IN THE
SUPREME COURT OF PENNSYLVANIA
MIDDLE DISTRICT

No. 67 MAP 2005

ERIE INSURANCE EXCHANGE,

Appellant,

v.

JEAN A. HOLLOCK,

Appellee.

BRIEF OF *AMICUS CURIAE* UNITED POLICYHOLDERS IN SUPPORT OF APPELLEE

Appeal from the Order of the Superior Court filed January 22, 2004, Affirming the Order of the Court of Common Pleas of Luzerne County Entered January 23, 2002 No. 6790-C, 1999

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October 24, 2005

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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 100 cases throughout the United States.

STATEMENT OF QUESTIONS PRESENTED

1. Whether conduct of a party during a bad faith action under 42 Pa. Cons. Stat. Ann. § 8371 is admissible to support a finding of punitive damages?

Answered in the Affirmative by the Superior Court.

2. What scope of review should an appellate court apply when reviewing a punitive damages award?

The Superior Court reviewed the court's decision to award punitive damages based on its detailed factual findings under an "abuse of discretion" standard, but undertook "further review of the award" to test its constitutionality in light of the trial court's factual findings. See Superior Court Slip. Op. at 21.

STANDARD OF REVIEW

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 toward Ms. Hollock. 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.

United Policyholders will address the first of the two issues presented, *i.e.*, whether conduct of a party during a bad faith action under 42 Pa. Cons. Stat. Ann. § 8371 is admissible to support a finding of punitive damages. Unlike the insurance industry *amici*, United Policyholders will limit itself to the question presented. The conduct of a party during a bad faith action is admissible because the duty of good faith between a policyholder and its insurance company does not cease when bad faith litigation commences. An insurance company's conduct during the bad faith litigation is often indicative of whether its failures were good faith unavoidable mistakes or bad faith, reckless conduct.

Importantly, much of the "evidence" about which Erie complains is the trial court's evaluation of the credibility and behavior of Erie's witnesses on the stand. A trier of fact, like the trial judge here, must be able to consider the demeanor and credibility of witnesses. The trial judge found Erie's witnesses to be evasive, dishonest, arrogant, and malicious. It should be self-evident that such behavior is relevant to a trier of fact's reasoned judgment about whether an insurance company acted in good faith toward its policyholder. Surely, if the trial judge had found Erie's witnesses to be straightforward, honest, forthcoming, and genuinely concerned about Ms. Hollock's welfare, Erie would argue that such findings should weigh strongly against a finding of bad faith. When read comprehensively, the trial judge's conclusion that a substantial punitive damages

award was justified is unassailable. It is unfortunate that Erie still demonstrates absolutely no remorse for its reprehensible conduct toward its policyholder.

The implausible argument advanced by Erie and its amicis that an "intentional attempt to conceal the conduct of [Erie's] employees" through "a blatant attempt to undermine the truth finding process" is irrelevant to the question of bad faith. Erie's argument is akin to contending that a criminal's flight from the scene or an attempted cover-up of a fraud is irrelevant evidence No court in the nation would accept such a proposition.

STATEMENT OF FACTS

United Policyholder incorporates by reference the findings of fact from the trial court's decision. None of those findings of fact have been found to be clearly erroneous and none are challenged in the issues on review. Notably, the briefs of Erie and their *amici* ignore, contest, contradict or distort those facts. The trial court's careful and detailed findings speak for themselves.

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 WHENEVER THEY OCCUR.

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, Cmt. (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 AND TO JUSTIFY THE IMPOSITION OF PUNITIVE DAMAGES.

The Superior 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, the Superior 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).

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 persuasive evidence of

[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.

bad faith. Indeed, 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 argues that O'Donnell stands for the proposition that an insurance company cannot be liable for post-litigation bad faith, Erie is incorrect. Erie is even more far afield in its treatment of Ridgeway v. U.S. Credit Life Insurance Co., 793 A.2d 972 (Pa. Super. Ct. 2002). 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." 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.

The Superior Court has previously considered post-litigation conduct in affirming an award of punitive damages:

> The trial court pointed out that, in the underlying coverage litigation, Harleysville "made numerous exaggerations and misstatements in their briefs and court statements[.]" *See* Trial Court Opinion, 1/30/02, at 4 (Finding of Fact No. 4). Moreover, the trial court found that "Harleysville, knowing of its insured's financial difficulties as a result of the loss, did nothing to protect the Zimmermans while it pursued it's a legal position not recognized by the Pennsylvania courts." *Id.* These findings are supported in the record.

Zimmerman v. Harleysville Mut. Ins. Co., 860 A.2d 167, 173 (Pa. Super. 2004). In affirming an award of punitive damages, the Superior Court found that such evidence "supports the trial court's determination that the Zimmermans established their claim of bad faith against Harleysville." Id. at 174.

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 by providing 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."

Another common insurance company tactic is to try to avoid liability through disingenuous efforts to conceal the wrongdoing, while 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.

Erie and its *amici* argue that it should not be punished with punitive damages for lying at trial, arguing that punishment for perjury has certain due process protections. While those arguments would have some merit if the trial court entered punitive damages for perjury, that is not what the trial court did. The trial court awarded punitive damages for Erie's bad faith in denying and delaying benefits to Ms. Hollock under the insurance policy. No separate notice or warnings need be given by the court to a witness that if they lie or act deceptively or arrogantly, that such conduct can be used by the court in determining whether they made a good faith mistake in delaying or denying insurance benefits or, alternatively, acted in bad faith in doing so. A court sitting as finder of fact need not, and must not, put blinders on to the credibility and demeanor of witnesses. The court was right to find that "Erie's conduct in handling this claim ranged from intentional indifference to conscious efforts in an attempt to justify earlier misconduct." (Findings of Fact, ¶ 157). The court properly considered Erie's "semantic straining, verbal jousting [and] obfuscation

of the issues" in reaching the essential conclusion: "Erie acted in bad faith toward Jean Hollock."

III. COURTS IN OTHER JURISDICTIONS HAVE RULED THAT AN INSURANCE COMPANY'S DUTY OF GOOD FAITH DOES NOT END WITH THE INITIATION OF LITIGATION AND THAT AN INSURANCE COMPANY'S CONDUCT DURING LITIGATION CAN BE PROBATIVE EVIDENCE OF BAD FAITH.

Numerous courts, including several high courts, have ruled that conduct during litigation can be probative evidence of bad faith. This law is so well-established that it would be a disservice to call it merely the majority rule, rather than a national judicial consensus.

A number of state high courts have addressed the issue. In what is often considered the seminal case, the California Supreme Court allowed evidence of settlement offers during litigation to be admitted to prove an insurance company's bad faith. See White v. Western Title Ins. Co., 710 P.2d 309 (Cal. 1985). The Mississippi Supreme Court remanded a case solely for consideration of the insurance company's post-suit conduct. See Gregory v. Continental Ins. Co., 575 So.2d 534, 541-42 (Miss. 1990).

The Supreme Court of Montana considered the issue several times. While the Montana Supreme Court found that "actions taken after an insured files suit are at best marginally probative of the insurer's decision to deny coverage," it refused to "impose a blanket prohibition on such evidence" because "[i]n some instances . . . the evidence of the insurer's post-filing conduct may bear on the

reasonableness of the insurer's decision and its state of mind when it evaluated and denied the underlying claim." Palmer v. Framers Ins. Exch., 861 P.2d 895, 915 (Mont. 1993). In a subsequent decision, the court reiterated that "the continuing duty of good faith can be breached by the insurance company's postfiling conduct" which "includes the actions of attorneys conducting the defense of the insurer as its agents." Federated Mut. Ins. Co. v. Anderson, 991 P.2d 915, 922 (Mont. 1999). In Anderson, the Montana Supreme Court held that the insurance company's "fundamental right to defend itself extends only to legitimate litigation conduct," which would not include a frivolous appeal. Id. The court found that the insurance company's litigation conduct was "part of a continuing course of conduct designed to avoid a prompt, fair, and equitable settlement of a claim in which liability had become reasonably clear." Id. at 922-23. The Montana Supreme Court also reiterated its prior holding that "[t]he entire course of conduct between the parties is relevant to show malice in a bad faith claim" and "an insurer's postsettlement activity [is] relevant to show malice." Id. at 923.

The United States Court of Appeals for the Eleventh Circuit ruled that the insurance company's "litigation conduct . . . was relevant to the claim that [the insurance company] or those acting on its behalf dealt dishonestly with [the policyholder]." T.D.S. Inc. v. Shelby Mut. Ins. Co., 760 F.2d 1520, 1527 (11th Cir. 1985). In another case where the trial court found bad faith, the appellate

court ruled that the insurance company's litigation pleadings were relevant evidence of bad faith, concurring with the holding in T.D.S. that "an insurance company's litigation conduct was admissible, relevant evidence." Home Ins. Co. v. Owens, 573 So.2d 343 (Fla. Ct. App. 1990).

Similarly, the United States District Court for the District of Columbia admitted and considered evidence of post-litigation conduct:

> AMIC's [the insurance company] reluctance on the coverage issue continued even after this suit was filed. In response to interrogatories filed at the outset of this case, AMIC responded under oath by categorically denying that it ever had a duty to defend Central Armature [the policyholder] and by categorically denying that AMIC had any coverage for any of the claims in the Smith case. As full discovery showed, and as the testimony at trial confirmed, AMIC's answers were untrue.

Central Armature Works, Inc. v. American Motorists Ins. Co., 520 F. Supp. 283 (D.D.C. 1980).

Considering the totality of Erie's conduct, including its conduct during litigation, serves justice. Holding an insurance company responsible for its bad faith litigation conduct would not place a chilling effect on good faith litigation conduct. In denying a motion to strike allegations that the insurance company acted in bad faith and solely for purpose of delay in appealing the state court verdict in the underlying action, a federal district court held that the court must be permitted to consider all stages of the negotiation and litigation process, including

an insurance company's decision to appeal. Kyriss v. Aetna Life & Cas. Co., 624 F. Supp. 1130, 1133 (D. Mont. 1986). The court rejected the contention that holding an insurance company responsible for all of its actions and decisions would create a "chilling effect" on the exercise of legitimate rights exercised with appropriate motivation. Id.

Similarly, Arizona appellate court ruled that the "litigation privilege" did not shield an insurance company's litigation conduct from review as part and parcel of its bad faith:

> The gravamen of TAA's bad faith claim is not a communication, but a course of "wrongful and tortious" conduct evidenced by the insurers' actions during the coverage actions. Furthermore, TAA's claim does not assail a pleading but instead alleges that its insurers followed a course of conduct in which they failed to perform their duties fairly and in good faith. To be sure, the insurers in this case do not contend that the filing of the coverage actions erased their duties of good faith and fair dealing. The duties nonetheless would be rendered meaningless if, as we understand these insurers to argue, the litigation privilege could be employed to excuse a breach of those duties, which occurs as part of the conduct of a coverage action.

Tucson Airport Auth. v. Certain Underwriters at Lloyd's, London, 918 P.2d 1063 (Ariz. Ct. App. 1996).

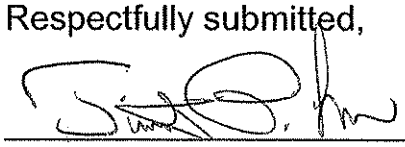
Accordingly, substantial and persuasive authority from other courts supports considering the totality of the insurance company's conduct, including

conduct that occurs during litigation, in considering the good faith or bad faith of the insurance company.

CONCLUSION

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

Respectfully submitted,



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Dated: October 24, 2005

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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 regular mail:

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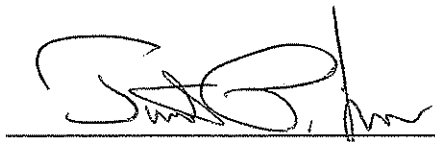

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