S213873

SUPREME COURT OF CALIFORNIA

THOMAS NICKERSON,

Plaintiff and Appellant,

v.

STONEBRIDGE LIFE INSURANCE COMPANY,

Defendant and Respondent.

2d Civil No. B234271

(Los Angeles County
Super. Ct. No. BC405280)

OPENING BRIEF ON THE MERITS

After a Decision by the Court of Appeal
Second Appellate District, Division Three

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TABLE OF CONTENTS

ISSUE FOR REVIEW 1

INTRODUCTION 2

STATEMENT OF THE CASE 4

A. Factual summary 4

1. The Stonebridge policy 4

2. Nickerson and his claim for hospital-confinement benefits under the policy 6

B. Procedural summary 9

1. The trial 9

2. Post-trial motions 10

3. The Court of Appeal's decision 11

ARGUMENT 13

A. *Brandt* fees represent compensation for an economic loss to the policyholder, and therefore must be taken into account during due-process review of punitive-damage awards 13

B. There is no due-process justification for excluding post-verdict *Brandt*-fee awards from judicial scrutiny of punitive-damage awards under the Fourteenth Amendment 16

1. The purpose of due-process review is twofold—to ensure that the defendant has received "fair notice" of sanctionable conduct and that the punishment is not excessive 16

2. Due process does not require reviewing courts to ignore portions of the harm that the insurer has inflicted on its policyholder 18

a. In California, insurers have been on notice for decades that if they tortiously withhold insurance benefits they can be held liable for all harm suffered by the policyholder—including the policy benefits and the cost to recover them 18

b. Punitive-damage awards that reflect the harm caused by the insurer's conduct are not excessive..... 21

3. Courts can properly consider issues and information not presented to the jury when they apply the *BMW* due-process guideposts 22

C. Rules that insulate insurers from the harm they inflict on policyholders reduce the deterrent effect of punitive-damage awards and have adverse consequences for the court system 25

CONCLUSION 29

TABLE OF AUTHORITIES

Cases

Amerigraphics, Inc. v. Mercury Cas. Co.
(2010) 182 Cal.App.4th 1538 ..... passim

BMW of North America v. Gore
(1996) 517 U.S. 559 ..... passim

Boeken v. Philip Morris Inc.
(2005) 127 Cal.App.4th 1640 24

Brandt v. Superior Court
(1985) 37 Cal.3d 813 ..... passim

Bullock v. Philip Morris USA., Inc.
(2008) 159 Cal.App.4th 655 ..... 4, 23

Century Sur. Co. v. Polisso
(2006) 139 Cal.App.4th 922 23

Comunale v. Traders & General Ins. Co.
(1958) 50 Cal.2d 654 19

Cooper Industries, Inc. v. Leatherman Tool Group, Inc.
(2001) 532 U.S. 424, 121 S.Ct. 1678 23

Crisci v. Security Ins. Co. of New Haven, Conn.
(1967) 66 Cal.2d 425 ..... 19, 20

Egan v. Mutual of Omaha Ins. Co.
(1979) 24 Cal.3d 809 20

Gruenberg v. Aetna Ins. Co.
(1973) 9 Cal.3d 566 ..... 19, 20

Major v. Western Home Ins. Co.
(2009) 169 Cal.App.4th 1197 ..... 12, 14, 15, 21

Montrose Chemical Corp. v. Admiral Ins. Co.
(1995) 10 Cal.4th 645 25

Neal v. Farmers Ins. Exchange
(1978) 21 Cal.3d 910 ..... 18, 19, 20

Roby v. McKesson Corp.
(2009) 47 Cal.4th 686 16

Simon v. San Paolo U.S. Holding Co., Inc.
(2005) 35 Cal.4th 1159 ..... passim

State Farm Mut. Auto. Ins. Co. v. Campbell
(2003) 538 U.S. 408 ..... passim

TXO Production Corp. v. Alliance Resources Corp.
(1993) 509 U.S. 443 18

Statutes

California Civil Code § 3333 ..... 18, 19, 20

ISSUE FOR REVIEW

In its order filed January 15, 2014, the Court stated that review in this case was limited to this issue: Is an award of attorney fees under *Brandt v. Superior Court* (1985) 37 Cal.3d 813, properly included [in a court's due-process review of a punitive-damage award] as compensatory damages where the fees are awarded by the jury, but excluded from compensatory damages when they are awarded by the trial court after the jury has rendered its verdict?

INTRODUCTION

Post-judgment review of punitive-damage awards requires courts to evaluate the award against three constitutional "guideposts" prescribed by the U.S. Supreme Court. The second guidepost is "the disparity between the actual or potential harm suffered by the plaintiff and the punitive damages award." (*BMW of North America v. Gore* (1996) 517 U.S. 559, 575 ("*BMW*").

In insurance bad-faith cases, part of the harm that policyholders suffer when insurers improperly refuse to pay policy benefits is the cost to hire counsel to collect those benefits. In *Brandt v. Superior Court* (1985) 37 Cal.3d 813, 817, this Court held that those attorney's fees are recoverable as compensatory damages. In practice, the determination of the size of the *Brandt* award will sometimes be made by the jury and sometimes be made by the trial court in post-trial motions. This Court explained in *Brandt* that the latter procedure is normally preferable. (*Id.*, 37 Cal.3d 813, 819-820.)

The issue in this appeal is whether a *Brandt*-fee award must be taken into account as part of the second *BMW* guidepost when it is the trial judge who calculates the *Brandt* fees after the trial. Two cases have held that it cannot: *Amerigraphics, Inc. v. Mercury Cas. Co.* (2010) 182 Cal.App.4th 1538, 1565, and the Court of Appeal's decision below. In their view, consideration of court-awarded *Brandt* fees when reviewing a punitive-damage award would violate a defendant's due-process rights.

Neither court explained the basis for the rule they adopted. But when that rule is measured against the interests that due process protects, it becomes clear that it lacks a viable rationale. Defendants enjoy no due-process right to have some portion of the harm that they inflict ignored when courts review a punitive-damage award against them. Rather, the second *BMW* guidepost requires consideration of all harm caused by the tortfeasor.

In the punitive-damage context, the U.S. Supreme Court has made clear that the due-process clause protects two interests: (1) a defendant's right to "fair notice" of the sanction that a state may impose for given conduct; and (2) a defendant's right to be free of excessive or arbitrary punishment for that conduct. (*State Farm Mut. Auto. Ins. Co. v. Campbell* (2003) 538 U.S. 408, 416-417 ("*State Farm*").

Neither aspect of due process is implicated when a reviewing court considers a post-trial award of *Brandt* fees. "Fair notice" is satisfied because insurers have known for 30 years that their exposure in bad-faith cases extends to *Brandt* fees. And taking those fees into account as part of the actual harm suffered by the policyholder does not lead to excessive or arbitrary awards.

Nor are reviewing courts limited to considering matters that were before the jury when they apply the *BMW* guideposts. The third guidepost, for example, requires a comparison of the difference between the punitive damages awarded by the jury and the civil penalties authorized or imposed in comparable cases. This inquiry is

always undertaken by a reviewing court after the jury has reached its verdict. (*See, e.g., Bullock v. Philip Morris USA., Inc.* (2008) 159 Cal.App.4th 655, 689-690.)

The *Amerigraphics* rule not only lacks a due-process justification, it diminishes the deterrent effect of punitive-damage awards by decoupling them from the full range of harm that the insurer's conduct has caused. Any rule that insulates some aspect of the harm that insurers have inflicted on their policyholders from being reflected in a punitive-damage award will artificially shrink those awards, making them less likely to deter future misconduct.

The rule also needlessly makes for longer trials in a time of shrinking judicial capacity, because it encourages plaintiffs to forego the streamlined post-trial process for awarding *Brandt* fees.

In sum, although adopted in the name of due process, the *Amerigraphics* rule lacks any due-process warrant and creates ancillary mischief. It should not survive as part of California's insurance bad-faith jurisprudence.

STATEMENT OF THE CASE

A. Factual summary

1. The Stonebridge policy

Stonebridge sold Nickerson an indemnity benefit policy that promised to pay him $350 per day for each day he was confined in a hospital for a covered injury. (Typed opn. at 2.) Although coverage

was triggered by hospital confinement, the policy proceeds were available for Nickerson to use any way he desired. (Typed opn. at 3.)

The policy's insuring clause for the "Accidental Daily Hospital Confinement Benefit" stated: "We will pay the Daily Hospital Confinement Benefit stated on the Schedule Page for each day of Confinement due to a covered injury, beginning with the first day of Confinement. A Covered Person must be under the professional care of a Physician, and such Confinement must begin within 90 days of the accident causing the injury. (Capitalization omitted.) (*Id.*)

The policy defined "hospital confinement" as "being an inpatient in a Hospital for the necessary care and treatment of an Injury. Such confinement must be prescribed by a Physician." (*Id.*) The policy also contained a definition for the term "necessary treatment," which stated:

> NECESSARY TREATMENT means medical treatment which is consistent with currently accepted medical practice. Any confinement, operation, treatment, or service not a valid course of treatment recognized by an established medical society in the United States is not considered 'Necessary Treatment.' No treatment or service or expense in connection therewith, which is experimental in nature, is considered 'Necessary Treatment.'

We may use Peer Review Organizations or other professional medical opinions to determine if health care services are:

1. medically necessary; and

2. consistent with professionally recognized standards of care with respect to quality, frequency, and duration; and

3. provided in the most economical and medically appropriate site for treatment. (Typed opn. at 3.)

2. Nickerson and his claim for hospital-confinement benefits under the policy

Nickerson served in the U.S. Marine Corps, and as a veteran was entitled to medical care at Veterans Administration ("VA") hospitals at no cost. (*Id.* at 4.) He uses a wheelchair because he was paralyzed from the chest down in 1997 in a snowmobile accident. (*Id.*) Nickerson is single and has worked as a live-in caretaker for other veterans since 2000 in exchange for free rent. (*Id.*) His only income is a very small military pension. (*Id.*) Nickerson drives a specially modified van that was outfitted to meet his needs. (*Id.* at 16.)

In February 2008, Nickerson fell from the wheelchair lift on his van to the pavement and broke his leg. (*Id.*) He was taken to the VA hospital in Long Beach, first to the emergency room and then to the spinal-cord unit, which was equipped to treat paraplegics and

quadriplegics. (*Id.*) Nickerson suffered a comminuted, displaced fracture of his right tibia and fibula, meaning that the leg was broken, splintered, and out of place. (*Id.*) He was placed in a full-leg splint, a so-called Long Beach splint, which extended from his upper thigh to the beginning of his toes. (*Id.*) He soon experienced complications from the injury, including heterotopic ossification (formation of bone in a joint), bruising, swelling, blistering, infection, and a risk of gangrene. (*Id.*)

Nickerson was discharged from the hospital when his doctors determined it was safe for him to return home. (Typed opn. at 5.) In all, Nickerson was hospitalized at the VA hospital from February 11 until May 30, 2008, a total of 109 days. (*Id.*) His recovery was delayed by the various complications he faced. (*Id.* at 7.) His doctors recommended that his fractured leg be kept fully extended in the splint with no flexion permitted until it had fully healed. This restriction was not lifted until May 5, 2008. (*Id.*) Because his home had narrow doorways and corners that he could not have negotiated in his wheelchair with his leg fully extended, his doctors determined that it was not safe for Nickerson to return home. (*Id.*)

When Nickerson submitted his claim to Stonebridge, its claims personnel were concerned about the length of his hospital stay, so they relied on the "necessary care" provision to order a medical peer review. In ordering that review, Stonebridge asked the reviewer to answer three questions:

(1) Was the confinement medically necessary for inpatient treatment of the right tibia/fibula fracture? If so, for how many days?

(2) Was treatment consistent with professionally recognized standards of care with respect to quality, frequency and duration? And

(3) Was treatment provided in the most economical and medically appropriate site for treatment? (Typed opn. at 6.)

Stonebridge did not request or authorize the medical reviewer to contact Nickerson's treating physicians to discuss the reasons why Nickerson's hospital course was so lengthy, or the other treatment options available to him. (*Id.*) Nor did the Stonebridge claims adjusters make any attempt to discuss Nickerson's case with his treating doctors. (*Id.*)

The reviewer advised Stonebridge that hospitalization until February 29, 2008 was medically appropriate, but that after that date "a more economical and medically appropriate facility could have been chosen." (*Id.*) Stonebridge paid Nickerson for the days between February 8 and February 29, 2008—19 days of his hospitalization—and denied the balance of his claim. (*Id.*)

Nickerson had his physician write an appeal letter, explaining why the physician believed that it was medically necessary for him to remain hospitalized through May 30, 2008. (*Id.* at 7.) The letter explained that Nickerson could not have been discharged safely after 19 days of treatment, that he was not even cleared to use a

wheelchair until March 24, 2008, and even after that time he could not return home because of the need to keep his leg fully extended at all times. (*Id.*) Stonebridge never forwarded the letter to the peer reviewer or discussed it with him, and affirmed its earlier denial of any benefits after the 19th day of hospitalization. (*Id.*)

B. Procedural summary

1. The trial

At trial, the claims adjuster assigned to the claim, Amy Hammer, testified that she was unaware when she received the medical reviewer's report that VA hospitals were free for veterans like Nickerson. She acknowledged that she did not believe that the Long Beach VA Hospital kept patients hospitalized unnecessarily. She conceded that Nickerson's claim fell within the policy's grant of coverage and not within any of the policy's stated exceptions. She also conceded that the Long Beach VA Hospital was the most economical site for Nickerson's treatment – contrary to the medical reviewer's suggestion that after 19 days Nickerson should have been moved to a "more economical" treatment facility. (Typed opn. at 8.)

At the close of Nickerson's case, the trial court granted his motion for a directed verdict on his cause of action for breach of contract, finding that, as a matter of law, the "Necessary Treatment" limitation in the policy was unenforceable because it was not conspicuous, plain, and clear. (*Id.*) The court awarded Nickerson the unpaid policy benefit totaling $31,500. (*Id.*)

The jury returned a special verdict finding that Stonebridge's failure to pay policy benefits was unreasonable and without proper cause, thereby constituting a tortious breach of the implied covenant of good faith and fair dealing. The jury awarded Nickerson $35,000 in emotional-distress damages. The issue of *Brandt* fees was not litigated to the jury because the parties had stipulated before trial to allow the trial judge to determine the *Brandt* fees post-trial.

The special-verdict form asked the jury to determine whether Stonebridge had acted with malice, fraud, or oppression in three distinct questions. The jury responded "no" to malice and oppression, but "yes" on fraud. (Typed opn. at 9.) The jury awarded Nickerson punitive damages of $19 million, which equaled 5 percent of the company's $368 million net worth. (*Id.*)

2. Post-trial motions

After the trial, the parties stipulated that Nickerson's attorney's fees to obtain the policy benefits were $12,500, and the trial court awarded this amount in *Brandt* fees. (*Id.* at 9.)

Stonebridge moved for JNOV seeking to reduce the punitive-damage award to $35,000. It argued that the award was unconstitutionally excessive, and could not exceed the amount of emotional-distress damages awarded. (*Id.*) It also moved for a new trial seeking a reduction in the punitive-damage award "to a minimal amount." (*Id.*)

The trial court denied the JNOV motion, and after conducting the due-process analysis required by *State Farm*, it reduced the punitive damage award to a ratio of punitive to compensatory damages of 10:1 (excluding the value of the policy benefits and *Brandt* fees). (Typed opn. at 10.)

The court conditionally granted Stonebridge's new trial motion unless Nickerson consented to a remittitur of the punitive damage award to $350,000, in which event the new-trial motion would be denied. (*Id.*) Nickerson rejected the reduction in punitive damages and filed a timely appeal from the order granting a new trial. (*Id.*) Stonebridge timely appealed from the judgment and the denial of its JNOV motion. (*Id.*)

3. The Court of Appeal's decision

Stonebridge did not challenge in its post-trial motions or on appeal the directed verdict on the breach-of-contract cause of action or the sufficiency of the evidence to support the finding that it breached the implied covenant of good faith and fair dealing. (*Id.* at 9.)

In a published 2-1 opinion, the Court of Appeal affirmed the trial court's order. Writing for the majority, Justice Aldridge found that there was substantial evidence in the record to support the jury's finding that Stonebridge's conduct constituted "fraud" within the meaning of Civil Code section 3294, subd. (c), and that

Stonebridge's conduct was highly reprehensible under the *BMW* guideposts. (Typed opn. at 13-22.)

The majority found that the maximum amount of punitive damages was ten times the $35,000 emotional-distress award. (*Id.* at 23-27.) In a short paragraph titled "additional considerations," the majority opinion rejected Nickerson's contentions that the compensatory damages included in the ratio should include the policy benefits and the *Brandt* fees. The court's analysis on these points states:

> To alter the ratio of punitive to compensatory damages, Nickerson contends the trial court erred in failing to measure the punitive damage award against additional categories of compensatory damages, i.e., . . . the policy benefits, and the *Brandt* fees. We disagree. . . . [T]he trial court properly declined to include the policy benefits in its ratio calculation as punitive damages are not authorized in contract actions. (*Major v. Western Home Ins. Co.* (2009) 169 Cal.App.4th 1197, 1224.) Finally, *Brandt* fees are not properly included in determining the compensatory damage award when they are awarded by the trial court *after* the jury awards punitive damages. (*Amerigraphics, supra,* 182 Cal.App.4th at p. 1565.) *Major v. Western Home*

Ins. Co., cited by Nickerson, does not alter our conclusion because there, the jury awarded *Brandt* fees as part of the tort damages. (*Major v. Western Home Ins. Co., supra,* at p. 1224.) Thus, the trial court properly included all of the relevant damages in the denominator of its ratio. (Typed opn. at 27, 28.)

Presiding Justice Klein concurred in the majority opinion. Justice Croskey dissented. In his view, the jury's finding on the special-verdict form that Stonebridge had acted without "malice" was inconsistent with its finding that it had acted with "fraud," and the record did not support the jury's fraud finding. (Dissenting opn. at 3-5.)

ARGUMENT

A. *Brandt* fees represent compensation for an economic loss to the policyholder, and therefore must be taken into account during due-process review of punitive-damage awards

Brandt held that a policyholder's damages in an insurance bad-faith case include the attorney's fees incurred to recover the policy benefits. (*Brandt,* 37 Cal.3d at p. 817.) "When an insurer's tortious conduct reasonably compels the insured to retain an attorney to obtain the benefits due under a policy, it follows that the insurer should be liable in a tort action for that expense. The attorney's fees are an economic loss—damages—proximately caused by the tort." (*Id.*)

Brandt fees are not attorney's fees awarded as attorney's fees; they are awarded as part of the plaintiff's compensatory damages. "These fees must be distinguished from attorney's fees *qua* attorney's fees . . . what we consider here is attorney's fees recoverable as damages." (*Id.*, 37 Cal.3d at p. 817.)

Since *Brandt* fees constitute an element of damages, their determination must be made by the fact finder, unless the parties stipulate otherwise. (*Id.*, 37 Cal.3d at p. 819.) But this Court expressed a preference in *Brandt* for the use of such stipulations. "A stipulation for a postjudgment allocation and award by the trial court would normally be preferable since the determination then would be made after completion of the legal services . . . and proof that otherwise would have been presented to the jury could be simplified because of the court's expertise in evaluating legal services." (*Id.*, 37 Cal.3d 813, 819-820.)

Because *Brandt* fees form a portion of a bad-faith plaintiff's compensatory damages, the court recognized in *Major v. Western Home Ins. Co.*, 169 Cal.App.4th at p. 1225, that it was proper for a reviewing court to include them when performing the due-process review required by *State Farm* and *BMW*.

Specifically, *Major* included them under the second *BMW* guidepost because they represented part of the actual harm that the insurer had inflicted on the policyholder when it tortiously refused to pay the policy benefits. (*Major*, 169 Cal.App.4th at p. 1224 ["*Brandt*

fees are considered extracontractual tort damages that compensate a plaintiff for an insurer's bad faith refusal to pay policy benefits. . . ."].)

But *Major's* conclusion that *Brandt* fees should be included in a reviewing court's due-process analysis was later restricted in *Amerigraphics* to cases where the fees were calculated by the jury. (*Amerigraphics,* 182 Cal.App. 4th at p. 1565.) In *Amerigraphics* the parties had stipulated to having *Brandt* fees determined by the trial court in post-trial motions. Because the fees were determined by the trial court and not the jury, the Court of Appeal refused to consider the *Brandt* fees as part of its due-process analysis of the punitive-damage award. (*Id.*)

Unfortunately, the *Amerigraphics* court offered few details about the basis for its conclusion. This is its analysis of the issue:

> Amerigraphics attempts to alter the ratio by arguing that its total compensatory damages was $516,541 (jury verdict plus *Brandt* fees), and therefore as remitted, the punitive damages award is only 3.2 times the compensatory damages award. But contrary to Amerigraphics's argument, the trial court properly excluded the amount of *Brandt* fees in determining the compensatory damages award, since the *Brandt* fees were awarded by the court after the jury had already

returned its verdict on the punitive damages. (*Id.*, 182 Cal.App.4th at p. 1565.)

The Court of Appeal in this case followed *Amerigraphics* on this point. (Typed opn. at 27-28.)

B. There is no due-process justification for excluding post-verdict *Brandt*-fee awards from judicial scrutiny of punitive-damage awards under the Fourteenth Amendment

1. The purpose of due-process review is twofold—to ensure that the defendant has received "fair notice" of sanctionable conduct and that the punishment is not excessive

"The due process clause of the Fourteenth Amendment to the United States Constitution places constraints on state court awards of punitive damages." (*Roby v. McKesson Corp.* (2009) 47 Cal.4th 686, 712, citing *State Farm,* 538 U.S. at pp. 416–418, and *BMW,* 517 U.S. at p. 568.) These limitations are both procedural and substantive. (*State Farm,* 538 U.S. at pp. 416-417.)

The procedural limitation relates to notice. "Elementary notions of fairness enshrined in our constitutional jurisprudence dictate that a person 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." (*State Farm,* 538 U.S. at p. 417, citing *BMW,* 517 U.S. at p. 568.)

This language formed the preamble to the *BMW* Court's introduction of the now-familiar "guideposts" that have become the

foundation of due-process review of punitive-damage awards.[1] The Court relied on its evaluation of those guideposts to determine that the punitive-damage award against BMW was excessive because the carmaker had not been put on notice that it could face a $4 million sanction for selling a car that was worth $4,000 less than the buyer expected. (*BMW*, 517 U.S. at p. 568.)

But the due-process clause goes beyond simply requiring the States to provide notice of the size of the punitive-damage awards they might levy. It also substantively limits the size of those awards, because it "prohibits the imposition of grossly excessive or arbitrary punishments on a tortfeasor." (*State Farm*, 538 U.S. at p. 416.) In *State Farm*, the Court relied on the *BMW* guideposts to conclude that the punitive-damage award was excessive and therefore violated the due-process clause.

The *BMW* guideposts accordingly provide the means for a reviewing court to evaluate whether a given punitive-damage award satisfies both the "fair notice" and the "excessiveness" (or the procedural and substantive) aspects of due-process.

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[1] The three guideposts are "(1) the degree of reprehensibility of the defendant's misconduct; (2) the disparity between the actual or potential harm suffered by the plaintiff and the punitive damages award; and (3) the difference between the punitive damages awarded by the jury and the civil penalties authorized or imposed in comparable cases." (*Simon v. San Paolo U.S. Holding Co., Inc.* (2005) 35 Cal.4th 1159, 1172, citing *State Farm*, 538 U.S. at p. 418, and *BMW*, 517 U.S. at p. 575.

2. Due process does not require reviewing courts to ignore portions of the harm that the insurer has inflicted on its policyholder

a. In California, insurers have been on notice for decades that if they tortiously withhold insurance benefits they can be held liable for all harm suffered by the policyholder—including the policy benefits and the cost to recover them

When there is clear case authority that tells potential defendants (here, insurers) that if they engage in certain types of conduct that they will be held liable for the harm that that they cause, the "fair notice" aspect of due process is satisfied. (*See TXO Production Corp. v. Alliance Resources Corp.* (1993) 509 U.S. 443, 465-466, 113 S.Ct. 2711, 2724 [West Virginia case law indicating that punitive damages could be imposed for egregiously tortious conduct satisfied the prior-notice component of the Due Process Clause].)

It has been clear to insurers who do business in California for at least the last 35 years—and arguably considerably longer—that if they commit the tort of insurance bad faith, they will be held liable for all detriment suffered by their policyholder as a result of their tortious conduct. (*See, e.g., Neal v. Farmers Ins. Exchange* (1978) 21 Cal.3d 910, 922 [insurer's tortious breach of implied covenant renders it liable "to pay compensatory damages for all detriment proximately caused by that breach (see Civ.Code, s 3333)." In

addition, *Neal* affirmed a punitive-damage award against the insurer. (*Id.* at pp. 928-929.)

The rule that this Court applied in *Neal* had its genesis in this Court's 1958 decision in *Comunale v. Traders & General Ins. Co.* (1958) 50 Cal.2d 654, 663, which held that an insurer's failure to accept a reasonable offer to settle the case against its insured within policy limits could constitute a tortious breach of the implied covenant of good faith and fair dealing.

Nine years later, in *Crisci v. Security Ins. Co. of New Haven, Conn.* (1967) 66 Cal.2d 425, 430, this Court clarified that tort liability for an insurer's wrongful failure to settle was not imposed for a bad-faith breach of the policy's terms—"but for failure to meet the duty to accept reasonable settlements, a duty included within the implied covenant of good faith and fair dealing." *Crisci* affirmed an award against the insurer that included compensatory damage for the insured's mental suffering, since such damages were generally available under the tort measure of damages specified in Civil Code section 3333. (*Id.*, 66 Cal.2d at pp. 432-433.)

While *Comunale* and *Crisci* dealt with the insurer's failure to settle a third-party claim against the insured within policy limits, in *Gruenberg v. Aetna Ins. Co.* (1973) 9 Cal.3d 566, 573-575, this Court made clear that an insurer's breach of the implied covenant in first-party cases also constituted a tort: "[W]hen the insurer unreasonably and in bad faith withholds payment of the claim of its insured, it is

subject to liability in tort." (*Id.* at p. 575.) *Gruenberg* reaffirmed that the origin of the tort liability was not in the insurer's breach of the policy terms, but in its breach of the implied-in-law obligation to deal with its policyholder in good faith. (*Id.* at p. 574.)

Six years later, in *Egan v. Mutual of Omaha Ins. Co.* (1979) 24 Cal.3d 809, 824, the Court made clear that, under Civil Code section 3333, the measure of damages for the insurer's tortious breach of its good-faith obligations included the benefits that the policyholder "would have been entitled to receive had the contract been honored by the insurer." (*Id.* at p. 824, n. 7.)

Brandt, which was decided in 1985, relied on the same rationale to hold that, "When an insurer's tortious conduct reasonably compels the insured to retain an attorney to obtain the benefits due under a policy, it follows that the insurer should be liable in a tort action for that expense. The attorney's fees are an economic loss—damages—proximately caused by the tort." (*Brandt*, 37 Cal.3d at p. 817.)

Accordingly, this Court's decisions in *Crisci*, *Egan*, *Neal*, and *Brandt* made it clear decades ago that the compensatory damages potentially recoverable for insurance bad faith included the value of the lost policy benefits, emotional distress, and the attorney's fees incurred to recover the policy benefits; and that punitive damages could also be recovered.

No insurer could be taken by surprise in 2008 (when Stonebridge adjusted Nickerson's claim) by the concept that if it denied the claim in bad faith that it could be held liable in tort for the full panoply of damages recoverable in bad-faith litigation.

b. Punitive-damage awards that reflect the harm caused by the insurer's conduct are not excessive

Since insurers have long been on notice of the nature and severity of the sanctions they face for denying insurance claims without proper cause, then the only other due-process justification that could potentially underlie the *Amerigraphics* rule is avoiding excessive punitive awards. But allowing reviewing courts to consider court-awarded *Brandt* fees under the second *BMW* guidepost will not—in fact cannot—result in excessive punitive-damage awards.

Neither Stonebridge nor any court has suggested that it is improper to include jury-awarded *Brandt* fees in the analysis of the second *BMW* guidepost. (*Major*, 169 Cal.App.4th at p. 1224.) From the standpoint of their impact on the *size* of a punitive-damage award, there is no difference between a *Brandt* award made by a jury and one made by the trial court. So, whatever justification exists for excluding court-awarded *Brandt* fees from the due-process analysis, it cannot be that they create a risk of making the punitive awards excessive.

Regardless of who calculates the *Brandt* fees, they are properly included in the punitive-damage calculus because they represent part of the actual harm that the insurer has inflicted on its insured. *Brandt* fees therefore fall squarely within what courts are supposed to consider under the second *BMW* guidepost.

3. Courts can properly consider issues and information not presented to the jury when they apply the *BMW* due-process guideposts

Although the *Amerigraphics* court never stated the rationale for its refusal to consider court-awarded *Brandt* fees, it appears that the court viewed the insured's attempt to rely on the court-awarded *Brandt* fees as impermissible bootstrapping—an effort to rely on information that the jury did not consider in order to justify the jury's award.

But this view misconceives the nature of judicial review of punitive-damage awards under the due-process clause. Due-process review does not focus on whether the defendant's conduct was sufficiently egregious to warrant the sanction of punitive damages. That is a factual determination by the jury that is reviewed for substantial evidence on appeal. (*Simon*, 35 Cal.4th at p. 1172.)

Nor does a court undertaking due-process review attempt to determine the "right" amount of punitive damages for the particular case. Rather, "its constitutional mission is only to find a level higher than which an award *may not* go." (*Simon*, 35 Cal.4th at p. 1188, emphasis in original.) "In enforcing federal due process limits, an

appellate court does not sit as a replacement for the jury but only as a check on arbitrary awards." (*Id.*)

Accordingly, when applying the *BMW* guideposts to decide whether an award of punitive damages is constitutionally excessive, reviewing courts make "an independent assessment" of the three guideposts—including "the relationship between the award and the harm done to the plaintiff." (*Simon*, 35 Cal.4th at p. 1172, citing *Cooper Industries, Inc. v. Leatherman Tool Group, Inc.* (2001) 532 U.S. 424, 436, 121 S.Ct. 1678.)

This type of independent assessment allows reviewing courts to consider matters that were not resolved by the jury. The clearest example of this is the application of the third *BMW* guidepost. The comparison that it requires between the punitive-damage award and civil penalties authorized for comparable conduct is not a matter that is ever addressed by the jury. (*See, e.g., Century Sur. Co. v. Polisso* (2006) 139 Cal.App.4th 922, 959 [explaining that third *BMW* guidepost "was not intended to be a factor for the jury's consideration"]; *Bullock v. Philip Morris USA., Inc.*, 159 Cal.App.4th at pp. 689-690 ["the third guidepost is an appropriate consideration only for a reviewing court"].)

This Court's decision in *Simon* also illustrates that a reviewing court's evaluation of the second *BMW* guidepost can consider matters not resolved by the jury. The jury in that case awarded the plaintiff $5,000 in compensatory damages for fraud and punitive

damages of $1.7 million. (*Simon*, 35 Cal.4th at p. 1166.) The plaintiff argued that the punitive award was not constitutionally excessive because the fraud could have caused him to lose $400,000 in anticipated profits. In addressing that argument, this Court explained that, in the absence of an express finding on the amount of potential harm, "we must independently decide whether defendant's promissory fraud did, or foreseeably could have, hurt plaintiff in the amount of $400,000." (*Id.*, 35 Cal.4th at p. 1175.)

Based on its independent evaluation of that issue, the Court concluded that the loss the plaintiff claimed was not a foreseeable result of the defendant's tortious conduct, and therefore could not be factored into the due-process analysis of the punitive award. (*Id.* at pp. 1178-1179.) But the *Simon* opinion makes clear that if the Court *had* agreed with the plaintiff about the size of the potential harm he faced, it would have measured the punitive-damage award against that potential harm—even though the jury had not calculated it.

Boeken v. Philip Morris Inc. (2005) 127 Cal.App.4th 1640, 1703, provides another example of a reviewing court considering matters that were not before the jury when evaluating a due-process challenge to a punitive-damage award. There, the reviewing court reduced the punitive-damages ratio based on a second punitive-damage award that had been entered against the defendant several years after the jury verdict in the case under review.

Collectively, these cases demonstrate that a court's evaluation of the *BMW* guideposts is not limited to matters resolved by the jury. As a result, it is perfectly proper for a reviewing court to consider *Brandt* fees—whether awarded by the jury or by a trial court post-verdict—when evaluating the actual harm that the plaintiff suffered in an insurance bad-faith case. This is what the second *BMW* guidepost requires.

C. Rules that insulate insurers from the harm they inflict on policyholders reduce the deterrent effect of punitive-damage awards and have adverse consequences for the court system

Insurers know exactly what kind of harm is likely to result when they wrongfully withhold policy benefits—the policyholder will be deprived of the benefits and will suffer a loss in that amount,[2] and the policyholder will have to hire counsel to recover the lost benefit. So, in any given case, the insurer's bad-faith exposure starts with, and will include, the policy benefits that were withheld and *Brandt* fees. These damages are easy for the insurer to predict, since it knows the value of the benefits it is refusing to pay and, given its experience with litigation, it can accurately estimate

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[2] This is true in both the first-party and the third-party situation. In the former, the insurer is obligated to pay the benefits to the policyholder directly, and in the latter the insurer is obligated to pay the benefits to a third party to extinguish the policyholder's liability. (*See, e.g., Montrose Chemical Corp. v. Admiral Ins. Co.* (1995) 10 Cal.4th 645, 663 [explaining distinction between first-party and third-party coverage].)

the legal fees that the policyholder will incur in order to recover them.

But the damages in any given bad-faith case other than policy benefits and *Brandt* fees are less easily forecasted. They will depend on the policyholder's financial condition and on whether non-payment of the benefits will create some type of unique financial hardship or consequential damage going beyond the value of the unpaid benefits. And if the insured is a person, it will also depend on where his or her emotional makeup falls on the spectrum between stoic and sensitive.

The approach taken by the Court of Appeal in this case eliminated from due-process consideration of the punitive-damage award the elements of damages that are most easily predicted by the insurer, and instead tethered the award solely to the idiosyncrasies of the particular insured, turning the aspect of "fair notice" on its head.

This approach also undermines the deterrent effect of punitive damages. This is problematic because deterrence is the primary goal in imposing punitive damages. (*Simon*, 35 Cal.4th at p. 1185.) Punitive-damage awards that exclude the most common elements of harm that bad-faith plaintiffs will suffer—the loss of policy benefits and the cost of hiring counsel to recover them—will be artificially reduced, diminishing their deterrent effect.

This process is illustrated vividly by the decision in *Amerigraphics*. The insurer in that case delayed 690 days to pay a valid claim, putting its insured out of business. (*Amerigraphics*, 182 Cal.App.4th at pp. 1558-1560.) The appellate court found that the insurer's conduct was "despicable," "intentionally dishonest," and "showed a conscious disregard of Amerigraphics's rights." (*Id.*, 182 Cal.App.4th at p. 1559.) The jury awarded punitive damages of $3 million. The trial court cut the award to $1.7 million, an amount 10 times higher than the policy proceeds added to pre-judgment interest. The Court of Appeal cut the award to $500,000, resulting in a punitive-to-compensatory ratio of 3.8:1.

Because the insured was a corporation, no damages for emotional-distress damages were recoverable. And because the insured was losing money before its premises flooded, it could not establish any "lost profits." So there were no compensatory damages beyond the loss of the $130,000 policy benefits. The court correctly held that those proceeds represented "tort" damages that would support a punitive-damage award, so it affirmed a punitive-damage award. (*Id.*, 182 Cal.App.4th at p. 1558.)

But the size of the award the court affirmed was substantially lower than it should have been because the court excluded the $386,541 *Brandt*-fee award because those fees had not been awarded by the jury. Had the court considered the full amount of the policyholder's damages, which included the *Brandt* fees, the trial

court's $1.7 million award would likely have been affirmed, since it would have produced a 3:1 ratio of punitive to compensatory damages, which was lower than the ratio that the Court ultimately used.

The decision to exclude the *Brandt* fees in *Amerigraphics* therefore diminished the value of the punitive-damage claim (and concomitantly the deterrent effect of the award) in a case that the court deemed fully worthy of punitive damages, by roughly $1 million.

The rule adopted in *Amerigraphics* also forces bad-faith plaintiffs to choose between a streamlined post-trial determination of *Brandt* fees and the ability to include those fees in the punitive-damage award. Many plaintiffs will want to maximize the potential size of the punitive-damage award, and will therefore put the *Brandt*-fee issue to the jury. This is bad for the judiciary on many levels.

- It forces the plaintiffs' attorneys to testify as witnesses, and to be challenged by defense counsel;
- It makes bad-faith trials more complex by injecting attorney's fee issues, and the potential for expert testimony on those issues. Juries would have to decide which hours spent by plaintiff's counsel were properly allocable to issues that *Brandt* makes recoverable, whether the hours spent were reasonable, and the

reasonable cost of those hours—all issues that are tangential to the insurance issues in the case;

- More complex trials means longer trials, increasing the risk of alienating and confusing jurors; and
- Longer, more complex trials mean fewer trials, increasing the judiciary's burgeoning backlog in a time of ongoing austerity.

Fortunately, these problematic side effects of the rule adopted in *Amerigraphics* are avoidable. Because the rule requiring *Brandt* fees to be decided by the jury in order to count toward the punitive-damage award has no actual due-process warrant, elimination of the rule will eliminate the problems it causes.

CONCLUSION

Due process is served by a rule that holds tortfeasors (here insurers) accountable for all the harm they cause—whether that harm manifests itself as the loss of insurance-policy benefits, emotional- distress or consequential loss caused by the non-payment of those benefits, or the costs incurred to obtain those benefits.

Due process therefore requires courts to consider *Brandt* fees as part of the second *BMW* guidepost, regardless of whether the *Brandt* award was made by the jury or by the trial court in post-trial proceedings. The Court of Appeal's conclusion to the contrary should be vacated, and the punitive-damage award in this case

adjusted upward to reflect *all* the harm that Stonebridge inflicted on Nickerson.

Dated: February 10, 2014.

Respectfully submitted,
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Dated: February 10, 2014.

Jeffrey Isaac Ehrlich

Nickerson v. Stonebridge Life Insurance Company
Supreme Court No. S213873
Court of Appeal No. B234271
Superior Court Case No. BC405280

PROOF OF SERVICE

STATE OF CALIFORNIA, COUNTY OF LOS ANGELES I am employed in the County of Los Angeles, State of California. I am over the age of 18 and not a party to the within action; my business address is: 600 South Indian Hill Boulevard, Claremont, California 91711.

On **February 10, 2014,** I served the foregoing documents described as **OPENING BRIEF ON THE MERITS** on the interested parties in this action by placing a true copy thereof enclosed in sealed envelopes addressed as follows:

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[XX] BY MAIL I am "readily familiar" with the firm's practice of collection and processing correspondence for mailing. Under that practice it would be deposited with U.S. postal service on that same day with postage thereon fully prepaid at Claremont, California, in the ordinary course of business. I am aware that on motion of party served, service is presumed invalid if postal cancellation date or postage meter date is more than one (1) day after date of deposit for mailing in affidavit.

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[XX] (State) I declare under penalty of perjury under the laws of the State of California that the above is true and correct.

Executed on **February 10, 2014,** at Claremont, California.

Susan Lacey

Nickerson v. Stonebridge Life Insurance Company
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Court of Appeal No. B234271
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