a complex task: it must strike a balance between protecting its citizens from insurance company abuses such as denial of meritorious claims while at the same time protecting those same citizens from the rising premiums that result from overpaying claims or paying fraudulent claims. Each state must take account of those competing concerns as it enacts and implements laws and regulations governing a vast array of insurance company practices. To ensure the success of its chosen system, each state must also adjust its intricate system of insurance regulation on a continuing basis to reflect the evolving concerns of its constituents.

Enforcing territorial limits on the states' authority to regulate the insurance business within their respective borders is critical to the success of these state legislative and regulatory programs. If any state is permitted to engage in extraterritorial regulation or punishment of insurance activity, its actions will inevitably disrupt the carefully designed regulatory regimes of its sister states. An insurance company that fears extraterritorial punishment from one state is likely to alter its conduct in other states in order to avoid that punishment, thereby defeating the other state legislatures' regulatory objectives. Thus, punitive damages awards that penalize extraterritorial conduct – such as the award reinstated by the Utah Supreme Court in this case – impair the statutory and constitutional prerogative of each state to make its own decisions with respect to the regulation of insurance.

The Utah Supreme Court's reinstatement of a $145 million punitive damages award based almost entirely on out-of-state conduct clearly violates the Due Process

Clause. This Court has consistently held that extraterritorial regulation or punishment is impermissible under the Due Process Clause regardless of whether it is a court, a jury, a legislature, or a regulatory body that interferes with out-of-state conduct. In its recent decision in *BMW of North America, Inc. v. Gore*, 517 U.S. 559 (1996), this Court applied that principle to hold that a state has no legitimate interest in imposing punitive damages to deter out-of-state conduct. Utah's insurance commissioner may not, consistent with the Due Process Clause, regulate the business of insurance outside Utah. No more may a single Utah jury constitute itself a roving insurance commissioner authorized to punish and deter, via punitive damages, a "nationwide scheme" consisting almost entirely of out-of-state conduct.

ARGUMENT

I. INSURANCE REGULATION REQUIRES STATE LEGISLATURES TO BALANCE COMPETING CONCERNS, AND EACH STATE'S REGULATORY REGIME REFLECTS POLICIES THAT ONLY THAT STATE HAS A RIGHT TO DETERMINE.

The problem in this case is neatly summarized by what plaintiffs' counsel told the jury in closing argument. He explicitly invited the jurors to punish State Farm for its out-of- state conduct.

> 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 are you important? Because *you are the regulators.* We do not have objective and effective regulators of the insurance industry.

Joint Appendix at 3217-18 (emphasis added). But in fact it is the legislators of each of the sovereign states – the

members of NCOIL – who are charged with regulating the business of insurance in their states. The McCarran-Ferguson Act provides that "[t]he business of insurance . . . shall be subject to the laws of the several States." 15 U.S.C. § 1012(a). This Court has held, moreover, that Congress did not intend that any one state could impose its insurance regime on other states. Because, as discussed below, punitive damages awards based on extraterritorial conduct violate both congressional intent and fundamental constitutional principles by substituting one state's policy judgments for those of its sister states, the decision below should be reversed.

Pursuant to the McCarran-Ferguson Act, each state's legislators are authorized to design a regulatory regime that fits the unique needs of their individual state. Even without the threat of out-of-state punitive damages awards, this is no easy feat. On the one hand, lawmakers must ensure that insurance policyholders are able to collect on meritorious claims. On the other hand, lawmakers must implement rules that screen out unmeritorious or fraudulent claims and reduce unnecessary costs. A failure to satisfy the former objective will result in unfair denials of individual policyholders' claims. A failure to satisfy the latter objective will result in the equally undesirable outcome of higher insurance premiums for all policyholders. Not surprisingly, the several states have reached a wide range of conclusions about the proper balance to strike with regard to these competing concerns, both in terms of substantive rules and available remedies. *Cf. BMW*, 517 U.S. at 570 (differences in state disclosure requirements "demonstrate[] that reasonable people may disagree about the value of" a given rule).[2]

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[2] The resulting variation in state insurance law is consistent not only with congressional intent under the McCarran-Ferguson Act, but also with the foundational principles of our federal constitutional system.

States have, for example, enacted differing rules with regard to many of the claims practices for which State Farm was punished in this litigation. Far from condemning such practices, many states condone or even require them. For instance, state law varies with regard to the following claims practices:

- *Specification of non-original equipment manufacturer ("non-OEM") parts for automobile repair.* No state bans the use of non-OEM parts, a majority of states explicitly allow their use, and two states either mandate or encourage their use. *See Fifty-State Survey of Statutes and Regulations Governing Claims Settlement Practices*, Petitioner's Lodging L580 (hereinafter "*Fifty-State Survey*"). Massachusetts *requires* non-OEM parts to be used in many circumstances. *See* MASS. REGS. CODE tit. 211, § 133.04(1). Hawaii encourages the use of non-OEM parts by requiring insureds who insist on OEM parts to pay the price differential. *See* HAW. REV. STAT. § 431:10C-313.6(a).[3]

As Justice Brandeis famously pronounced in *New State Ice Co. v. Liebmann*, 285 U.S. 262, 311 (1932), "[i]t is one of the happy incidents of the federal system that a single courageous State may, if its citizens choose, serve as a laboratory; and try novel social and economic experiments without risk to the rest of the country."; *see also, e.g., Allen v. Illinois*, 478 U.S. 364, 375 (1986) (Rehnquist, J.) ("[T]he essence of federalism is that states must be free to develop a variety of solutions to problems and not be forced into a common, uniform mold.") (quoting *Addington v. Texas*, 441 U.S. 418, 431 (1979)) (internal quotation marks omitted).

[3] State law also varies with regard to the safeguards required for specification of non-OEM parts, with at least forty-three states regulating the use of non-OEM parts in some way. *See generally* John C. Bratton & Stephen M. Avila, *After-Market Crash Parts: An Analysis*, 18 J. INS. REG'N 150, 155-67 (1999) (surveying state regulation of non-OEM parts). Some states, for example, require that non-OEM parts be of a like kind and quality. *See* CAL. CODE REGS. tit. 10, § 2695.8(g)(1); GA.

- *Use of appearance allowances to settle claims.* Almost all states, some of them expressly, allow insurance companies to use appearance allowances to settle minor vehicle damage claims. *See, e.g.*, ARIZ. ADMIN. CODE R20-6-801(H)(8); CONN. GEN. STAT. § 38(a)-816(6)(o); KAN. ADMIN. REGS. 40-1-34(c); MO. CODE REGS. ANN. tit 20, § 100-1.050(2)(G); NEV. ADMIN. CODE ch. 686A, § 680(8); OKLA. STAT. tit. 36, § 1250.8(I); 31 PA. CODE § 146.8(g); UTAH ADMIN. CODE R590-190-12(A); *see also Fifty-State Survey, supra.*

- *Deductions for betterment or depreciation.* At least twenty-six states have regulations under which insurance companies are specifically allowed to make deductions for depreciation or betterment on property damage claims.[4]

COMP. R. & REGS. r. 120-2-52-.05(4); ILL. ADMIN. CODE tit. 50, § 919.80(d)(5)(C); 806 KY. ADMIN. REGS. 12:095, § 8(4); MO. CODE REGS. ANN. tit. 20, § 100-1.050(2)(D)(2)(B); NEB. ADMIN. CODE 210-45-005; N.H. REV. STAT. ANN. § 407-D:3; N.J. ADMIN. CODE tit. 11, § 2-17.10(a)(11); N.C. ADMIN. CODE tit. 11, r. 4.0426; OR. REV. STAT. § 746.287; R.I. CODE R. 02-030-073(7)(B)(2); WYO. INS. R. & REGS. ch. 19, § 5.

[4] *See* ALASKA ADMIN. CODE tit. 3, § 26.080(e); ARIZ. ADMIN. CODE R20-6-801(H)(6); ARK. R. & REGS. tit. 43, § 10(g); CAL. CODE REGS. tit. 10, § 2695.8(j)-(k); GA. COMP. R. & REGS. r. 120-2-52-.04(2); HAW. REV. STAT. § 431:10C-313(c); ILL. ADMIN. CODE tit. 50, § 919.80(d)(4); KAN. ADMIN. REGS. 40-1-34 (adopting the National Association of Insurance Commissioners' Unfair Claims Settlement Practices Model Regulation (June 1976 ed.)); 806 KY. ADMIN. REGS. 12:095, § 7(d); MINN. STAT. ANN. § 72A.201, subdivision 5(10); MO. CODE REGS.ANN. tit. 20, § 100-1.050(2)(E); NEB. ADMIN. CODE 210-60-009.05; NEV. ADMIN. CODE ch. 686A, § 680(6); N.J. ADMIN. CODE tit. 11, § 2-17.10(a)(2); N.Y. COMP. CODES R. & REGS. tit. 11, § 216.7(b)(11); OHIO ADMIN. CODE § 3901-1-54(H)(2)-(3); OKLA. STAT. tit. 36, § 1250.8(G); OR. ADMIN. R. 836-080-240(11); 31 PA. CODE § 146.8(e); R.I. CODE R. 02-030-073(7)(A)(2); S.D. INS. BULL. 98-7 (Oct. 1, 1998); UTAH ADMIN. CODE R590-190-11(7); VT. CODE R. 21-

- *Use of market surveys to calculate the value of a vehicle.* Almost half of the states, many of them expressly, permit or recommend use of fair market value rather than Blue Book value in settling total-loss vehicle claims.[5]

State law also diverges sharply as to the availability of punitive damages against insurance companies. *See generally* 2 BARRY R. OSTRAGER & THOMAS R. NEWMAN, HANDBOOK ON INSURANCE COVERAGE DISPUTES § 12.10[c], at 765-66 (Aspen Law & Business 2002). For example:

- Although in third-party cases such as this one, most states recognize the tort of bad faith (or treat a breach of the covenant of good faith and fair dealing as a tort), many states recognize no such tort in first-party situations and limit insureds to their contractual remedy. *See* Douglas R. Richmond, *An Overview of Insurance Bad Faith Law and Litigation*, 25 SETON HALL L. REV. 74, 80 n.33 (1994) (listing cases); *id.* at 104 n.170; Roger C. Henderson, *The Tort of Bad*

020-008(7)(B); 14 VA. ADMIN. CODE 5-400-80(E); WASH. ADMIN. CODE § 284-30-390(8); W. VA. CODE ST. R. § 114-14-7.3(e).

[5] *See* ALASKA ADMIN. CODE tit. 3, § 26.080(a)(1)(B); ARIZ. ADMIN. CODE R20-6-801(H)(1)(b); ARK. R. & REGS. tit. 43, § 10(a)(2); CAL. CODE REGS. tit. 10, § 2695.8(b)(1); GA. COMP. R. & REGS. r. 120-2-52-.06; HAW. REV. STAT. § 431:10C-311; ILL. ADMIN CODE tit. 50, § 919.80(c); KAN. ADMIN. REGS. 40-1-34 (adopting the National Association of Insurance Commissioners' Unfair Claims Settlement Practices Model Regulation (June 1976 ed.)); 806 KY. ADMIN. REGS. 12:095, § 7(b); MASS. REGS. CODE tit. 211, § 133.05; MINN. STAT. ANN. § 72A.201, subdivision 6; MONT. CODE ANN. § 33-23-202; NEV. ADMIN. CODE ch. 686A, § 680(1); N.J. ADMIN. CODE tit. 11, § 3-10.4; N.Y. COMP. CODES R. & REGS. tit. 11, § 216.7(c); N.C. ADMIN. CODE tit.11, r. 4.0418; OHIO ADMIN. CODE § 3901-1-54(H)(7); OKLA. STAT. tit. 36, § 1250.8(A)(2); OR. ADMIN. R. 836-080-240(3); 31 PA. CODE § 62.3(e)(1)(iii); UTAH ADMIN. CODE R590-190-11(1)(b); VT. CODE R. 21-020-008(8)(B); WASH. ADMIN. CODE § 284-30-390(1).

Faith in First-Party Insurance Transactions After Two Decades, 37 ARIZ. L. REV. 1153, 1153-54 nn.2-25 (1995) (listing statutes and cases for twenty-five states).

- Even among those states that allow bad faith actions against insurers, some states do not allow punitive damages at all,[6] and many states have now imposed caps that limit the amount of punitive damages that may be recovered.[7]

[6] Nebraska and New Hampshire do not allow punitive damages, *see Distinctive Printing & Packaging Co. v. Cox*, 443 N.W.2d 566, 574 (Neb. 1989); *Panas v. Harakis*, 529 A.2d 976, 986 (N.H. 1987), while Washington, Louisiana, and Massachusetts allow them only if specifically authorized by statute. *See Mackay v. Acorn Custom Cabinetry, Inc.*, 898 P.2d 284, 290 (Wash. 1995); *Santana v. Registrars of Voters*, 502 N.E.2d 132, 135 (Mass. 1986); *Int'l Harvester Credit Corp. v. Seale*, 518 So. 2d 1039, 1041 (La. 1988). Connecticut and Michigan effectively bar punitive damages by limiting them to specific items. *See Collens v. New Canaan Water Co.*, 234 A.2d 825, 831-32 (Conn. 1967) (litigation expenses); *Kewin v. Mass. Mut. Life Ins. Co.*, 295 N.W.2d 50, 55 (Mich. 1980) (intangible injuries).

[7] *See* COLO. REV. STAT. § 13-21-102 (award of punitive damages by jury limited to amount of actual damages; judge can increase award to no more than three times the actual damages); CONN. GEN. STAT. § 52-240b (in product liability actions, court determines amount of punitive damages not to exceed an amount equal to twice the actual damages); FLA. STAT. ch. 768.73(1)(a)-(c) (absent high likelihood of injury or specific intent to harm, punitive damages limited to three times the amount of actual damages or $500,000); GA. CODE ANN. § 51-12-5.1(g) (punitive damages capped at $250,000 in tort actions not involving products liability, specific intent to cause harm, or substance abuse); KAN. STAT. ANN. § 60-3701(e)-(f) (punitive damages limited to the lesser of the annual gross income of the defendant or $5 million; court can increase to 1-1/2 times the defendant's profit from the misconduct); NEV. REV. STAT. § 42.005(1) (punitive damages limited in most insurance cases to the greater of $300,000 or three times the compensatory damages); N.D. CENT. CODE § 32-03.2-11(4) (punitive damages limited to the greater of two times the compensatory damages or $250,000); OKLA. STAT. tit. 23, § 9.1(B)-(D) (capping punitive damages

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Avery v. State Farm Mut. Auto. Ins. Co., 746
2001), *appeal pending*.

- In addition, even those states that allow punitive or extracontractual damages for bad faith claims often impose special procedural or proof requirements that make it extremely difficult for a plaintiff those damages.[8]

Thus, state laws governing plaintiffs' rights and remedies against insurance companies vary dramatically depending on the policy choices of individual state legislators. Some states believe that insurers should be encouraged to err on the side of paying claims. Other states believe that insurers

at the greater of the amount of actual damages or $100,000 for reckless conduct; at the greater of three times the actual damages, $500,000, or the financial benefit gained from the conduct if the defendant acted intentionally and with malice; and no cap if the court finds beyond a reasonable doubt that the defendant intentionally and maliciously engaged in life-threatening conduct); TEX. CIV. PRAC. & REM. CODE ANN. § 41.008 (punitive damages capped at the greater of (a) $200,000 or (b) two times the economic damages plus any noneconomic damages up to $750,000); VA. CODE ANN. § 8.01-38.1 (capping punitive damages awards at $350,000).

[8] *See generally* Barry R. Ostrager & Thomas R. Newman, *Bad Faith and Wrongful Refusal to Settle: Liability in Excess of Policy Limits*, 518 PLI/Litigation 233, 275-82 (1995) (citing cases); *see also, e.g., id.* at 277 ("[T]he New York courts routinely dismiss claims for punitive damages against insurers when there has been no allegation or showing that the insurer, 'in its dealings with the general public, had engaged in a fraudulent scheme evincing such a high degree of moral turpitude and ... such wanton dishonesty as to imply a criminal indifference to civil obligations.'") (quoting *Eccobay Sportswear, Inc. v. Providence Washington Ins. Co.*, 585 F. Supp. 1343, 1344 (S.D.N.Y. 1984)); *Commercial Union Ins. Co. v. Liberty Mut. Ins. Co.*, 393 N.W.2d 161, 164 & n.5 (Mich. 1986) (articulating "higher standard" of proof for imposition of statutory punitive damages in insurance bad faith actions); *Linthicum v. Nationwide Life Ins. Co.*, 723 P.2d 675, 679-80 (Ariz. 1986) (jury may not award punitive damages unless plaintiff establishes through clear and convincing evidence the defendant's "evil mind" and "aggravated and outrageous" conduct); *Shamblin v. Nationwide Mut. Ins. Co.*, 396 S.E.2d 766, 771-73 (W. Va. 1990) (insured "must establish a high threshold of actual malice in the settlement process").

should be encouraged to impose fair claims handling procedures that prevent fraud and hold costs down. Regardless of the ultimate merit of each state's choices, that state's statutory and sovereign authority to make those choices without interference from other states should be respected.

Punitive damages awards such as the one imposed by Utah in this case severely interfere with other states' ability to regulate the insurance industry within their own territorial boundaries. Insurance companies are likely to conform their *national* conduct to the laws of the states imposing the highest punitive damages awards, thus defeating the carefully considered policy choices of other states.

For example, the Utah jury imposed punishment based on the specification of non-OEM parts in other states. There is no need to speculate about the impact such an award will have on insurance company behavior. In the wake of a not-dissimilar Illinois class action jury award of $1.2 billion against State Farm based on the use of non-OEM parts, several national insurance companies discontinued that practice at a national level.[9] Yet, as discussed above, the vast majority of states permit or require the use of non-OEM parts because that practice stabilizes repair costs, promotes competition in the replacement parts market, and results in lower insurance premiums. *See* page 6, *supra*; Bratton & Avila, *supra*, at 167-69. By discouraging that practice, the Utah award will undermine the policy of all the states that wish to permit, encourage, or require the use of non-OEM parts, and will effectively deprive those states of the ability to regulate intrastate insurance company behavior.

[9] Matthew W. Rearden, *OEM or Non-OEM Automobile Replacement Parts: The Solution to Avery v. State Farm*, 28 FLA. ST. U. L. REV. 543, 548 (2001); *Avery v. State Farm Mut. Auto. Ins. Co.*, 746 N.E.2d 1242 (Ill. App. Ct. 2001), *appeal pending*.

The Utah jury also imposed punitive damages, without any cap, based on State Farm's conduct in other states in first-party situations having no factual relationship to anything that happened to plaintiffs here. *See* Petitioner's Brief ("Pet. Br.") 10-11. That action flies in the face of other states' policies with regard to punitive damages. Many states have determined that liability for bad faith in first-party situations should not be allowed, or have capped or forbidden punitive damages against insurance companies. Those states have weighed the risks and benefits of punitive damages and have concluded that such awards are not in the best interests of their citizens because, for example, they lead to higher insurance premiums,[10] thereby benefiting a few successful plaintiffs at the expense of thousands of other policyholders.[11] But when one state grants a significantly

[10] *See* Jonathan M. Karpoff & John R. Lott, Jr., *On the Determination and Importance of Punitive Damage Awards*, 42 J.L. & ECON. 527, 531 (1999); William A. Mayhew, *Bad Faith and the Uninsured Motorist*, 19 FORUM 618, 619 (1984) (noting that fear of punitive damages leads insurance companies to settle claims for more than their value, leading to higher premiums); Randy Papetti, Note, *The Insurer's Duty of Good Faith in the Context of Litigation*, 60 GEO. WASH. L. REV. 1931, 1961-62 (1992) ("Insurance companies, fearful of incurring tort liability, are more likely to satisfy questionable claims," and "[l]itigation costs and punitive damages payouts can contribute to insurance availability shortages.").

[11] This problem is particularly acute in this case because State Farm is a "mutual" insurance company. Unlike stock insurance companies, mutual insurance companies operate "wholly for the benefit of their policyholders," each of whom has an ownership interest in the company. *Penn Mut. Life Ins. Co. v. Lederer*, 252 U.S. 523, 533 (1920). Mutual insurance companies operate at cost, and return profits in excess of reasonable reserves to the policyholders in the form of dividends or downward adjustments to premiums. *Fidelity & Cas. Co. v. Metro. Life Ins. Co.*, 248 N.Y.S.2d 559, 566 (N.Y. Sup. Ct. 1963). Conversely, mutual insurance companies recoup losses through higher premiums. Richard Bromley et al., *Tax Consequences of Raising Capital for a Mutual Insurance Company*, 511 PLI/TAX 685, 689 (2001). Thus, the punitive damages award in this case in effect gives one policyholder a massive windfall at the expense of every other policyholder.

higher punitive damages award based on conduct outside that state, the first state in substance imposes on the other states its view of the utility and propriety of punitive damages. Once again, the upshot is that insurance premiums will rise commensurately, not just in the state where the punitive damages were awarded but throughout the country, in contravention of the considered policy judgments of many states' lawmakers.[12]

Without this Court's intervention, therefore, a single jury in Utah will be permitted to subvert the considered policy judgments of the other forty-nine states regarding the substantive rules that govern insurance claims and the procedural rules that regulate the availability of punitive damages. Congress intended a very different result. As this Court has recognized, a major impetus behind the McCarran-Ferguson Act 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." *FTC v. Travelers Health Ass'n*, 362 U.S. 293, 302 (1960). "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.* Thus, one state's attempt to usurp the rightful authority of its sister states to regulate insurance through extraterritorial punitive damages is inconsistent with congressional intent. As discussed below, such a result also

[12] That result is even more egregious here because the State of Utah may itself collect "50% of the amount of the punitive damages in excess of $20,000" after attorneys' fees and costs. *See* UTAH CODE ANN. § 78-18-1(3)(a). Utah not only regulates out-of-state conduct by means of Utah jury verdicts, it profits from it.

violates the Due Process Clause and basic constitutional principles of state sovereignty and comity.

II. UTAH MAY NOT CIRCUMVENT DUE PROCESS LIMITATIONS ON ITS LEGISLATIVE JURISDICTION THROUGH THE EXPEDIENT OF A JURY AWARD.

That the Utah Supreme Court's reinstatement of the $145 million punitive damages jury award in this case punishes out-of-state conduct in which Utah has no legitimate interest is beyond dispute. *See generally* State Farm Br. 16-22. The trial court allowed "extensive expert testimony regarding fraudulent practices by State Farm *in its nation-wide operations* ... to determine whether State Farm's conduct *in the Campbell case* ... was sufficiently egregious to warrant punitive damages." Pet. Br. 6a-7a (emphasis added). The Utah Supreme Court's reinstatement of the award was similarly flawed. The court stated that it sought to remedy "the harmful effect on the larger community of *all those who deal with the company*." *Id.* at 21a (emphasis added). This "harmful effect" was catalogued in twenty-eight pages of factual findings by the trial court that "point to a scheme motivated by the goal of making a profit by any means necessary." *Id.* at 18a, 22a. Those twenty-eight pages, however, refer repeatedly to State Farm's dissimilar conduct in other states. *Id.* at 113a-142a. Much of that out-of-state conduct is clearly lawful – and indeed sometimes mandated – in the states where it occurred. The plaintiffs made no showing of how any of that out-of-state conduct adversely affected the citizens of Utah.

By reinstating a jury award that punishes conduct occurring entirely outside Utah's borders, the Utah Supreme Court acted in direct contravention of this Court's established Due Process Clause jurisprudence.[13] Like its decisions interpreting a host of other constitutional provisions,[14] this Court's due process precedents incorporate principles of state sovereignty, comity, and federalism. Those principles indicate that a state has no legitimate

[13] Both before and after the enactment of the McCarran-Ferguson Act in 1945, this Court has consistently held under the Due Process Clause that a state has no legitimate interest in taxing or regulating insurance companies extraterritorially. *See Connecticut Gen. Life Ins. Co. v. Johnson*, 303 U.S. 77, 80-81 (1938) ("due process clause denies to the state power to tax or regulate the corporation's property and activities [outside the state]"); *State Bd. of Ins. v. Todd Shipyards*, 370 U.S. 451 (1962) (due process restrictions on state power survive McCarran-Ferguson Act). The Act could not and does not abrogate those due process guarantees. *See id.* at 456 (Congress "indicated without ambiguity that such state 'regulation or taxation' should be kept within the limits set by the *Allgeyer*[*v. Louisiana*, 165 U.S. 578 (1897)], *St. Louis Cotton Compress*[*Co. v. Arkansas*, 260 U.S. 346 (1922)], and *Connecticut General Life* decisions"); *FTC v. Travelers Health Ass'n*, 362 U.S. 293, 300 (1960) (Congress did not intend "that a State could regulate activities carried on beyond its own borders").

[14] "It is a firmly established principle of American jurisprudence that the law, statutory or otherwise, ... of one state has no extraterritorial effect in another state." 16 AM. JUR. 2D, *Conflict of Laws* § 9 (1998). In a wide range of contexts, this Court has consistently enforced the limits of state sovereignty and comity by rejecting state efforts to apply local law to transactions that occurred entirely in other states. *See, e.g., Bonaparte v. Tax Court*, 104 U.S. 592, 594 (1881) ("No State can legislate except with reference to its own jurisdiction. ... Each State is independent of all the others in this particular."); *Healy v. Beer Inst.*, 491 U.S. 324, 336 (1989) ("[T]he Commerce Clause ... precludes the application of a state statute to commerce that takes place wholly outside of the State's borders, whether or not the commerce has effects within the State.") (internal citation & quotations omitted); *Huntington v. Attrill*, 146 U.S. 657, 669 (1892) ("Laws have no force of themselves beyond the jurisdiction of the State which enacts them, and can have extraterritorial effect only by the comity of other States."); *Bigelow v. Virginia*, 421 U.S. 809, 824 (1975) ("A State does not acquire power or supervision over the internal affairs of another State merely because the welfare and health of its own citizens may be affected when they travel to that State.").

interest in regulating or punishing extraterritorial conduct. As the Court explained in *BMW*, "it follows from these principles of state sovereignty and comity that a state may not impose economic sanctions on violators of its laws with the intent of changing the tortfeasors' lawful conduct in other States." 517 U.S. at 572. "[B]y attempting to alter [the defendant's] nationwide policy, Alabama would be infringing on the policy choices of other States," and so "the economic penalties that a [State] inflicts . . . must be supported by the State's interest in protecting its own consumers and its own economy." *Id.* Thus, a state has no legitimate interest in punishing conduct that has no connection to protecting that state's citizens. Although "Alabama may insist that BMW adhere to a particular disclosure policy in [Alabama]," it may not "impose sanctions on BMW in order to deter conduct that is lawful in other jurisdictions." *Id.* at 572-73.

The *BMW* decision is consistent with a long line of this Court's due process cases prohibiting regulation or punishment of extraterritorial conduct where that conduct is "unrelated to any local interests." *Osborn v. Ozlin*, 310 U.S. 53, 65 (1940); *see also, e.g., Conn. Gen. Life Ins. Co. v. Johnson*, 303 U.S. 77 (1938) (invalidating under the Due Process Clause a California tax on premiums paid in Connecticut by one insurance company to another for reinsurance of life insurance policies written in California on California residents, despite the fact that both insurance companies were authorized to do business in California); *Allied-Signal, Inc. v. Dir., Div. of Taxation*, 504 U.S. 768, 780 (1992) (recognizing both "the States' wide authority to devise formulae for an accurate assessment of a corporation's intrastate value or income; and the necessary limit on the States' authority to tax value or income that

cannot in fairness be attributed to the taxpayer's activities within the State").[15]

The decision below cannot be squared with those precedents. Utah may not punish State Farm "for conduct that was lawful where it occurred and that had no impact on [Utah] or its residents." *BMW*, 517 U.S. at 573.[16] To uphold the Utah Supreme Court's reinstatement of this award would allow Utah and other states to use jury awards of punitive damages to circumvent the well-established principles of state sovereignty and comity underlying this Court's due process cases. Indeed, if any of Utah's other branches of

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[15] Under principles of federalism as well, a state has no legitimate interest in extraterritorially regulating or punishing out-of-state conduct. *See BMW*, 517 U.S. at 585 ("The fact that BMW is a large corporation . . . does not diminish its entitlement to fair notice of the demands that the several States impose on the conduct of its business. Indeed, its status as an active participant in the national economy *implicates the federal interest in preventing individual States from imposing undue burdens on interstate commerce*. While 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.") (emphasis added).

[16] It is true that this Court has not banned the use of out-of-state conduct evidence for all purposes. A state has a legitimate interest in allowing the admission of evidence of similar out-of-state conduct for limited purposes where that evidence is relevant to intrastate concerns such as "the determination of the degree of reprehensibility of the defendant's [intrastate] conduct," *BMW*, 517 U.S. at 574 n.21 (citing *TXO Prod. Corp. v. Alliance Resources Corp.*, 509 U.S. 443, 462 n.28 (1993)), or "the defendant's character and prospects for rehabilitation." *Id.* at 573 n.19. But the narrow exception has been exceeded here. As explained above, the Utah jury and court did not limit their use of the evidence to evaluating the reprehensibility of State Farm's conduct or its likelihood of recidivism, but rather to punish and deter conduct occurring in other states – indeed, to act as "national" insurance commissioners. That use of extraterritorial evidence is clearly outside the exception identified in *BMW*. Further, the out-of-state practices were not similar to the specific conduct, *i.e.*, failure to settle third-party claims, at issue in this case.

government had undertaken to punish State Farm for the same out-of-state conduct, that action would clearly violate the Due Process Clause because the out-of-state conduct has no legitimate connection to Utah's intrastate interests.

The Utah legislature would be prohibited by the Due Process Clause from declaring State Farm's out-of-state activities unlawful, *see, e.g., Home Insurance. Co. v. Dick*, 281 U.S. 397, 410 (1930) (Due Process Clause prohibited Texas from creating "rights and obligations" with respect to insurance contracts "which are neither made nor are to be performed in Texas"); from conditioning the renewal of a business license on a requirement that State Farm conform its out-of-state conduct to Utah law, *see, e.g., American Oil Co. v. Neill*, 380 U.S. 451, 459 (1965) (invalidating tax imposed against business licensees' out-of-state sales and explaining "that the granting by a State 'of the privilege of doing business there and its consequent authority to tax the privilege do not withdraw from the protection of the due process clause the privilege' of doing business elsewhere" (quoting *Connecticut General Life Insurance*, 303 U.S. at 82)); from taxing State Farm's interstate activities unless there were a "nexus" between those activities and Utah's legitimate interests, *see Hunt-Wesson, Inc. v. Franchise Tax Board*, 528 U.S. 458, 464 (2000);[17] or from applying Utah

[17] *See also Am. Oil*, 380 U.S. at 458;

> The taxation of property not located in the taxing State is constitutionally invalid, both because it imposes an illegitimate restraint on interstate commerce and because it denies to the taxpayer the process that is his due. A State will not be permitted, under the shelter of an imprecise allocation formula or by ignoring the peculiarities of a given enterprise, to "project the taxing power of the state plainly beyond its borders."

Norfolk & W. Ry. Co. v. Missouri State Tax Comm'n, 390 U.S. 317, 325 (1968) (citation omitted); *Allied-Signal*, 504 U.S. at 777-78 ("[I]n a Union of 50 States, to permit each State to tax activities outside its

law to contracts executed and performed outside of the state, *see Alaska Packers Association v. Industrial Accident Commission*, 294 U.S. 518, 540 (1935); *Hoopeston Canning Co. v. Cullen*, 318 U.S. 313, 317 n.3 (1943) (state had no legislative jurisdiction "where neither the original insured nor the company were residents of the state, the property insured was elsewhere, and the contract was made elsewhere").

Similarly, if the Utah Commissioner of Insurance had sought to accomplish what the Utah jury did, that is, to fine State Farm for out-of-state conduct, his actions would undoubtedly be rejected as an unconstitutional intrusion upon the right of those states to regulate insurance transactions within their borders. *See* State Farm Br. 41-42. State administrative agencies are bound by state sovereignty and comity principles inherent in the Due Process Clause and therefore may not regulate outside state borders unless the conduct at issue has a sufficient relation to intrastate activity. *See Connecticut Gen. Life*, 303 U.S. at 80-81 ("[T]he due process clause denies to the state power to tax or regulate the corporation's property and activities elsewhere."); *Quill Corp. v. North Dakota*, 504 U.S. 298, 319 (1992) (Scalia, J., concurring) ("It is difficult to discern any principled basis for distinguishing between jurisdiction to regulate and jurisdiction to tax.").

Utah's state courts could not even apply Utah state law to the conduct at issue. If this same case had been brought as a class action, alleging exactly the same conduct but seeking compensatory and punitive damages on behalf of each plaintiff allegedly afflicted, the Utah court would have been required to apply other states' law including their law

borders would have drastic consequences for the national economy, as businesses could be subjected to severe multiple taxation.").

governing punitive damages[18] to out-of-state conduct. *See Phillips Petroleum Co. v. Shutts*, 472 U.S. 797 (1985). In *Shutts*, this Court articulated sovereignty-based limits on choice of law provisions. *See id.* at 821-22. A state "may not abrogate the rights of parties beyond its borders having no relation to anything done or to be done within them." *Id.* at 822 (quoting *Home Ins. Co. v. Dick*, 281 U.S. at 410) (internal quotation marks omitted)). Thus, the Court held that "Kansas' lack of 'interest' in claims unrelated to that State, and the substantive conflict with jurisdictions such as Texas, [rendered] application of Kansas law to every claim in this case ... sufficiently arbitrary and unfair as to exceed constitutional limits." *Id.* Utah has essentially circumvented that constitutional requirement by awarding punitive damages, based on out-of-state conduct directed to out-of-state residents, to in-state plaintiffs.

Juries making punitive damages assessments have no greater authority to regulate out-of-state conduct than do regulators, courts applying choice of law principles, or legislatures. *See BMW*, 517 U.S. at 572 n.17 ("State power may be exercised as much by a jury's application of a state rule of law in a civil lawsuit as by a statute."). Utah does not possess the power through any of its branches to impose its own laws on out-of state conduct unless it demonstrates that those out-of-state activities have an identifiable and substantial connection to intrastate activities. Utah should not be permitted to utilize jury awards of punitive damages to circumvent these important constitutional limitations.

[18] The law of punitive damages is substantive, and therefore the adjudicating court must apply choice of law principles in order to determine which state's punitive damages law applies. *Johnson v. Occidental Fire & Cas. Co.*, 954 F.2d 1581, 1583 (11th Cir. 1992) (law of punitive damages is substantive and is therefore subject to choice of law principles).

III. THIS COURT SHOULD EXTEND THE HOLDING OF *BMW v. GORE* TO PROHIBIT EXTRATERRITORIAL PUNISHMENT OF UNLAWFUL CONDUCT.

Whereas *BMW* clearly prohibits states from punishing lawful out-of-state conduct, that decision left open the question whether a state may regulate out-of-state conduct that is unlawful in another state. *BMW*, 517 U.S. at 573 n.20. If this Court addresses that open question here, it should extend the same due process protections to prohibit a state from extraterritorially punishing conduct that is unlawful in the state where it occurs.

Extending the same rule to extraterritorial punishment of unlawful conduct makes sense because the degree to which a particular state punishes activity is just as important to that state's overall regulatory regime as is whether the state punishes the activity at all. Even if conduct is also unlawful in a sister state, the sister state may have good reasons for not punishing the conduct as severely. Variations in the level of punishment reflect each state's careful calibration of damages based on its individual assessment of the nature of conduct and the effect of punitive awards on insurance policy rates. Permitting another state to impose higher punitive damages for the same conduct obviously disrupts the considered policy judgments that have led these states to impose punitive damages caps. *See supra* (discussion of statutory caps on punitive damages).

As the lower courts have generally recognized,[19] the logic of *BMW* therefore applies equally to conduct that is

[19] *See Cont'l Trend Res., Inc. v. OXY USA, Inc.*, 101 F.3d 634, 637 (10th Cir. 1996) (reading *BMW* to "prohibit reliance upon inhibiting unlawful conduct in other states"); *Johansen v. Combustion Eng'g, Inc.*, 170 F.3d 1320, 1333 (11th Cir. 1999) ("punitive damages must be based upon conduct in a single state – the state where the tortuous conduct occurred – and reflect a legitimate state interest in punishing and

unlawful in another state. "While 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." *BMW*, 517 U.S. at 585. The imposition of unlimited punitive damages for conduct where other states have made a conscious decision to cap or prohibit punitive damages would greatly impair those other states' ability to regulate the insurance industry within their territorial boundaries. *See supra.* Moreover, imposing punitive damages based on conduct that is unlawful but not subject to punitive damages in another state also violates this Court's admonition that "a person [must] receive fair notice not only of the conduct that will subject him to punishment, *but also of the severity of the penalty that a State may impose.*" *Id.* at 574 (emphasis added). Thus, if the Court reaches this issue, it should make plain that a state may not administer extraterritorial punishment, even of conduct that is unlawful in the state where it occurred.

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deterring that conduct"); *Ford Motor Co. v. Ammerman*, 705 N.E.2d 539, 561 (Ind. Ct. App. 1999), *cert. denied*, 529 U.S. 1021 (2000) (extraterritorial punishment is not permitted even where conduct "is unlawful in every state of the union"); *Ace v. Aetna Life Ins. Co.*, 40 F. Supp. 2d 1125, 1133 (D. Alaska 1999) (*BMW* should be read "broadly enough to suggest that [a state] must leave some room within which the other states can exercise their own interests in defining the precise extent of and in deterring wrongful conduct").

CONCLUSION

For the foregoing reasons, the decision of the Utah Supreme Court should be reversed.

Respectfully submitted,

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