

[Caps on punitive damages are harmful to consumers](#)

This week UP [filed an important brief](#) on the issue of punitive damages in the great state of Tennessee. Punitive damages, those awarded by a jury to compensate an injured plaintiff above-and-beyond the amount owed to compensate for the harm caused, are an important component of the civil justice system that promotes fairness and helps to deter future wrongful conduct.

The deterrent effect of punitive damages and economic fairness in insurance bad faith

Imagine you've been paying for disability insurance, but when you start getting severe migraines, can't work and file a claim for your benefits to cover your lost income - the insurance company rejects your claim without a valid basis. You sue them for bad faith breach of the insurance contract. It turns out they've been arbitrarily denying migraine based claims because they think they can get away with it and save a lot of money. You win in court. Should the insurance company only pay what it owed in the first place? No - and the reason is simple: If an insurance company faces no additional financial penalty for cheating - what is to prevent it from doing it again to another one of its policyholders in a similar situation? This is where punitive damages come in. A jury gets the opportunity to examine all the facts and circumstances surrounding the wrongful claim denial and can award the aggrieved policyholder additional compensation. Not only does the policyholder get additional compensation for enduring a protracted legal battle just to get their valid claim paid but the insurance company will stop their arbitrary cheating because the financial downside was worse than the upside. It's right in the name - punitive. These damages are supposed to punish a wrongdoer and deter them from similar behavior going forward.

Now that insurers and their business allies have succeeded in restricting consumer legal rights to recover punitive damages in many states, bad actors in the business of insurance have less incentive to do the right thing. If they think they can get away with strategic cheating without punishment, they can more easily gamble on denying valid claims. The gamble is worthwhile where the worst that can happen is

they have to pay what they owed in the first place.

The superficial appeal of limits on punitive damages v. the reality of the impact of such limits

Since the landmark decision of [Campbell v. State Farm](#), where the U.S. Supreme Court imposed limitations on punitive damages, courts have made it increasingly difficult for plaintiffs to recover punitive damages. More specifically, courts are more likely to reduce a “large” punitive damages award. The way they do this is by taking the policy benefits owed (they call these the compensatory damages) and they impose a ratio, usually on the order of 1:1, maybe 1:3 in particularly egregious cases, and that is the maximum punitive damages award allowed. For example, if you have a \$300,000 house fire claim, the insurance company might only face a punitive damages award of an additional \$300,000. They do this because insurance companies cried foul. They claimed that their constitutional rights were being violated by the imposition of large punitive damages awards. But the reality is, for most large, well-capitalized insurance companies, 1:1 is a drop in the bucket, a line-item. This hardly scares them at all. Imagine, instead, if they paid, \$10,000,000 in punitive damages...that might make them think twice. And that is exactly the point. Punitive damages should be tied to the insurance company’s net worth, not the amount of the claim. Otherwise, in a majority of cases such an award will have little deterrent effect.

Some state legislatures getting into the business of imposing statutory caps on punitive damage awards. This approach is even more extreme than a judge reducing a jury verdict, because the maximum amount of exposure (the basis by which an insurance company might gamble on a claim denial) is written right into the law. All an insurance company needs to do is some simple math – what is the amount of the claim and what is the maximum penalty. Another line item. Courts (historically) and commentators have recognized that the value in allowing a punitive damages award is its unpredictability. If a wrongdoer does not know how much liability they might face, they will be less likely to commit the wrongful act. And from a public policy perspective, punitive damages are one of the few, if not the exclusive mechanism through which an individual consumer can hold a large, powerful corporation accountable for unfair business practices. This is particularly true in the insurance context where a consumer pays premiums for insurance protection because he or she does not have the financial strength to absorb a loss out of their own pocket.

In order for the modern profit-driven insurance system to work, consumers must have some leverage when they are wronged, in a transaction in which the insurance company has all the power. This is not the side of the story that you hear from the industry and tort reform advocates, but is one that we at UP

hear, all too often and why we oppose caps, statutory or otherwise, on punitive damages.

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