Punitive Damages and Due Process

Eichenseer v. Reserve Life Insurance Co., 881 F.2d 1355 (5th Cir. 1989).

During the 1988-89 Term, the Supreme Court concluded that punitive damages were not controlled by the Eighth Amendment's provision governing excessive fines. Several Supreme Court Justices and academics, however, have noted both that the Due Process Clauses of the Fifth and Fourteenth Amendments may provide limitations. Despite the suggestion of a constitutional limitation, the Court refused to grant review on several cases that presented the issue. Meanwhile, the circuit and state courts continue to struggle with the issue. In *Eichenseer*, the Fifth Circuit Court of Appeals upheld a $500,000 award of punitive damages against a challenge that the award violated due process requirements.

The trial court found that the insurer acted in bad faith in delaying payment of a medical claim. The court awarded $1000 in compensatory damages and $500,000 in punitive damages. The insurer appealed, arguing the punitive damages award violated its right to due process under the Fourteenth Amendment.

The court of appeals rejected the argument on three grounds. First, the court noted that state case law provided the insurer with adequate notice of the type of conduct which would result in punitive damage awards. Second, it found that the insurer had prior notice because it previously was liable for punitive damages for mishandling the investigation of a claim. Third, the court suggested that the trial court had carefully followed state law in assessing damages. It further noted that the state law provided for consideration of several factors in setting damages such as the deterrent effect of the award on the defendant and others, the financial worth of the defendant, the degree of the offense, the defendant's motive, and the overall justice of the award. On this basis, the court concluded there was not a violation of due process rights.

Excess Coverage Insurer's Duty to Defend

Harville v. Twin City Fire Insurance Co., 885 F.2d 276 (5th Cir. 1989).

Despite a provision in an excess coverage insurance policy that provided that the excess coverage insurer had a duty to defend when the primary insurer did not provide coverage, the Fifth Circuit Court of Appeals concluded that the primary insurer's insolvency did not require the excess coverage insurer to defend the insured. In a prior suit, the plaintiff sued a manufacturer for damages resulting from a pump explosion. The manufacturer had a primary insurance policy with a limit of $300,000. It also carried an excess coverage policy with a limit of $5 million. The primary insurance policy contained a provision requiring the insurer to defend. Likewise, the excess coverage insurance stated that the insurer would defend if the claim was within the coverage and "no underlying insurer [was] obligated to defend." After the suit was filed, the primary insurer became insolvent. The lawyer for the manufacturer later withdrew from representation and the excess coverage insurer refused to defend. The manufacturer settled the claim for the pump explosion, in part, by assigning its rights against the excess coverage insurer to the plaintiff. The plaintiff sued the excess coverage insurer to recover on a claim of bad faith failure to defend.

On appeal, the court held that the excess coverage insurer was not required to defend the manufacturer despite the provision in the insurance contract. The court concluded that requiring the insurer to defend when the primary insurer became insolvent would shift a new risk of the primary carrier's insolvency to the excess coverage insurer. The court felt that shift would have two undesired effects. First, it would frustrate the provision of low cost excess coverage. Second, it would unduly complicate the insurance transaction by requiring the excess coverage insurer to investigate the solvency of the primary insurer. Since the excess coverage insurer had no duty to defend, it could not be liable for bad faith in its decision to withhold a defense for the manufacturer.

Damages for Bad Faith Failure to Settle Claim

Frankenmuth Mutual Insurance Co. v. Keeley, 1989 Mich. Lexis 2358 (Mich. S. Ct. 1989).

The Michigan Supreme Court concluded that an insurer's damages for a bad faith failure to settle a claim is not limited by its insured's ability to pay damages in excess of the policy limits. The insured party, Keeley, fired a gun at Boone, leaving Boone a quadriplegic. Boone offered to settle the claim for the $50,000 policy limit, but Frankenmuth, the insurer, refused. Boone then received a judgment against Keeley for $250,000. In a separate suit concerning Frankenmuth's duty to defend Keeley, Keeley counterclaimed alleging a bad faith failure to settle the claim within the policy limits. The court held that Frankenmuth had a duty to defend Keeley and that the insurer had breached its duty to settle the claim. The trial and appellate courts, however, limited Keeley's damages to the amount of Keeley's assets that would be available to pay Boone. The Michigan Supreme Court reversed.

The supreme court noted a split of authority concerning the proper amount of damages when the insured is not able to pay the amount of the excess judgment. On the one hand, a minority of courts have concluded that the insured is not damaged if the award is limited to the amount that he would have to pay absent any bad faith on the part of the insurer. These courts, therefore, held that the insurer is liable only when the insured has paid or could pay an amount more than the policy limits. The majority of courts, however, have concluded that the insurer's duty of good faith does not permit it to derive a windfall depending on the solvency of its insured. In these cases, the insurer was liable for the full amount of the excess judgment if it failed to settle in bad faith.

In this case, the court adopted the majority rule of full liability for two reasons. First, it felt the majority rule better promoted the use of good faith on the part of the insurer. Second, the court noted that the bad faith of the