TIME STAMP AND RETURN

IN THE SUPERIOR COURT OF PENNSYLVANIA

DOCKET NO. 298 MDA 2002

ERIE INSURANCE EXCHANGE,

Appellant

v.

JEAN A. HOLLOCK,

Appellee

BRIEF FOR AMICUS CURIAE
UNITED POLICYHOLDERS
IN SUPPORT OF APPELLEE JEAN A. HOLLOCK

Appeal from the Order Entered January 23, 2002
Denying Erie Insurance Exchange's Motion for Post-Trial Relief
and the Verdict Entered January 7, 2002 in the Court of Common
Pleas of Luzerne County at No. 6790-C of 1999

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MISCELLANEOUS

STATEMENT OF INTEREST OF AMICUS CURIAE

United Policyholders ("UP") was founded in 1991 as a non-profit organization dedicated to educating the public on insurance issues and consumer rights. The organization is tax-exempt under Internal Revenue Code §501(c)(3). UP is funded by donations and grants from individuals, businesses, and foundations.

In addition to serving as a resource on insurance claims for disaster victims and commercial policyholders, UP actively monitors legal and marketplace developments affecting the interests of all policyholders. UP receives frequent invitations to testify at legislative and other public hearings, and to participate in regulatory proceedings on rate and policy issues.

A diverse range of policyholders throughout the United States communicate on a regular basis with UP, which allows us to provide important and 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.

UP's *amicus* brief was cited in the United States Supreme Court's opinion in Humana v. Forsyth, 525 U.S. 299 (1999), and our arguments were adopted by the California Supreme Court in Vandenberg v. Superior Court, 21

Cal.4th 815 (1999). UP has filed *amicus* briefs on behalf of policyholders in over ninety cases throughout the United States.

STATEMENT OF QUESTIONS PRESENTED

1. Whether a trier of fact can consider an insurance company's disingenuous efforts during bad faith litigation to conceal its prior bad faith conduct as relevant evidence, within the totality of the evidence, of a continuing course of bad faith insurance claims handling and a lack of credibility?

2. Whether a court can consider as relevant evidence conduct that contravenes the Unfair Insurance Practices Act, and other statutes governing insurance company conduct, when determining whether an insurance company has acted in bad faith?

3. Whether a court can consider as relevant evidence of bad faith an insurance company's intentional or reckless disregard of its own procedures and guidelines that were designed to protect policyholders and avoid bad faith?

4. Whether, having found that an insurance company acted in bad faith, a court is permitted to award appropriate punitive damages?

STANDARD OF REVIEW

The Insurance Federation of Pennsylvania, Inc., and the National Association of Independent Insurers ("NAII") (collectively, the "Insurance Associations") argue that the trial court wrongly admitted and considered evidence of Erie Insurance Exchange's ("Erie") violations of (1) its own standards, practices and guidelines and (2) the standards of conduct established by the Unfair Insurance Practices Act. These issues were not preserved or raised by the Appellant and are not properly subject to review in this Court. Commonwealth v. Cotto, 562 Pa. 32, 45 n.6, 753 A.2d 217, 224 n.6 (2000). The Insurance Associations also contend that the trial court erred in considering Erie's disingenuous testimony and in awarding punitive damages.

Erie bears the burden to establish its entitlement to relief on appeal by showing error by the trial court. Miller v. Miller, 744 A.2d 778, 788 (Pa. Super. Ct. 1999). Generally, the standard of review for allegations of an incorrect admission of evidence is abuse of discretion. Commonwealth v. Cotto, 562 Pa. 46, 54, 753 A.2d 225, 229 (2000) ("appellate court may reverse a trial court's ruling regarding the admissibility of evidence only upon a showing that the trial court abused its discretion"). Only if an evidentiary ruling turns on a question of law will the review be plenary. Zieber v. Bogert, 565 Pa. 376, 381 n. 3, 773 A.2d 758, 760 n. 3 (2001).

The trial court as trier of fact is free to weigh all of the evidence and assess its credibility, and such determinations will not be disturbed on appeal. Gaydos v. Gaydos, 693 A.2d 1368, 1371 (Pa. Super. Ct. 1997) (*en banc*). Erie's challenge to the Court's award of punitive damages will not be disturbed on appeal absent an abuse of discretion. SHV Coal, Inc. v. Continental Grain Co., 526 Pa. 489, 496, 587 A.2d 702, 705 (1991); cf. Miller, 744 A.2d at 790-91 (award of counsel fees in matrimonial action, which requires a review of all relevant circumstances, including ability to pay, is reviewed for abuse of discretion).

SUMMARY OF ARGUMENT

The trial court comprehensively analyzed the facts of record and the applicable law. After evaluating the totality of the evidence and the credibility of witnesses, the court determined that Erie engaged in bad faith. The trial court then awarded the damages that are provided by the Pennsylvania Bad Faith Statute. In doing so, the trial court committed no reversible error. The arguments of Erie and its insurance industry *amici* to the contrary are wholly without merit.

LEGAL ARGUMENT

I. THE PURPOSE OF THE BAD FAITH STATUTE IS TO PROTECT POLICYHOLDERS FROM INSURANCE COMPANY BREACHES OF THE DUTY OF GOOD FAITH AND FAIR DEALING.

An insurance company owes a duty of good faith and fair dealing toward its policyholder. Birth Center v. St. Paul Cos., 787 A.2d 376, 385 (Pa. 2001). Pursuant to this duty, an insurance company must act at all times honestly, fairly and in utmost good faith, and must refrain from putting its own financial interests over the interests of its policyholders. See Romano v. Nationwide Mut. Fire Ins. Co., 435 Pa. Super. 545, 646 A.2d 1228 (1994).

In the insurance context, the duty of good faith and fair dealing is a "heightened duty" that arises out of the special relationship that exists between an insurance company and its policyholder:

> The Pennsylvania Supreme Court has long held that an insurer must act with the "utmost good faith" toward its insured. This heightened duty is necessary because of the special relationship between an insurer and its insured and the very nature of the insurance contract. The insurer's duty of good faith, therefore, is contractual and arises because the insurance company assumes a fiduciary status by virtue of the policy's provisions, which give the insurer the right to handle claims and control settlement.

Romano, 435 Pa. Super. at 550, 646 A.2d at 1231 (citations omitted). Although the acts constituting a violation of the duty of good faith are impossible to catalogue, examples of such violations traditionally have included "evasion of the spirit of the bargain, lack of diligence and slacking off, willful rendering of imperfect performance, abuse of a power to specify terms, and interference with or failure to cooperate in the other party's performance." Somers v. Somers, 418 Pa. Super. 131, 136-37, 613 A.2d 1211, 1213-14 (1992); Restatement (Second) of Contracts ("Restatement") § 205, comment d (1981).

A policyholder need not establish fraud, ill will, or intentional conduct on the part of the insurance company. Klinger v. State Farm Mut. Auto. Ins. Co., 115 F.3d 230, 233 (3d Cir. 1997) "[B]ad faith means a frivolous or unfounded refusal to pay, lack of good faith investigation into fact, and failure to communicate with the claimant." Romano, 435 Pa. Super. at 553, 646 A.2d at 1232. See Younis Bros. & Co. v. CIGNA Worldwide Ins. Co., 899 F. Supp. 1385, 1389 (E.D. Pa. 1995), aff'd, 91 F.3d 13 (3d Cir. 1996), cert. denied, 519 U.S. 1077 (1997); Polselli v. Nationwide Mut. Fire Ins. Co., 23 F.3d 747, 751 (3d Cir. 1994).

The Bad Faith Statute applies to the wide variety of instances in which insurance companies act in bad faith toward their policyholders. See, e.g., Klinger, 115 F.3d 230 (delay in paying claim for UIM benefits); Bracciale v. Nationwide Mut. Fire Ins. Co., No. 92-7190, 1993 WL 323594 (E.D. Pa. Aug. 20, 1993) (refusal to provide a defense based on a policy exclusion that did not encompass all claims in the underlying complaint); Carpenter v. Federal Ins. Co., 432 Pa. Super. 111, 120-121, 637 A.2d 1008, 1013 (1994) (failure to undertake a reasonable investigation into the policyholder's change in name and corporate status prior to denying coverage and forcing the policyholder to institute a declaratory judgment action); see also, Diamon v. Penn Mut. Fire Ins. Co., 247 Pa. Super. 534, 372 A.2d 1218 (1977) (pressing criminal charges against the policyholder without a legitimate basis for doing so).

II. THE TRIAL COURT PROPERLY CONSIDERED EVIDENCE OF THE INSURANCE COMPANY'S COVER-UP PRIOR TO AND DURING TRIAL AS EVIDENCE OF BAD FAITH CONDUCT.

This Court has ruled definitively that "the plain language of section 8371 clearly reveals the lack of any restrictive language limiting the scope of bad faith conduct to that which occurred prior to the filing of the lawsuit." O'Donnell v. Allstate Ins. Co., 734 A.2d 901, 906 (Pa. Super. Ct. 1999). Accordingly, this court has "refuse[d] to hold that an insurer's duty to act in good faith ends upon the initiation of suit by the insured." Id. If an insurance company's misconduct involves the insurer-insured relationship, the misconduct is relevant to the bad faith action, whenever it occurs. Id. at 909 (citing Slater v. Liberty Mut. Ins. Co., No. Civ. A. 98-1711, 1999 WL 178367 (E.D. Pa. Mar. 30, 1999));[1] see also, Rottmund v. Continental Assurance Co., 813 F. Supp. 1104 (E.D. Pa. 1992) (finding conduct during litigation relevant to bad faith claim).

[1] The court in Slater made clear that it was not holding that an insurance company could avoid bad faith liability for bad faith conduct arising in the insurer-insured relationship which occurs after litigation. Id., at *2 n.3. Similarly, if the insurance company initiated an action against a policyholder "in a bad faith effort to evade a duty under a policy," such behavior can also subject an insurance company to bad faith. Id. It reasonably follows that an insurance company's provision of false or misleading testimony in litigation, in an effort to conceal pre-litigation bad faith, may also be subject an insurance company to bad faith liability.

Although a zealous defense is not bad faith, abuse of the litigation process to perform an improper investigation, to harass a policyholder for the purpose of having the policyholder abandon her claim, or to cover up an insurance company's bad faith claims handling can all be evidence of bad faith. Indeed, this Court has implied that discovery violations in litigation can be bad faith if there is evidence that they were pursued as a bad faith investigative practice:

> In the absence of any evidence which demonstrates that Allstate was motivated by a dishonest purpose or ill motive, or otherwise breached its fiduciary or contractual duty by utilizing the discovery process to conduct an improper investigation, we must reject Appellant's attempt to equate the propounding of interrogatories with the type of bad faith investigative practices actionable under section 8371.

O'Donnell, 734 A.2d at 909. Under O'Donnell, therefore, an abuse of the discovery process to conduct an improper investigation can constitute bad faith. Similarly, abusing the litigation process by testifying deceptively in an action under an insurance policy in order to cover-up bad faith claims handling constitutes bad faith. At a minimum, it is relevant evidence of bad faith. The key question under O'Donnell is whether the litigation behavior falls within the bounds of zealous advocacy or whether it is part of the operative facts of bad faith committed by the insurance company against its policyholder.

Accordingly, when Erie and the Insurance Associations argue that O'Donnell stands for the proposition that an insurance company cannot be liable for post-litigation bad faith, they are incorrect. They are even more far afield in their treatment of Ridgeway v. U.S. Life Credit Life Insurance Co., 793 A.2d 972 (Pa. Super. Ct. 2002). The Insurance Associations contend that this Court in Ridgeway ruled that "there is no duty of good faith and fair dealing to breach once the bad faith case is in litigation." (Ins. Ass'n Br. at 13). There is no such holding in Ridgeway. On the contrary, Ridgeway stands for the unremarkable proposition that an insurance company's failure to pay a bad faith judgment is not itself bad faith under the Pennsylvania Bad Faith Statute. The Court reasoned that an action to enforce a judgment does not arise "under the insurance policy" within the meaning of the Bad Faith Statute. Id. at 977-78. This should give Erie some solace for if, following this appeal, Erie fails to pay the bad faith judgment rendered by the trial court, forcing Ms. Hollock to execute on the judgment, Erie knows it may not be held liable yet again for punitive damages under the Bad Faith Statute. Of course, this has nothing to do with the case presently before the Court.

Unlike Ridgeway, Ms. Hollock's case against Erie "arises under the insurance policy." Just this year, this Court definitively stated that a UIM bad faith claim is an action arising under an insurance policy:

> [Nationwide] believes attorney fees generated in the prosecution of the statutory bad faith claims are not recoverable under the terms of the statute which provides for an award in an "action arising under an insurance policy." It is Nationwide's position that the bad faith claim is a separate and distinct claim from the insurance policy contract claim and as such it does not "arise under an insurance policy."
>
> We find Nationwide's reading of the statutory provision contrived. The court in this matter found that Nationwide engaged in bad faith in an action brought by Bonenberger arising under an insurance policy. It is absurd to argue that Bonenberger could recover the costs of pursuing recovery on the UIM claim and be denied recovery of attorney fees in the action which determined that Nationwide engaged in bad faith for its failure to pay those same UIM benefits.

Bonenberger v. Nationwide Mut. Ins. Co., 791 A.2d 378, 383 (Pa. Super. Ct. 2002) (emphasis added). Because the obligation to pay Ms. Hollock's uninsured motorist claim arises from the insurance policy, not from a bad faith judgment, Ridgeway is wholly distinguishable.

Contrary to the contention of the Insurance Associations, the trial court did not "hold the defendant liable for conduct relating solely to the bad faith action." (Ins. Ass'n Br. at 9). Rather, the trial court made detailed findings of fact of bad faith permeating the entirety of Erie's treatment of its policyholder, properly characterizing that conduct as dishonest (Findings of Fact, ¶45), disingenuous (Findings of Fact, ¶¶ 45, 62, 93, 97, 110), and evidencing "a pattern of deliberate indifference to the rights of its policyholder, including multiple instances of contradictory testimony concerning Erie's policies, procedures, and guidelines by high-ranking Erie executives." (Findings of Fact, ¶153). The court found Erie's conduct to range "from intentional indifference to conscious efforts in an attempt to justify previous misconduct." (Findings of Fact, ¶157).

It was in the context of Erie's conscious efforts to justify its previous misconduct that the court criticized Erie's litigation conduct. The court specifically concluded that the deposition and trial testimony revealed a pattern of bad faith conduct which compounded Erie's earlier bad faith. (Conclusions of Law, ¶80). The court further ruled that Erie was engaged in a "an intentional attempt to conceal, hide or otherwise cover-up the conduct of Erie employees in the handling of the Hollock claim." (Conclusions of Law, ¶80). Because the Hollock claim arises under an insurance policy and Erie's misconduct was related to Erie's failure to handle the claim appropriately, the court properly considered Erie's ongoing bad faith. It would have been inappropriate for the court to ignore the utter lack of credibility of Erie's witnesses, and their efforts to cover-up their claims activities, in evaluating whether, under the totality of the circumstances, Erie acted in bad faith. An appropriate and zealous defense is not bad faith. On the other hand, a cover-up of bad faith claims handling through the provision of false and misleading testimony is unquestionably probative of the bad faith of an insurance company. Accordingly, the court properly considered evidence of Erie's cover-up.

One tactic utilized by many insurance companies facing potential bad faith liability is to characterize their misconduct as "honest mistakes." Other insurance companies, like Erie, try to avoid liability through disingenuous efforts to conceal their wrongdoing, claiming that they acted appropriately. Surely, a court can consider, in determining whether an insurance company's actions were reckless or intentional, as opposed to being an honest mistake, whether the insurance company engaged in a cover-up of its conduct and testified in a contradictory manner about its obligations and actions.

III. A WEALTH OF PENNSYLVANIA PRECEDENT ESTABLISHES THAT VIOLATIONS OF THE STANDARDS OF CONDUCT ESTABLISHED BY THE UNFAIR INSURANCE PRACTICES ACT IS RELEVANT EVIDENCE OF BAD FAITH.

Violations of the standards of conduct established by the Unfair Insurance Practices Act ("UIPA") and associated regulations constitute evidence of bad faith. See Romano v. Nationwide Mut. Fire Ins. Co., 435 Pa. Super. 545, 552-53, 646 A.2d 1228, 1232 (1994). In Romano, this Court explained that, beyond looking at common law definitions of bad faith, "the parameters of Section 8371 may also be discerned by reference to analogous Pennsylvania insurance law." Romano, 435 Pa. Super. at 554, 646 A.2d at 1233. The Court found that the UIPA and the insurance regulations can be considered in determining whether an insurance company acted in bad faith, because the Supreme Court of Pennsylvania has ruled that conduct that violates the UIPA or the insurance regulations is "bad faith" conduct. Id. (citing D'Ambrosio v. Pennsylvania Nat'l Mut. Cas. Ins. Co., 494 Pa. 501, 431 A.2d 966 (1981)).

While Romano is the leading case, it is not alone in finding that insurance company behavior that conflicts with the Pennsylvania statutes and regulations governing insurance company conduct is relevant evidence of bad faith. See O'Donnell v. Allstate Ins. Co., 734 A.2d 901, 906 (Pa. Super. Ct. 1999) ("conduct which constitutes a violation of the UIPA may also be considered when determining whether an insurer acted in bad faith under the statute"); Turner Constr. Co. v. First Indem. of Am. Ins. Co., 829 F. Supp. 752, 762 (E.D. Pa. 1993) (bad faith conduct may be identified by reference to the UIPA "because courts recognize that the 'unfair and deceptive acts or practices' the UIPA proscribes constitute acts of 'bad faith' for purposes of § 8371"), aff'd. without op., 22 F.3d 303 (3d Cir. 1994); Parasco v. Pacific Indem. Co., 920 F. Supp. 647, 655 n.5 (E.D. Pa. 1996) ("the UIPA serves as a reference from which a court may determine whether an insurer has acted in bad faith in a given case"); Certainteed Corp. v. Federal Ins. Co., 913 F. Supp. 351, 360-61 (E.D. Pa. 1995) (alleged conduct violating the UIPA can be considered in determining whether an insurance company acted in bad faith); Coyne v. Allstate Ins. Co., 771 F. Supp. 673, 678 (E.D. Pa. 1991) (rejecting a constitutional challenge to the Pennsylvania bad faith statute on the ground of vagueness, reasoning that the parameters of the bad faith statute could be discerned by reference to the UIPA); see also, Leo

v. State Farm Mut. Auto. Ins. Co., 908 F. Supp. 254, 256 (E.D. Pa. 1995) (like the UIPA is used as an aid to statutory construction of the Bad Faith Statute, so may it help in interpreting ambiguous sections of the Consumer Protection Act).

The UIPA, and the other insurance statutes and regulations, establish a code of conduct with which insurance companies are expected to comply when operating in the Commonwealth of Pennsylvania. Indeed, one purpose of the UIPA is to define what acts or practices of insurance companies are unfair or deceptive. See 40 P.S. § 1171.2. The idea that a bad faith plaintiff would be required to take broad discovery and present as evidence the pattern and practice of an insurance company in violating the standards set by the UIPA is non-sensical. That would only be necessary if the UIPA claim were being adjudicated in the trial court, which it is not. See Romano, 435 Pa. Super. at 552-53, 646 A.2d at 1232.[2] Instead, courts look to the UIPA to give meaning to the concept of bad faith. Whether an insurance company violates the standards of insurance company behavior regularly, or only in the bad faith plaintiff's case,

[2] Notably, the Court in Romano cited the section of the UIPA which prohibits an insurance company from compelling litigation to recover amounts due on an insurance policy. Id., 435 Pa. Super. at 554, 646 A.2d at 1233 (citing 40 P.S. §1171.5(a)(10)(vii). Under the reasoning of the Insurance Associations, contrary to the discussion in Romano, courts would not be able to consider such behavior unless the policyholder in a bad faith action showed that the treatment afforded the policyholder was consistent with a pattern and practice by an insurance company, which would itself require discovery into all similar cases handled by the insurance company. Most of the cases that have looked to the UIPA to define bad faith conduct have involved behavior contrary to 40 P.S. §1171.5(a)(10), but no court has required pattern and practice evidence. See, e.g., Certainteed, 913 F. Supp. at 360 n.15; Parasco v. Pacific Indem. Co., 920 F. Supp. at 655.

the relevance to the bad faith cause of action remains the same – the insurance company failed to follow the standards for insurance company behavior established in Pennsylvania. This is evidence that the insurance company is not acting in utmost good faith, in that insurance companies acting in good faith would follow the standards set by the UIPA. If an insurance company does not follow those standards in a particular case, it is more likely that the insurance company is not acting in good faith. See Pa. R. Evid. 401 (evidence is relevant if it has a tendency to make the existence of any fact that is of consequence to the determination of the action more likely than not).

The central question in a bad faith case is usually not whether the insurance company has engaged in a particular business practice on a regular basis, but whether the insurance company knowingly or recklessly disregarded its obligations to its policyholder. Pennsylvania's insurance statutes and regulations establish what an insurance company is required to do when handling a claim and how it is supposed to treat its policyholder. When a policyholder proves that its insurance company failed to follow these basic rules of conduct, a judge or jury can, and probably will, consider that to be strong evidence of an insurance company's bad faith.

IV. AN INSURANCE COMPANY'S VIOLATIONS OF ITS OWN INTERNAL GUIDELINES, MANUALS, AND PROCEDURES, WHICH WERE ADOPTED TO GUARD AGAINST BAD FAITH CONDUCT, IS RELEVANT EVIDENCE OF BAD FAITH.

Pennsylvania law requires insurance companies "to adopt and implement reasonable standards for the prompt investigation of claims arising under insurance policies." 40 P.S. § 1171.5(a)(10)(iii) (emphasis added). Consistent with this law, many insurance companies create manuals to guide their employees in the performance of their duties.

This Court recently determined that manuals and guidelines may be relevant and useful in evaluating a bad faith claim:

> Individuals expect that their insurers will treat them fairly and properly evaluate any claim they may make. A claim must be evaluated on its merits alone, by examining the particular situation and the injury for which recovery is sought. An insurance company may not look to its own economic considerations, seek to limit its potential liability, and operate in a fashion designed to "send a message." Rather, it has a duty to compensate its insureds for the fair value of their injuries. Individuals make payments to insurance carriers to be insured in the event coverage is needed. It is the responsibility of insurers to treat their insureds fairly and provide just compensation for covered claims based on the actual damages suffered. Insurers do a terrible disservice to their insureds when they fail to evaluate each individual case in terms of the situation presented and the individual affected. Thus, a company manual, which dictates a certain philosophy in claims handling, may be relevant and useful in evaluating a bad faith claim.

Bonenberger v. Nationwide Mut. Ins. Co., 791 A.2d 378, 381 (Pa. Super. Ct. 2002) (emphasis added).[3]

Similarly, Pennsylvania federal courts have ruled that evidence of an insurance company's departure from the procedures established in its guidelines or manuals is relevant evidence of bad faith. See Robertson v. Allstate Ins. Co., Civ. A. No. 98-4904, 1999 WL 179754, at *6 (E.D. Pa. Mar. 10, 1999); Adams v. Allstate Ins. Co., 189 F.R.D. 331 (E.D. Pa. 1999); Kaufman v. Nationwide Mut. Ins. Co., Civ. A. No. 97-1114, 1997 WL 703175, at *2 (E.D. Pa. Nov. 12, 1997). In Robertson, a UIM bad faith case, the court ruled as follows:

> This court has determined that information contained in the manuals is relevant because it contains instructions concerning procedures used by Allstate employees in handling UIM claims such as plaintiff's claim. Although the fact that Allstate employees departed from

[3] Incidentally, many courts have relied upon internal claims manuals in their decisions concerning insurance coverage. See e.g. Cincinnati Ins. Co. v. Clark, No. 91-0820, 1992 WL 34128 (E.D. Pa. Feb. 19, 1992) (ordering insurance company to produce claims manuals pertinent to interpretation and application of key policy term); In re: Northeast Enters., Inc. v. Allstate Ins. Co., No. 91-15394, 1992 WL 78815, at *7 n.4 (E.D. Bankr. Pa. Apr. 8, 1992) (utilizing claims manuals pertinent to interpretation and application of key policy term); Andover Newton Theo. Sch. v. Continental Cas. Co., 930 F.2d 89, 94 (1st Cir. 1991) (relying on claims manual in finding ambiguity in the insurance policy); Hall v. Harleysville Ins. Co., 164 F.R.D. 406, 409-410 (E.D. Pa. 1996) (ordering production of entire claims manual over objections of insurance company that such documents were irrelevant and burdensome); Glenfed Dev. Corp. v. Superior Court, 53 Cal. App. 4th 1113 (Cal. Ct. App. 1997) (finding claims manuals discoverable because they are admissible); Hoechst Celanese Corp. v. National Union Fire Ins. Co. of Pittsburgh, 623 A.2d 1099, 1107 (Del. Super. Ct. 1991) (granting plaintiff's motion to compel insurance company's claims and underwriting material, including manuals, guidelines and interpretative documents); Federal Sav. and Loan Ins. Corp. v. Commonwealth Land Title Ins. Co., 130 F.R.D. 507, 508-09 (D.D.C. 1990) (affirming grant of plaintiff's motion to compel discovery of insurance company's internal policy manuals).

> established standards in handling plaintiff's UIM claim would not alone establish bad faith, such information "is probative evidence for plaintiff to demonstrate bad faith." See Kaufman v. Nationwide Mut. Ins. Co., 1997 WL 703175, at *2 n. 2 (E.D. Pa. Nov. 12, 1997) (in bad faith case, insurer ordered to produce information in claims manuals concerning procedures used by insurer's employees in handling UIM claims).

Robertson, 1999 WL 179754, at *6.

Cases from other states and learned treatises have reached the same conclusion. The oft-cited treatise by Couch states plainly, "[c]laims manuals and underwriting manuals are admissible in bad-faith cases where it is shown that the contents are relevant to the issues raised in the case." 17 Couch on Insurance § 253:169 (3d ed. 2000). In Miel v. State Farm Mutual Automobile Insurance Co., 912 P.2d 1333, 1337 (Ariz. Ct. App. 1995), the court affirmed the admission of a portion of the insurance company's claims manual and articles from the insurance company's in-house newsletter. The court noted their relevance, finding that the claims representative admitted that she failed to follow the established procedures. Id.; see also Vining v. Enterprise Fin. Group, Inc., 148 F.3d 1206 (10th Cir. 1998) (affirming admittance of training manual); State Farm Mut. Auto. Ins. Co. v. Engelke, 824 S.W.2d 747, 753 (Tex. App. 1992) (affirming court-ordered production of training manuals).

Ignoring this mountain of law affirming the relevance of claims manuals, such as Erie's Claims Handling Expectations, the Insurance

Associations argue misleadingly that "the trial court determined not only that bad faith could be found by a violation of an industry standard, but also that the insurance industry standard could be set by the carrier's own internal operating guidelines." (Ins. Ass'n Br. at 19). The argument proffered by the Insurance Associations is not located in the trial court's findings or conclusions. After fabricating this "argument" and misattributing it to the trial court, the Insurance Associations curiously claim "there is no precedent for this" and that "exhaustive research has failed to disclose any cases upholding this argument." (Ins. Ass'n Br. at 19).[4]

The question is not, as the Insurance Associations would pose it, whether the manuals and guidelines create an "industry standard," whether they create a "higher standard" for those who adopt them, or whether the violation of procedures set forth in a claims manual is bad faith *per se*. The standard of bad faith remains the same for all. The question is whether, in this bad faith action,

[4] The cases referenced in the treatise quoted by the Insurance Associations do not stand for the proposition for which they are cited. See Larocque v. State Farm Ins. Co., 660 A.2d 286 (Vt. 1995) (statement in manual directing that claims were to be handled in an efficient and cooperative manner did not create a duty for the insurance company to act in good faith toward plaintiffs who sued the insurance company's policyholder); Manzella v. Gilbert-Magill Co., 965 S.W.2d 221 (Mo. Ct. App. 1998) (in an action for professional negligence against a broker or agent, the court found that an insurance broker or agent was not required to follow the insurance company's underwriting guidelines regarding the purchase of an insurance policy). Notably, the treatise cited by the Insurance Associations is authored by Allan Windt, a Pennsylvania attorney who regularly represents insurance companies. See, e.g., Byrne v. Southeastern Pa. Transp. Auth., 541 Pa. 45, 660 A.2d 50 (1995) (representing Allstate); Continental Cas. Co. v. Hartford Acc. & Indem. Co., 836 F. Supp. 246 (E.D. Pa. 1993) (representing Hartford); White Mountain Constr. Co. v. Transamerica Ins. Co., 631 A.2d 907 (N.H.

the trial court abused its discretion by admitting and considering evidence of an insurance company's disregard, without rational excuse, of the procedures it adopted to govern its handling of UIM claims. According to the Pennsylvania Rules of Evidence, relevant evidence is "evidence having any tendency to make the existence of any fact that is of consequence to the determination of the action more probable or less probable than it would be without the evidence." Pa. R. Evid. 401. "Evidence is relevant if it logically tends to establish a material fact in the case, tends to make a fact at issue more or less probable, or supports a reasonable inference or presumption regarding the existence of a material fact." Commonwealth v. Minerd, 562 Pa. 46, 56, 753 A.2d 225, 230 (2000).

Evidence that an insurance company's employees ignored their own company guidelines does have a tendency to show that they lacked a reasonable basis for their actions, acting intentionally or recklessly in ways which would or could harm a policyholder. It was well within the trial court's discretion to find that it is more likely that an insurance company is acting recklessly in disregard of its duties if it ignores, rather than follows, its own guidelines that have been crafted to govern its conduct. Indeed, insurance companies sometimes defend bad faith actions by claiming that they handled the claim "by the book" – in other words, consistent with its own internal guidelines and manuals. Clearly, insurance companies cannot have it both ways. They cannot claim that they act in good

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1993) (representing Transamerica Insurance Company). Respectfully, Mr. Windt may not be an objective commentator.

faith when they follow their guidelines, but argue that evidence of the violation of those guidelines is irrelevant to showing bad faith.[5]

In comprehensively evaluating the totality of the evidence, the trial court properly considered Erie's intentional or reckless disregard of its own procedures and policies that were designed to protect policyholders and avoid bad faith.

V. HAVING FOUND BAD FAITH, THE COURT WAS WELL WITHIN ITS DISCRETION TO AWARD APPROPRIATE PUNITIVE DAMAGES.

A. Whenever Bad Faith Is Found, The Court May Award Punitive Damages.

The Pennsylvania Bad Faith Statute provides as follows:

> In an action arising under an insurance policy, if the court finds that the insurance company has acted in bad faith towards the insured, the court may take all of the followings actions:
>
> (1) Award interest on the amount of the claim from the date the claim was made by the insured in an amount equal to the prime rate of interest plus 3%.
>
> (2) Award punitive damages against the insurer.
>
> (3) Assess court costs and attorney fees against the insurer.

[5] The Insurance Associations' citation to Bergman v. United Services Automobile Association, 742 A.2d 1101 (Pa. Super. Ct. 1999) is misplaced. In Bonenberger, the Court clarified that "Bergman holds that the admission or exclusion of expert testimony in actions on insurance policies based on a claim of bad faith remain a matter within the sound discretion of the trial court." Bonenberger, 791 A.2d at 382. The Court concluded that "[t]o suggest that Bergman holds that expert testimony is not admissible in a bad faith claim is a misstatement of the law." Id.

42 Pa. Cons. Stat. Ann. § 8371. Upon a finding of bad faith, the court "may" award interest, award punitive damages, and assess court costs and attorney fees. The statute empowers the court to award punitive damages whenever bad faith is found.

Here, the trial court found that Erie acted in bad faith. Nevertheless, Erie argues that the court was powerless to award punitive damages unless it made a separate and independent finding that Erie engaged in "outrageous" or "especially egregious" conduct (as if bad faith were not by its nature outrageous) or that Erie engaged in "acts of malice, vindictiveness, and a wholly wanton disregard of the rights of others." (Erie Br. at 44-46). Erie's effort to graft language onto the Bad Faith Statute should be rejected. The Bad Faith Statute does not say that the court may award punitive damages upon a finding of bad faith only if it also finds the bad faith conduct to be outrageous, especially egregious, malicious, vindictive, or in wanton disregard of the rights of others. The Legislature empowered courts to award punitive damages whenever and wherever bad faith is found.[6]

One of the goals of the Bad Faith Statute is to make bad faith behavior economically unattractive to insurance companies. Remedies other than punitive damages that are provided by the Bad Faith Statute (including interest, costs, and attorney fees) only serve to place the policyholder in the position she would have found herself had the insurance company not committed bad faith. Klinger, 115 F.3d at 236. Punitive damages are a necessary component of the statutory scheme because they dissuade insurance companies from acting in bad faith. In other words, punitive damages make bad faith unprofitable.[7] In enacting the Bad Faith Statute, the Legislature purposefully provided remedies beyond those available under contract law to fight the serious problem of insurance company bad faith. Punitive damages are the lynchpin of the statute.

If insurance companies can profit from bad faith, a result contrary to public policy, then insurance companies who act only in good faith would be at a

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[6] Even if Erie were correct as a legal matter, which it is not, the trial court specifically found Erie's conduct to be outrageous. (Conclusions of Law, ¶101).

[7] Unfortunately, many insurance companies who act in bad faith escape liability under the current system, because policyholders must prove bad faith by clear and convincing evidence. When the policyholder can prove bad faith by a preponderance of the evidence, but not by the higher standard of clear and convincing evidence, the insurance company gets away with bad faith. This result appears to have been unintended. When the Pennsylvania Supreme Court adopted a clear and convincing evidence standard in Cowden, this Court had not decided whether bad faith would be treated as a tort or a contract claim. See Cowden v. Aetna Cas. & Sur. Co., 389 Pa. 459, 469, 134 A.2d 223, 227 (1957) (noting the divergence of opinion on the rationale of recovery). While the court was unclear as to whether liability was to be based in contract or tort, the Court ruled that bad faith must be shown by clear and convincing evidence, which is rarely if ever the standard used to prove a breach of contract. It is normally applicable only to prove certain torts, such as fraud. Later, this Court held that bad faith was a contractual claim based on the implied covenant of good faith and fair dealing. Gray v. Nationwide Mut. Ins. Co., 422 Pa. 500, 223 A.2d 8 (1966). After that, this Court ruled that the tort of bad faith would not be recognized in Pennsylvania. See D'Ambrosio, 494 Pa. 501, 431 A.2d 966. When adopting the Bad Faith Statute, the Legislature did not require that bad faith be proven by clear and convincing evidence. Although the trial judge in this case properly instructed the jury that the current standard for proving bad faith is clear and convincing evidence, the more appropriate standard is

serious competitive disadvantage. On the other hand, if punitive damages are regularly awarded for bad faith, the costs of doing business would properly increase only for those companies who act in bad faith. Those companies who consistently act in good faith will be at a competitive advantage. More importantly, if strong punitive damages awards were meted out consistently in cases like this one, policyholders would suffer significantly less misconduct. Instead of blithely ignoring the needs of its policyholders, as Erie did here, insurance companies will be forced to consider the full import, and potential impact, of their decisions on their policyholders. For these reasons, courts should almost always award punitive damages when an insurance company is found to have acted in bad faith. The Court of Appeals for the Third Circuit has explained that the "obvious design" of the Bad Faith Statute is, first, to place the policyholder in the same economic position she would have been in had the insurance company performed as it had promised by awarding attorney fees, and second, to punish the insurance company by awarding punitive damages. Klinger, 115 F.3d at 236. Both of these purposes should be honored.

The record demonstrates that fear of bad faith caused Erie to adopt procedures for the handling of UIM claims. Hopefully, the award of punitive damages in this case will encourage Erie to follow those procedures and its obligations under its insurance policies in the future. The breadth and scope of

preponderance of the evidence. Accordingly, United Policyholders requests that the preponderance standard be adopted for proving bad faith in Pennsylvania.

section 8371 evidences the Legislature's intent to make the policyholder whole and to punish insurance company bad faith. Here, the trial court did exactly that.

B. The Trial Court Awarded An Appropriate Amount of Punitive Damages.

The amount of punitive damages awarded by the court was appropriate. The court considered the relevant factors in its decision, including the character of the act, the nature and extent of the harm, and Erie's wealth. (Conclusions of Law, ¶¶ 87-103). Apparently, Erie still has not accepted that bad faith is serious misconduct deserving serious penalties. Erie raises only two points which require some discussion.

First, Erie argues that the amount of punitive damages is not commensurate with the amount of compensatory damages because the punitive damages are ten times the amount of the compensatory damages. This is not a relevant consideration. See Kirkbride v. Libson Contractors, Inc., 521 Pa. 97, 103-04, 555 A.2d 800, 803 (1989). In any event, just last month, this Court affirmed an award of punitive damages that was "slightly less than eleven times the total compensatory damages of $335,008" or 7.2 times the total damages as alternatively calculated by the court. Colyer v. National Grange Mut. Ins. Co., No. 929 MDA 2001, slip op. at 4 (Pa. Super. Ct. 2002).[8] In Colyer, this Court ruled that the amount of punitive damages is within the discretion of the trial court; the award did not shock the conscience; and because this Court did not have the benefit of assessing the credibility of the witnesses, it would not second-guess the trial judge. Id. The result here should be no different.

Second, Erie claims that a large punitive damage award is uncalled for because "the maximum civil penalty for a violation of UIPA is fixed at $5,000 for a knowing violation and $1,000 for an innocent violation." (Erie Br. at 49). Erie ignores the other penalties provided by UIPA, including the suspension or revocation of Erie's license to sell insurance in Pennsylvania. See 40 P.S. §1171.9. Over fifty percent of Erie's business comes from Pennsylvania. Best's Insurance Reports--Property & Casualty, Vol. I, at 1533 (1997 ed.). In 1996, the year that Erie received notice of Ms. Hollock's UIM claim, Erie obtained over $1 billion in premium revenue from Pennsylvania.[9] Id. A revocation or suspension of Erie's license would clearly cause significant damage to Erie, far in excess of

[8] If that alternative calculation, which includes the arbitration award, were applied here, Ms. Hollock's punitive damage award would be only four times the compensatory damages.

[9] More specifically, the $1,093,793,000 premium that Erie derived from Pennsylvania policyholders reflected 59.6% of the total direct premiums obtained by Erie in 1996. Id. In that year, Erie ranked among the 25 largest property and casualty insurance groups in the United States. Id. at 1532. Now, it ranks in the top 20. Best's Insurance Reports--Property & Casualty, Vol. I, at 1564 (2001 ed.). In 2000, Erie obtained $1,188,655,000 in premium from Pennsylvania, representing 53.9% of its total. Id.

the $2.8 million punitive damages award. Viewed in this light, the trial court's punitive damage award appears practically insignificant.[10]

Importantly, the remedies in the Unfair Insurance Practices Act are meant to supplement – not limit – judicial and statutory remedies, including punitive damages under the Bad Faith Statute.[11] The court's punitive damages award appropriately seeks to punish Erie's misconduct and to deter future bad faith. The court's judgment should be affirmed.

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10 It is approximately one-quarter of one percent of Erie's premium revenue from Pennsylvania alone for a single year.

11 Most state unfair insurance practices acts are derived from the Unfair Trade Practices Model Act (the "Model Act") developed by the National Association of Insurance Commissioners ("NAIC"). Proposed Section 8(a)(C) to the Model Act would have given insurance commissioners the power to award "[s]uch other relief as is reasonable and appropriate." See 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 NAII, who has submitted an *amicus* brief here, strongly argued against the adoption of Section 8(a)(C) because the authority to award "other relief" was "so all-encompassing as to grant the regulator the power to impose judicial type remedies without the protection of appropriate judicial procedures." Statement to the NAIC (B) Committee by Mr. Donald McHaugh on behalf of the NAII, AMIA, and State Farm Mutual Insurance Company, 1972-1 NAIC Proceedings 443, 448. Based largely on this opposition, the insurance commissioners' power to order restitution to policyholders embodied in Section 8(a)(C) was deleted from the Model Act by the Law, Legislation & Regulation (B) Committee. See 1972-1 NAIC Proceedings, at 490. Thus, due to the insurance industry's strong opposition, the Model Act and the numerous state laws subsequently patterned after it have largely left the award of private damages for insurance company unfair trade practices and fraud, including punitive damages for bad faith, to other statutory law and the common law.

CONCLUSION

For all of the foregoing reasons, the trial court's judgment should be affirmed.

Respectfully submitted,

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CERTIFICATE OF SERVICE

I hereby certify that on this date two (2) true and correct copies of Brief for Amicus Curiae United Policyholders in Support of Appellee Jean A. Hollock were served upon the parties listed below by Federal Express:

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