



Recent Arizona Appellate Court Opinion Reduces Ratio of Bad Faith Punitive Damages Award to a 1:1 Ratio to Compensatory Damages

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In its recent decision, the Arizona Appellate Court, Division One, affirmed a bad faith verdict in the amount of \$155,000 and held that the \$55 million punitive damages award against the insurer was “unconstitutionally excessive.” Although the \$55 million award was subsequently reduced by the trial court to \$620,000, a ratio of 4:1, the Court of Appeals held that the record did not justify an award at a ratio greater than 1:1. *Nardelli v. Metropolitan Group Property and Casualty Ins. Co.*, 277 P.3d 789, 809 (Ariz. Ct. App. 2012). The court reasoned that the reprehensibility of Metropolitan Group Property and Casualty Ins. Co.’s (MetLife) misconduct was low to, at most, moderate and did not warrant a multimillion dollar punitive damages award.

Nardelli arose out of an auto theft claim submitted by the insureds, Kenneth and Tammy Nardelli (the Nardellis), when their 2002 Ford Explorer was stolen less than one year after purchasing it new from the dealership. Approximately two weeks later, the vehicle was found abandoned in Mexico with significant damage, including slit seats, cut wires and a torn interior. The vehicle identification number had also been removed. The vehicle was towed to an Arizona border town where an independent appraiser retained by MetLife appraised it. The appraiser estimated the cost to repair it to be \$815; however, the tow yard informed the Nardellis that the appraiser failed to look under the hood. The Nardellis had the vehicle towed to the original dealership’s body shop, where it was re-inspected by the MetLife field appraiser, Jerry Proctor (Proctor).

Proctor initially estimated the damage to be \$7,000 to \$8,000. After the dealership and the Nardellis discovered additional damage, Proctor ultimately supplemented his estimate to \$11,009, informing the Nardellis that he would not “total” the vehicle. The Nardellis disagreed with Proctor’s opinion because they continued to discover additional damage. They also did not believe Proctor’s estimate would

restore the vehicle to its pre-loss condition, as the policy required. Despite the Nardellis’ disagreement with the estimate and numerous discussions with managers within MetLife’s claims department, MetLife issued a check for \$10,759.13 (estimate less the deductible) to the Nardellis and their lender. The Nardellis tendered the check and the vehicle to their lender.

The Nardellis brought an action for breach of the implied covenant of good faith and fair dealing against MetLife. The jury awarded the Nardellis \$155,000 in compensatory damages and \$55,000,000 in punitive damages. The trial court subsequently reduced the punitive damages award to \$620,000. Both parties appealed. The Nardellis contended that the trial court should not have reduced the punitive damages. MetLife contended that the evidence did not support bad faith or punitive damages or, in the alternative, punitive damages should be further reduced.

The Court of Appeals upheld the jury’s verdict awarding compensatory damages for bad faith and concluded that a reasonable jury could find that MetLife acted in bad faith by: 1) deciding to repair rather than total the vehicle; 2) sending the Nardellis a check that did not cover the costs to restore the vehicle to its pre-loss condition; and 3) failing to advise the Nardellis of policy provisions relevant to their claim, including an endorsement providing additional benefits if the vehicle was a total loss, and the language pertaining to the appraisal right.

As discussed by the Court of Appeals, under Arizona law, commission of bad faith does not itself establish eligibility for punitive damages. *Rawlings v. Apodaca*, 151 Ariz. 149, 161-162 (Ariz. 1986). The plaintiff must establish, by clear and convincing evidence, that “defendant’s evil hand was guided by an evil mind.” *Rawlings* at 162. The Nardellis presented evidence that MetLife had instituted an aggressive company-

wide profit goal for 2002, assigned to the claims department a significant role in achieving that goal, aggressively communicated that goal within the claims department, and tied compensation of claims offices and individuals directly to the average amount paid on claims, without taking any steps to ensure that these profit goals would not result in unfair treatment to its insureds. The court concluded that a jury could reasonably find that the decisions made by MetLife in adjusting the Nardellis' claim were driven by financial self-interest and not by the merit of the claim, demonstrating outrageous conduct and warranting punitive damages.

But the Court of Appeals reversed the punitive damages award, finding it unconstitutional even though the trial court reduced it from \$55 million to \$620,000, a ratio of 4:1 to the compensatory award. The Court of Appeals examined the 1) degree of reprehensibility of MetLife's misconduct; 2) the disparity between the actual and the potential harm suffered by the Nardellis and the punitive damages award; and 3) the difference between the punitive damages award by the jury and the civil penalties authorized in comparable cases.

Reprehensibility

Noting that the harm to the Nardellis was largely economic by nature, the court did not find evidence to support "reprehensibility." The Court considered other factors when evaluating "reprehensibility," including: 1) there was no evidence that the Nardellis were financially vulnerable or that MetLife's actions were part of a pattern or longstanding history (although it did note MetLife's behavior of distancing itself from its own internal guidelines on claims handling); and 2) while the harm aggravated Kenneth Nardelli's pre-existing mental health condition, there was no evidence that MetLife knew of his condition or knew its actions would aggravate it. Although the court recognized that Arizona courts previously upheld substantial punitive damages awards, it distinguished those cases, explaining that those cases involved a higher level of intentionality and misconduct not displayed by MetLife. Overall, the court assessed the reprehensibility of MetLife's misconduct to be on the low end of the scale.

Ratio of Compensatory to Punitive Damages

The court admitted there is no "bright-line" ratio that should be applied when calculating punitive damages, and looked to previous cases in Arizona in which courts have examined the appropriate ratio. Applying the analysis in *Sec. Title Agency, Inc. v. Pope*, 219 Ariz. 480, 503 (App.2008), which cites to the landmark decision in *State Farm Mut. Auto. Ins. Co. v. Campbell*, 538 U.S. 408, 425 (2012), the court followed the reasoning in *Campbell* and determined that a 4:1 ratio "might be close to the line of constitutional impropriety" in light of the substantial award of compensatory damages. Accordingly, the court ultimately concluded a 1:1 ratio to be acceptable.

Comparative Penalties

The final factor considered was the comparable civil penalties that could be assessed against MetLife, as had been analyzed in previous Arizona cases. The court noted that the penalty for unfair claims settlement practices in Arizona is capped at \$50,000 and reasoned that this penalty would not place a carrier in MetLife's position on notice that it could ultimately be subject to a punitive damages award of \$55 million.

After considering these three factors, the court determined that the Nardellis were only entitled to an award of punitive damages equal to the compensatory damages award of \$155,000. The Court of Appeals' reduction of the ratio, as well as the strong dissent cautioning against justifying an award of punitive damages in mere "garden variety" intentional tort cases, appears to be the continuation of a judiciary trend to prevent the overly broad application of punitive damages. Although the potential for extraordinarily large punitive damages awards still exists, the Arizona courts are closely examining such awards on a case by case basis. Arizona judges, rather than juries, are the final decision-maker on the amount of punitive damages, and do not hesitate to slash huge verdicts if they view the evidence differently from the jury.

To discuss any questions you may have regarding the issues discussed in this alert, or how they may apply to your particular circumstances, please contact:

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