2d Civil No. B143750
(Consolidated with 2d Civil No. B145559)

IN THE COURT OF APPEAL

OF THE STATE OF CALIFORNIA

SECOND APPELLATE DISTRICT

DIVISION SEVEN

PERRY E. HANSTAD, et al.,

Plaintiffs, Respondents and Cross-Appellants,

vs.

TRUCK INSURANCE EXCHANGE,

Defendant, Appellant and Cross-Respondent.

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Appeal from the Los Angeles Superior Court, Case No. BC 156849
Honorable Frank Gafkowski, Jr., Judge

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# APPELLANT'S OPENING BRIEF

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## INTRODUCTION

$41,367,496.00.

That's the judgment in this case.

Punitive damages: $40 million.

When a judgment involves such big numbers, and in particular such a huge punitive damage number, special care must be taken to ensure that it rests on solid ground — constitutionally, legally and factually. (E.g., *Cooper Industries, Inc. v. Leatherman Tool Group, Inc.* (2001) 532 U.S. 424, 121 S.Ct. 1678 [constitutionality of punitive damages requires "searching scrutiny" and *de novo* review].)

The punitive damage award here fails at each of these hurdles. It cannot withstand even minimal scrutiny, let alone the searching scrutiny required by the state and federal constitutions. It doesn't come close.

Not only does the punitive damage award founder on constitutional, legal *and* factual fronts, but a substantial chunk of the $865,897 in economic compensatory damages ultimately awarded for bad faith (specifically, the $404,000 *Brandt* award) also is insupportable both legally and factually.

### A. The Punitive Damage Award Must Be Reversed.

The punitive damage award must be wiped out. This is so for multiple reasons:

- Under the law, the *jury* is required to select the proper ratio between punitive and compensatory damages, so as to attempt to assure the ratio is reasonable. Here, however, the $2,136,973.20 compensatory award on which the jury fashioned the original 18.72-to-1 ratio reflected in the verdict was improperly inflated by more than $1 million. The trial court has already reduced the compensatory damage award by almost $770,000, based on Hanstad's concessions that it was too high: Hanstad first waived his contract damages of $239,176.20, agreeing that they were encompassed in the economic damages on his tort claim; then, he stipulated to an

additional $530,301 reduction in compensatory damages as reflected in the amended judgments. By reason of this $769,477.20 in conceded reductions that the trier of fact (the jury) never knew about, the ratio of punitive damages to compensatory damages escalated dramatically from its original 18.72-to-1, to 29.25-to-1. The ratio will escalate even further—to 41.50-to-1—because, as we shall demonstrate, the entire $404,000 *Brandt* award must be reversed as unproven and excessive, further reducing the compensatory basis on which punitive damages must necessarily be calculated.

Since the size of the compensatory damages caused by wrongful conduct necessarily influences the quantum of punishment that is appropriate, a new punitive damage trial is essential, at the least, so that the issue of the punitive damage award can be decided by the jury in light of the reduced compensatory damage figure.

Furthermore, the ratio between compensatory and punitive damages here is unconstitutionally high in any event. It was excessive at the verdict's original 18.72-to-1 ratio. It grew even more so at the 29.25 to 1 ratio reflected in the amended judgments, and it reaches even greater heights of extremism (at 41.5 to 1) when the improper *Brandt* fee award also is subtracted from the compensatory damages.

- The trial court prejudicially erred in admitting evidence on the issue of net worth of other entities in addition to Truck Insurance Exchange ("Truck"). Since Truck is the only defendant in the suit, only Truck's assets were relevant to the net worth determination. Yet the trial court allowed Hanstad, over objections, to use Truck's pooling agreements with other entities marketed under the logo, The Farmers Insurance Group of Companies, as a platform to introduce evidence of those other entities' net worth in addition to Truck's. This gave the jury a prejudicially inflated impression of Truck's net worth and likely contributed to the massive punitive award.

- The trial court usurped the jury's role on the critical "managing agent" punitive damage issue. As this Court recently held, a corporate employer is not deemed to ratify misconduct so as to be liable for

punitive damages, unless its officer, director, or managing agent actually knew about the misconduct *and* its malicious character. (*Cruz v. HomeBase* (2000) 83 Cal.App.4th 160, 163.)

In *White v. Ultramar, Inc.* (1999) 21 Cal.4th 563, 567, our Supreme Court held the determination of who is a managing agent is "a question of fact for decision on a case-by-case basis." Here, the trial court refused to instruct the jury on the managing agent issues or to elicit a special verdict addressing them. Instead it decided them against Truck as a matter of law, before the case was submitted to the jury. This deprived Truck of its constitutional right to a jury trial on this central issue.

It also guaranteed there would be a void as to an essential element of plaintiff's punitive damage case. Civil Code section 3294, subdivision (b), provides that a corporate employer is not liable for punitive damages unless an officer, director or managing agent personally committed, authorized or ratified the particular oppression, fraud, or malice on which punitive damages are based. But when the trial court improperly took the managing agent issue from the jury, it precluded the jury from making a factual connection essential to the imposition of punitive damages—namely, the connection between its finding of malice, oppression or fraud, on the one hand, and knowledge by the employer's managing agent of the misconduct and its malicious nature, on the other hand.

- Even if the jury had received proper instruction, reversal still would be required because plaintiff failed to introduce evidence sufficient to establish commission, authorization or ratification of fraud, oppression or malice by an officer, director or managing agent of Truck. In particular, plaintiff failed to demonstrate that anyone who handled this file had the necessary authority to establish corporate policy, that is, the broad principles and rules of general application which govern corporate conduct, to qualify as a managing agent. (*Cruz v. HomeBase, supra*, 83 Cal.App.4th at p. 163.)

- Because punitive damages are inconsistent with the clear language of Civil Code section 3294 limiting punitive damage liability to claims "not arising from contract," punitive damages should be declared *per*

*se* unavailable in an insurance bad faith action such as this one, where the claim necessarily does arise from a contract, namely, the insurance contract.

### B. The *Brandt* Award Must Be Reversed.

The $404,000 *Brandt* award (*Brandt v. Superior Court* (1985) 37 Cal.3d 813) also must be reversed. *Brandt* fees are compensatory damages. They are awarded to compensate an insured for the attorney's fees he *actually incurs* in obtaining contract benefits due under an insurance policy. As damages, they are strictly limited to the amounts the insured *actually owes* his attorneys for their efforts in obtaining contract damages—not tort damages—for him.

The *Brandt* fee award is insupportable for two separate reasons. First, plaintiff's proof of attorneys' fees was a lump sum, without any breakdown between the amount allocable to his contract claim (recoverable under *Brandt*) and his tort claim (not recoverable). Since *Brandt* fees are not available for fees incurred obtaining a tort recovery, plaintiff's failure to allocate is fatal. Second, despite Truck's protests, the trial court failed to confine the *Brandt*-fee claim to the terms of plaintiff's contingency fee agreement with his counsel; instead, the trial court permitted plaintiff to recover a hypothesized dollar value of his attorneys' services at their assumed hourly rates. Since *Brandt* fees are limited to amounts an insured *actually must pay* his attorneys, the hourly-rate evidence was irrelevant—it did not reflect plaintiff's actual damages. Having failed to provide evidence of the fee agreement, plaintiff failed to demonstrate that he owes his attorneys any amount at all. Because plaintiff failed to prove his *Brandt* case, the award must be stricken from the judgment.

### C. Roadmap To The Brief.

Sections I and II address reasons (respectively, the failure to have a jury to decide the appropriate punitive award based on the actual compensatory damages recovered, resulting in an unconstitutionally excessive punitive damage award, and the erroneous admission of financial

information for nondefendant entities) why Truck is at least entitled to reversal of the punitive damage award, followed by a new trial.

We address errors connected with the "managing agent" issue consecutively in Sections III and IV. Section III demonstrates that the trial court's error in taking the issue from the jury entitles Truck at least to a new trial on punitive damages. Section IV goes farther, showing that Hanstad's failure to prove any Truck managing agent's involvement in the claim entitles Truck to reversal with directions to enter judgment for Truck on the punitive damage claim.

Section V asks the Court to enforce the statutory mandate limiting punitive damage claims to actions "not arising from contract" and therefore to reverse the punitive damage award with directions to dismiss the punitive damage claim.

Section VI demonstrates why the *Brandt* fee award is unproven and therefore must be reversed with directions.

Finally, Section VII shows that the intertwined nature of liability and compensatory and punitive damage issues in this case mandates that if punitive damages are to be retried, the new trial must encompass redetermination of the bad faith claim in its entirety.

Truck concedes this case does not represent a model of claims handling. Yet that cannot overcome the factual, legal and constitutional deficiencies that drive the outcome here. Under the law, the $40 million punitive damage award and the $404,000 *Brandt* fee award should be reversed with directions to enter judgment in Truck's favor as to each of these elements. At the very least, there must be a retrial on punitive damages, which, in turn, compels a retrial on issues encompassing both bad faith liability compensatory damages, except for *Brandt* fees.

## STATEMENT OF RELEVANT FACTS AND PROCEDURE[1]

### A. Jay DeMay Forms Tri County Builders With Perry Hanstad.

Plaintiff Perry Hanstad and Jay DeMay formed a residential construction company called Tri County Builders. (RT 81, 482-484.) Although the business was a general partnership (RT 87, 159-161, 162, 1846), both Hanstad and DeMay contemplated that it would function essentially as if it were DeMay's business alone. (RT 159-161, 162, 1712, 3699.) Hanstad wasn't going to share in profits or losses; he was merely the "qualifying partner," supplying the contractor's license required to operate the business because DeMay didn't have a license. (RT 159-161, 162, 508-509, 1712-1714, 1846, 1857, 1867, 3705.)

### B. DeMay Purchases A CGL Insurance Policy.

Hanstad directed DeMay to get a comprehensive general liability (CGL) insurance policy for the business. (RT 1714.) DeMay met with his insurance agent, John Ekno, to purchase that and other insurance. (RT 195-205, 295, 3694.) Ekno sold insurance on behalf of Truck Insurance Exchange and other entities. (See RT 119-121, 1870, 2194-2195.)

DeMay gave Ekno all the relevant information necessary to obtain the policy. He told Ekno the business was a partnership. (RT 491-492, 497.) He told Ekno to expect a call from Hanstad to verify that the insurance had been obtained. (RT 247-250.)

Ekno filled out the paperwork. In the "dba if any" line on the policy application, he filled in the words "Tri County Builders," thus classifying the business as DeMay's sole proprietorship. (RT 206, 269; CT 1025.)

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1/ The fact summary is fashioned in deference to the rule requiring in most instances that the evidence be viewed in a light favorable to the judgment. (E.g., *Muzquiz v. City of Emeryville* (2000) 79 Cal.App.4th 1106, 1121-1122; 9 Witkin, Cal. Procedure (4th ed. 1997) Appeal, § 359, pp. 408-410.) At trial, Truck introduced evidence supporting a different view of the facts.

DeMay told Hanstad he had obtained the policy. Hanstad spoke with Ekno and received a certificate of insurance from Truck. (RT 95, 185-186, 314.) It showed the insured as "Jay DeMay, dba Tri County Builders." (RT 96.)

Hanstad believed that he, DeMay and Tri County Builders all had coverage under the CGL policy. (RT 97, 155-158, 1714.) Under the policy as written, however, neither Hanstad nor the partnership was named as an insured. (RT 96, 1959, 2293, 3389; CT 1029-1075.) The cost of the policy was based on the policy as issued; a policy also covering Hanstad and the partnership would have cost more. (RT 317.) The policy was in effect from November 1988 through March 1991. (RT 308, 2753.)

### C. DeMay Undertakes A Construction Job For Dr. And Mrs. Shafer That Ends In An Arbitration Demand.

In November 1989, Tri County Builders, acting solely through DeMay, contracted with Dr. and Mrs. John Shafer to do a home remodeling job. (RT 3047; CT 110-112, 1076-1081.) In December 1991, the Shafers filed an arbitration demand against DeMay, Hanstad and Tri County Builders, contending that the job had never been completed, that the work was shoddy and that they had been defrauded. (CT 110-128, 322-340; RT 1138.)

Hanstad wasn't personally involved in the Shafer project. (RT 1139, 1849.) He didn't learn its details until the Shafers filed a complaint with the contractors' board; before that, he just knew that DeMay had undertaken a big job. (RT 165, 1715, 1848.)

### D. DeMay Retains Defense Counsel Who Tenders The Shafer Arbitration Demand To Truck For Defense And Indemnity.

When the Shafers filed their arbitration demand, DeMay retained as defense counsel Sam Abdulaziz, who specializes in construction litigation. (RT 406, 2820-2821.) During the period of his involvement, Abdulaziz

represented DeMay, Hanstad and Tri County Builders in defending the Shafer matter. (RT 400-401, 1716, 1848.)

Abdulaziz tendered the claim to Truck on March 6, 1992. (RT 400-401, 2823-2824.) Truck promptly acknowledged receipt of the claim. The acknowledgment letter, like all ensuing correspondence in the claim, referred to the insured as "Jay DeMay dba Tri County Builders," just as on the policy. Truck's acknowledgment letter raised questions as to whether the Shafer claim potentially involved covered property damage and noted that a coverage investigation was underway. (CT 6896; see RT 1972-1973, 2826.)

### E. Truck Agrees To Defend The Shafer Claim Under A Reservation Of Rights, But Fails To Communicate To Hanstad That He Is Being Provided A Courtesy Defense.

Following a series of correspondence among Truck, Abdulaziz and coverage counsel who had been brought in by Abdulaziz on his clients' behalf (e.g., CT 6897, 6901-6907; RT 1118), Truck agreed to defend the Shafer claim under a reservation of rights. (RT 835, 1889-1890.)

Although the reservation of rights letter reflected that the Shafer claim had been brought against Tri County Builders (a California partnership), Jay DeMay (an individual), and Perry Hanstad (an individual), the letter was addressed only to DeMay (the insured listed on the policy) and the letter's subject matter line identified the insured as "Jay DeMay dba Tri County Builders." (CT 6912; RT 829, 836, 1889-1890.) The reservation of rights letter listed various reasons why some or all of the potential liability in the Shafer arbitration might not be covered under the policy.[2]

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2/ These reasons included, among others, the possibility of damages occurring outside the policy period; or falling outside the definitions of occurrence, bodily injury or property damage; or falling within the parameters of various exclusions; or constituting intentional or willful acts

(continued...)

Based on the policy description of the insured as "Jay DeMay dba Tri County Builders," Truck's personnel did not believe that Hanstad was insured under the policy. (RT 653, 661, 811, 821, 912, 1914; CT 6900, 6909.) Nonetheless, Truck intended that the defense include all three defendants named in the Shafer arbitration claim. (RT 906-907, 1946.) Although Truck considered the defense being provided Hanstad a courtesy defense, it never articulated that view in correspondence to Abdulaziz or Hanstad; Truck never sent any correspondence directly to Hanstad. (RT 1993.) At no point during the arbitration did anyone tell Hanstad he wasn't insured under Truck's policy. (RT 104-105, 111, 501.)

### F. Truck Revises Its Reservation Of Rights Letter And Selects New Counsel To Defend The Shafer Claim.

While DeMay and Hanstad wanted Abdulaziz to continue to defend the Shafer arbitration, Truck preferred to select different defense counsel. (RT 575, 1716-1717, 2080, 2825.) Truck consulted its coverage counsel, Lance Labelle, a partner at Berger, Kahn, Shafton, Moss, Figler, Simon & Gladstone, about this issue. (RT 602, 634-635, 1103-1106, 1110, 2010, 2397, 2400-2401, 2438, 2778, 2809-2810.)

Labelle concluded that the reservation of rights letter, as written, potentially created a conflict of interest that would entitle DeMay to select independent counsel to conduct the defense. (RT 576-579, 2404-2422; see Civ. Code, § 2860.)

Labelle then prepared and sent a superseding reservation of rights letter, dated June 10, 1992. (CT 6916-6926; RT 565, 578-583, 2009.) This letter removed all reservations regarding intentional or willful acts, the definition of occurrence, Insurance Code section 533 and Civil Code section 1668. (RT 2594.) Truck believed that this letter eliminated the

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2/(...continued)
uninsurable under Insurance Code section 533 and Civil Code section 1668. (CT 6912-6915; RT 1951.)

conflict of interest, thus allowing it to select defense counsel. (E.g., RT 2074-2080.) Labelle had so advised Truck. (RT 2403-2411.)

Truck retained the law firm of Bodkin, McCarthy, Sargent & Smith to defend the Shafer arbitration. (CT 6925-6926; RT 1147, 2483-2484.) That firm then defended DeMay, Hanstad and Tri County Builders. (RT 503, 753, 1147-1154, 1718-1719, 3005, 3402.)

Hanstad's role in the arbitration was tangential. He was not involved in the underlying facts and was not targeted as a wrongdoer. He paid very little attention to the proceedings and attended only one day of the hearing. (RT 1719-1720, 3030-3031, 3424, 3427.)

### G. The Shafers Win The Arbitration, Their Award Is Confirmed As A Judgment, And Truck Determines That Only A Fraction Of The Judgment Is Covered Under The Policy.

The Shafers won the arbitration. They were awarded $311,302.31, consisting of $153,732 in damages, $85,166 for attorneys fees and costs, pre-award interest of $40,513, and reimbursement of administrative fees and arbitrator compensation of $31,891.31; DeMay was further ordered to pay the Shafers $25,000 in punitive damages. (CT 129-137 [7/26/93 arbitration award], 138-139 [12/94 clarification of award], 146-147 [judgment].)

The superior court confirmed the award. Judgment was entered in the amount of $311,302.31 against DeMay, Hanstad and Tri County Builders jointly; an additional $25,000 was entered against DeMay alone. (CT 146-147, 267-268.)

Truck tried to calculate how much of the award was covered. (RT 351-359, 2202, 2216-2228, 2494-2495.) DeMay wanted Truck to pay the whole amount. (CT 1344-1345.) Based at least in part on Labelle's advice, Truck concluded that most of the damages didn't qualify as property damage covered under the policy. Ultimately, Truck paid a total of about $159,900, including payments directly to the Shafers totaling $124,900.

(RT 614-615, 694, 714, 2520, 2533, 2662-2664, 3048; CT 1346-1349.)[3] Truck did not obtain a release from the Shafers. (RT 2259.)

**H. Truck Buys Back The Policy From DeMay.**

Truck attempted, without success, to effect settlement with the Shafers. (RT 639, 2235-2239, 2507, 2517-2521.) Thereafter, it bought the insurance policy back from DeMay, paying him $35,000 in exchange for DeMay's relinquishing his right to sue Truck. (RT 555, 2244-2249, 2515-2517, 3028, 3704.)

**I. Hanstad Files Chapter 7 Bankruptcy.**

Hanstad and his wife were having financial difficulties unrelated to the Shafer matter; the Hanstads had filed a Chapter 13 bankruptcy proceeding in November 1992. (RT 1746, 1855.) They were paying off their debts under a plan formed in Chapter 13 when the Shafer judgment came down. (RT 1747, 3615-3616.)

The judgment made it impossible for them to follow through with the Chapter 13 plan, resulting in their suffering devastating financial losses, including the loss of their home, and serious exacerbation of Hanstad's existing health problems. (RT 1747-1748, 1828, 1838-1839, 3538-3549, 3578-3581.)

Hanstad filed Chapter 7 bankruptcy in October 1993 in order to discharge the Shafer judgment. (RT 126, 1749-1752, 1826-1827.)

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3/ Most of Truck's disbursements went to pay the components of the judgment reflecting administrative and arbitration costs, attorneys fees and interest. (RT 2259, 2528-2533.) About $3,000 went to indemnify covered property damage, although Truck subsequently determined that only $673.50 of the compensatory damages awarded actually was covered. (RT 724-726, 2556, 2584-2585, 2590, 2682.)

### J. The Shafers Sue Hanstad In The Bankruptcy Proceedings For Nondischargeability Of The Judgment.

On December 27, 1993, the Shafers filed in the Hanstad bankruptcy a "Complaint to Determine Debt To Be Non-Dischargeable." They contended that Hanstad could not discharge the arbitration judgment in bankruptcy because (although his own liability was vicarious) the award was based on fraudulent conduct committed by DeMay. (CT 151-153, 362-364; RT 126.)

### K. Hanstad Tenders The Nondischargeability Action To Truck, And Truck Declines To Defend.

Hanstad tendered the nondischargeability action to Truck, demanding a defense under the policy. (CT 154-155, 274-275; RT 785, 1844, 1859, 2300-2301.) Truck declined to defend on the ground that Hanstad was not insured under the policy, it having been issued to "Jay DeMay dba Tri County Builders." (CT 156-157, 276-277, 1359-1360; RT 144, 870, 1777.)

### L. Hanstad Loses The Nondischargeability Action And Remains Liable For The Shafer Judgment.

Hanstad defended himself in the nondischargeability action. (RT 147-154, 1780-1782.) Truck monitored the trial through its coverage counsel, the Berger Kahn firm. (RT 3373-3375.)

Hanstad lost the nondischargeability action. (CT 1181-1185 [findings of fact and conclusions of law], 1186-1187 [judgment].) The bankruptcy court held the entirety of the Shafer judgment to be fraud-based and therefore not dischargeable in bankruptcy. (RT 1782, 2370.)

**M. Hanstad Files This Lawsuit Against Truck.**

Hanstad filed this action against Truck for breach of contract and breach of the implied covenant of good faith and fair dealing. (CT 1-7.)

The trial took place over a seven-month period. It proceeded in three phases.

Phase One was tried to the court and addressed whether Hanstad was entitled to be treated as an insured under the policy issued to Jay DeMay dba Tri County Builders and, if so, whether Truck's duty to defend extended to the bankruptcy nondischargeability action. (RT 80-1283; CT 4832-4848.) The trial court held that Hanstad was entitled to be considered an insured under the policy based on principles of waiver, estoppel and reformation. The court held further that Truck's duty to defend encompassed both the arbitration proceedings and the bankruptcy nondischargeability action. (RT 1212-1221; CT 4832-4848.)

Phase Two, tried to a jury, addressed the issues of damages for breach of contract and bad faith, and the question whether there was any malice, oppression or fraud. (RT 1284-4289.) The jury was not asked to find (and was not even instructed on the issue) whether any employee who handled the claim was an officer, director or managing agent of Truck, or whether any Truck officer, director or managing agent committed or ratified the particular conduct that the jury determined to constitute oppression, malice or fraud. The trial court had ruled these were not factual issues, and it decided the managing agent issue as a matter of law. It reasoned that "anybody . . . who could make a determination by the company to cover or deny coverage or to deny a defense or grant a defense is a managing agent under the cases." (RT 4140-4143.)

The jury found for Hanstad, determining that Truck committed bad faith and acted with malice, oppression and fraud. The jury awarded $239,176.20, plus accrued interest, on the breach of contract claim; $1,397,797 plus accrued interest as economic damages on the bad faith

claim[4]; and $500,000 for physical or emotional injuries (i.e., noneconomic damages) on the bad faith claim. (RT 4273-4289; CT 6204-6210.)

Phase Three involved the amount of punitive damages. (RT 4290-4430.) The jury determined that punitive damages of $40 million were warranted. Over Truck's objections (RT 4293, 4303), the court admitted evidence not only of Truck's own net worth, but also of the net worth of other insurance exchanges marketed under the name, Farmers Insurance Group of Companies (RT 4317-4362). While the jury voted unanimously to award punitive damages in some amount, the vote on the $40 million sum was 9-3. (RT 4426-4430; CT 6213-6216.)

**N. Judgment Is Entered.**

Judgment was entered on May 19, 2000, in the amount of $41,897,797.00, plus interest at the rate of $55.16 per day from May 3, 2000. (CT 6217-6222, 6319-6320 [notice of entry].) This amount reflects the sum of the various damages awarded by the jury ($239,176.20 + $1,397,797.00 + $500,000 + $40,000,000), less the $239,176.20 that had been awarded as damages for breach of contract. The contract damage amount was deleted with Hanstad's consent, because it duplicated amounts awarded for bad faith.[5]

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4/ Plaintiff had asked the jury to award economic tort damages for the balance due on the Shafer judgment, his expenses in two bankruptcy proceedings, lost earnings, law books purchased preparatory to defending himself in the nondischargeability action, loan expenses, medical expenses and $404,000 in *Brandt* fees. (RT 4253.)

5/ Hanstad had asked the jury to award the $239,176.20 amount twice, i.e., both as damages for breach of contract and as an element of economic damages for bad faith. After the verdict was returned, he made an election of remedies in favor of the tort cause of action and the contract claim (along with the $239,176.20 damage award) dropped from the case. (See RT 4254, 4455.)

### O. Post-Trial Proceedings Result In Amended Judgments.

Truck moved for new trial and for judgment notwithstanding the verdict (JNOV). (CT 6336-6391, 6472-6704, 6705-6736 [opposition], 6760-6798 [opposition], 6820-6832.) In its motions, Truck showed that the economic damage award on the bad faith claim exceeded the amount Hanstad had requested by over half a million dollars. (CT 6354-6355; see RT 4253 [Hanstad asks jury to award $865,897 in economic damages].) Hanstad agreed to a $530,301 reduction in those damages; the judgment was reduced by that amount. (CT 6501, 6711; RT 4455-4456.) Following this, the new trial and JNOV motions were denied. (CT 7377.)

An amended judgment reflecting these revisions was filed on July 19, 2000. It awarded $41,367,496 (reflecting Hanstad's conceded reduction of $530,301), plus costs, for a total of $41,396,768.00, plus post-judgment interest accruing effective July 19, 2000. (CT 7378-7380.)

The judgment was amended again on September 19, 2000. This amendment, entered nunc pro tunc as of May 19, 2000, awarded $41,367,496.00, plus prejudgment interest from May 3-19, 2000, in the amount of $882.56, for a total of $41,368,378.56, plus 10% postjudgment interest on that amount from May 19, 2000, forward. (CT 6217-6222.)

### P. Truck Timely Appeals; Hanstad Cross-Appeals.

Truck timely appealed from the judgment, amended judgment, and certain post-trial orders on August 16, 2000 (CT 7407-7434) and from the further-amended judgment and additional post-trial orders on October 20, 2000 (Supplemental Clerk's Transcript ["SCT"] 44-47.) Hanstad cross-appealed from the judgment on August 28, 2000. (CT 7443-7445.)

### Q. Jurisdictional Statement.

Truck's appeal is taken from a judgment and amended judgments that dispose of all issues between the parties, from an order denying Truck's motion for judgment notwithstanding the verdict, and from an order denying in part Truck's motion to tax costs. The judgment and orders are

appealable under Code of Civil Procedure section 904.1, subdivisions (a)(1) and (a)(2).

## LEGAL DISCUSSION

### I.

### THE PUNITIVE DAMAGE AWARD MUST BE REVERSED BECAUSE THE RATIO BETWEEN IT AND THE COMPENSATORY DAMAGES WAS NOT DETERMINED BY THE JURY AND BECAUSE IT IS UNCONSTITUTIONALLY EXCESSIVE.

The punitive damage award must be reversed because of fatal infirmities in the ratio between punitive and compensatory damages. That ratio must be determined by the jury in the first instance and it must be reasonable. Here, neither requirement is satisfied. When the jury determined punitive damages, it did so based on compensatory figures now known to be admittedly inflated. For example, it did not know that Hanstad would later consent to reductions of over $750,000 in the compensatory damage verdict or that the *Brandt* award was entirely unsupported. Thus, the jury was meting out punishment based on an erroneous view that Hanstad suffered greater compensatory injury than he really did. But even if this were not the case, the $40 million punitive damage award still would be unconstitutionally excessive.[6]

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6/ Truck raised the excessiveness of the punitive and compensatory damages by motion for new trial. (Code Civ. Proc., § 657; CT 6336-6339, 6472-6704.)

### A. Truck is Entitled To Have *A Jury* Determine The Proper Amount Of Punitive Damages Based On Actual Compensatory Damages, Not Improperly Inflated Compensatory Damages.

A *jury* must determine the appropriate relationship between punitive damages and compensatory damages. (*Liodas v. Sahadi* (1977) 19 Cal.3d 278, 284; *Auerbach v. Great Western Bank* (1999) 74 Cal.App.4th 1172, 1190.) Accordingly, the *jury* is instructed that *it* is to take the relationship with the compensatory damage award into account in fixing the amount of punitive damages. (BAJI No. 14.72.2; see CT 6199.)[7]

The relationship of punitive to compensatory damages is a critical factor in the punitive damages assessment. (E.g., *BMW of North America, Inc. v. Gore* (1996) 517 U.S. 559, 580-581 [116 S.Ct. 1589, 1601-1602, 134 L.Ed.2d 809]; *Lane v. Hughes Aircraft Co.* (2000) 22 Cal.4th 405, 421-429 [conc. opn. of Brown, J.]; *Neal v. Farmers Ins. Exchange* (1978) 21 Cal.3d 910, 928 [amount of compensatory damages is one of three critical considerations (along with defendant's financial condition and reprehensibility of punished conduct) in fashioning punitive damage award].)

This is so because the punishment must be tailored to the offense and to the damages caused by the offense. To put it in the vernacular, the

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7/ Various decisions confirm this. (See, e.g., *Gagnon v. Continental Casualty Co.* (1989) 211 Cal.App.3d 1598, 1602 ["California has long followed the rule that punitive damages must bear a reasonable relation to the actual injury suffered. (Citations.) The proper proportion punitive damages should bear to the injury suffered is also a question for *the jury* to determine . . ." (italics added)]; see also *Pacific Mut. Life Ins. Co. v. Haslip* (1991) 499 U.S. 1, 16 [111 S.Ct. 1032, 1042, 113 L.Ed.2d 1] ["nothing is better settled than that, in . . . actions for torts where no precise rule of law fixes the recoverable damages, it is the peculiar function of the jury to determine the amount by their verdict," citation and quotation marks omitted]; *Defender Indus., Inc. v. Northwestern Mut. Life Ins. Co.* (4th Cir. 1991) 938 F.2d 502, 507 (en banc) ["An assessment by a jury of the amount of punitive damages is an inherent and fundamental element of the common-law right to trial by jury"].)

punishment must fit the crime. This cannot be accomplished without the jury giving serious consideration the amount of harm actually suffered by the plaintiff. (See, e.g., *Devlin v. Kearney Mesa AMC/Jeep/Renault, Inc.* (1984) 155 Cal.App.3d 381, 388 [the jury must work out "[t]he channeling of just the correct quantum of bile to reach the correct level of punitive damages . . ."].)

### B. Since The Jury Must Determine A Reasonable Ratio Between Compensatory Damages And Punitive Damages, Any Substantial Revision In The Former Mandates Retrial Of The Latter.

Any substantial revision in the compensatory damages fixed by the jury throws out of balance the jury's determination of the compensatory-to-punitive damage ratio. A substantial change in the compensatory damage award therefore necessarily requires retrial of the punitive damage award. "Exemplary damages must be redetermined" where a new trial is granted for compensatory damages. (*Liodas v. Sahadi*, *supra*, 19 Cal.3d at p. 284; see also *Auerbach v. Great Western Bank*, *supra*, 74 Cal.App.4th 1172, 1190 [punitive damage claim must be retried because of change in proportion compared to compensatory damages]; *Palmer v. Ted Stevens Honda, Inc.* (1987) 193 Cal.App.3d 530, 541-542 [jury cannot determine reasonable relationship between punitive and compensatory damages without considering amount of compensatory damages]; cf. *Adams v. Murakami* (1991) 54 Cal.3d 105 [remanding for *jury* redetermination of punitive damage amount where evidence of defendant's financial worth was lacking].)

*Liodas v. Sahadi* is directly on point and controlling. There, the jury was instructed improperly on the measure of damages for fraud by a fiduciary and was not instructed alternatively as to the measure of damages for ordinary fraud. Accordingly, the *amount* of compensatory fraud damages had to be revisited. This, the Supreme Court held, required that punitive damages be retried as well for the precise reason we advance

here—a jury had to reassess a reasonable relationship between compensatory and punitive damages:

> "The trial court . . . properly granted a new trial on the issue of compensatory damages. Exemplary damages must be redetermined as well, as 'it would be improper and premature to assess such damages until or concurrently with the assessment of the actual damages' and 'exemplary damages must bear a reasonable relation to actual damages' even though no fixed ratio exists to determine the proper proportion." (19 Cal.3d at p. 284, citations and internal quotation marks omitted.)

More recently, Division Four of this Court recognized that where the compensatory damage award is excessive, the punitive award must be retried:

> "We cannot, however, simply reduce the [excessive compensatory] damages and modify the award on the fraud cause of action at this stage. Because the jury was misled about the amount of compensatory damages it could award, its punitive damage award is suspect." (*Auerbach v. Great Western Bank, supra*, 74 Cal.App.4th at p. 1190.)

### C. The Massive Deductions Taken From The Verdict's Award Of Compensatory Damages Have Thoroughly Undermined The Compensatory Foundation Of The Punitive Damage Award, Requiring Its Reversal.

Here, the jury found by the narrowest possible 9-3 margin that what it mistakenly believed were appropriate compensatory damages of $2,136,973.20 deserved a punitive award of $40 million—18.72 times the compensatory damages.

When the trial court first eliminated the concededly duplicative $239,176.20 contract recovery and then subtracted the conceded $530,301 from the tort recovery, this shrank the compensatory damage level by

$769,477.20, reducing the total by over a third, to $1,367,496. This reduction significantly changed the ratio—the jury-determined relationship—between the compensatory and punitive damage awards. The ratio and relationship that the jury found appropriate, $18.72 for each $1 of compensatory damages, grew by more than 55 percent to $29.25 of punitive damages for each $1 of compensatory damages. That change in multiplier is substantial by any measure.

Furthermore, as we show in Section VI, *infra*, the *Brandt* fee award — an additional $404,000 — must be deducted from the remaining compensatory damages, taking them down (if liability is not retried altogether) to $963,496. That reduction further inflates the ratio to $41.50 in punitive damages for each $1 in compensatory damages. This reflects a 41.9 percent increase over the amended judgments' inflated 29.25-to-1 ratio and a whopping 121.7 percent increase over the 18.72-to-1 ratio reflected in the jury's verdict.

There is more than a reasonable chance the jury would have blinked if it had known that the compensatory damages it calculated were inflated by at least $769,477.20 and probably more than $1 million, or that the ratio it selected between compensatory and punitive damages—one of the significant factors in determining the amount of punitive damages—was actually to be radically higher than it supposed. Because the reduction in compensatory damages throws "the punitive damages . . . out of proportion to the actual damages suffered by the [plaintiff], the punitive damage claim will have to be retried." (*Auerbach v. Great Western Bank*, *supra*, 74 Cal.App.4th at p. 1190; *Gagnon v. Continental Casualty Co.*, *supra*, 211 Cal.App.3d at p. 1605 [error is prejudicial if jury cannot assess whether its award of punitive damages bears reasonable relation to compensatory damages].)

Reversal is required here. When Hanstad consented to reduce his damage award by over three quarters of a million dollars, and thereby his total compensatory damages by nearly one third, the relationship between compensatory damages and the punitive damages adopted by the jury

escalated drastically. A new trial of punitive damages is required in order to afford a *jury* the fair opportunity to determine the appropriate award in light of the governing factors —including the relationship to the *actual* damages—that the law deems relevant.

### D. The Punitive Damage Award—Nearly 30 Times Hanstad's Reduced Compensatory Damages—Is Unconstitutionally Excessive.

Even if the punitive damage award did not have to be reversed for the reasons already addressed, it would still succumb because it is excessive as a matter of law. It is inconsistent with constitutional principles of fair notice, due process, and equal protection. (Cal. Const., art. I, § 7, subd. (a); U.S. Const., 5th and 14th Amends.; *Lane v. Hughes Aircraft Co.*, *supra*, 22 Cal.4th at pp. 421-422 [conc. opn. of Brown, J.] [there must be objective guideposts to review excessiveness of punitive damage awards]; *BMW of North America, Inc. v. Gore*, *supra*, 517 U.S. at p. 574 [116 S.Ct. at p. 1598] ["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"].)

That the punitive damage award currently is nearly 30 times greater than the plaintiff's substantial compensatory damages is sufficient alone to establish that it is excessive. As two justices of our Supreme Court have observed, "in the case of large [compensatory] awards, punitive damages should rarely exceed compensatory damages by more than a factor of three, and then only in the most egregious circumstances clearly evident in the record." (*Lane v. Hughes Aircraft Co.*, *supra*, 22 Cal.4th at p. 429 [conc. opn. of Brown, J.] [punitive awards of 11.6 and 5.6 time substantial actual damages in employment discrimination and retaliatory discharge case would be excessive]; *Pacific Mut. Life Ins. Co. v. Haslip*, *supra*, 499 U.S. at pp. 23-24 [111 S.Ct. at p. 1046] [4 to 1 ratio of punitive damages to

compensatory damages is "close to the line" imposed by federal due process limitations].)[8]

Further, it cannot be said that Truck received the constitutionally required fair notice that it might be subjected to a $40 million punitive damage award for a wrongful coverage decision. Civil and criminal penalties provide the recognized dollar benchmark for providing constitutionally required fair notice of prospective punitive liability. (*BMW of North America, Inc. v. Gore*, *supra*, 517 U.S. at pp. 583-584 [116 S.Ct. at p. 1603]; *Lane v. Hughes Aircraft Co.*, *supra*, 22 Cal.4th at pp. 425-426 [conc. opn. of Brown, J.].) Almost without exception, such statutory remedies are limited to treble damages—i.e., no more than *double* the monetary loss. (See *Lane v. Hughes Aircraft Co.*, *supra*, 22 Cal.4th at pp. 425-426 [conc. opn. of Brown, J.] [noting 30 examples; "we are unable to find any context in which (a statute) has mandated a *greater* multiplier than three, notwithstanding the egregiousness of the wrong" (original emphasis)].) Under these standards, the punitive damage award in this case is astronomically out of line.

Moreover, the appropriate constitutional measure for whether an enhanced punitive damage award is justified by extraordinarily evil conduct is a comparison not to blameless conduct, but "*in light of the types of misconduct that will support punitive damages . . . .*" (*Adams v. Murakami*, *supra*, 54 Cal.3d at p. 111, fn. 2, italics added; *Vossler v. Richards Manufacturing Co.* (1983) 143 Cal.App.3d 952, 966, disapproved on other grounds in *Adams v. Murakami* [finding continued sale of surgical implant

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8/ California cases with high ratios of punitive to compensatory damages almost always involve only small compensatory awards. (E.g., *Finney v. Lockhart* (1950) 35 Cal.2d 161, 162-163 [2000:1 ratio, but only $1 in compensatory damages]; *Wetherbee v. United Ins. Co. of America* (1971) 18 Cal.App.3d 266 [200:1 ratio; $1,050 in compensatory damages]; *Moore v. American United Life Ins. Co.* (1984) 150 Cal.App.3d 610 [83:1 ratio but $30,000 in compensatory damages]; *Neal v. Farmers Ins. Exchange*, *supra*, 21 Cal.3d 910 [74:1 ratio, but less than $10,000 in compensatory damages and substantial injury for which no damages were recoverable].)

knowing it would cause excruciating pain to hundreds of mostly elderly arthritic patients less despicable, and hence less deserving of elevated punishment, than marketing of vehicle that management knew would result in fiery deaths].)

The conduct involved here—not a pattern of misconduct, but rather only an individual instance of wrongful failure to afford insurance benefits to one who was not named as an insured under an insurance policy as written and paid for—is far less reprehensible than that in many California cases, including wrongful death cases based on murder, in which sizeable punitive damages have been imposed. Yet the punitive award here is vastly greater than that affirmed in any of those cases.[9]

The $40 million punitive damage award is unconstitutional. It therefore must be reversed.

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9/ E.g., *Rufo v. Simpson* (2001) 86 Cal.App.4th 573 (affirming $25 million punitive damage award, approximately three times compensatory damages, for double murder, i.e., where the factors of reprehensibility and harm inflicted "have the greatest weight legally possible"); *Greenfield v. Spectrum Investment Corp.* (1985) 174 Cal.App.3d 111, disapproved on other grounds in *Lakin v. Watkins Associated Industries* (1993) 6 Cal.4th 644 (nationwide car rental company ratified and covered up employee's physical assault on customer; plaintiff severely beaten and sustained fractures, was disabled from work for six months and sustained permanent painful neck injury; punitive damages: $400,000); *West v. Johnson & Johnson Products, Inc.* (1985) 174 Cal.App.3d 831, 846-848, 851 (affirming reduction of $10 million punitive damages award to $1 million, where large corporate defendant consciously disregarded known health risk to thousands of women by marketing tampons prone to cause potentially fatal toxic shock syndrome); *Vossler v. Richards Manufacturing Co.*, *supra*, 143 Cal.App.3d at p. 966 (defendant's continued sale of surgical implant knowing it would cause excruciating pain to hundreds of mostly elderly arthritic patients held still less reprehensible than conduct in *Grimshaw* involving marketing of vehicle that management knew would result in fiery deaths; punitive damages: $500,000); *Grimshaw v. Ford Motor Co.* (1981) 119 Cal.App.3d 757, 821, 822 (affirming reduction of $125 million jury award to $3.5 million where corporate defendant's conduct threatened mayhem and death to thousands of people).

## II.

## THE PUNITIVE DAMAGE AWARD MUST BE REVERSED BECAUSE THE TRIAL COURT PREJUDICIALLY ERRED IN ALLOWING HANSTAD TO INTRODUCE EVIDENCE OF THE NET WORTH OF OTHER COMPANIES IN ADDITION TO TRUCK.

The trial court prejudicially erred in allowing Hanstad to introduce evidence of financial data going far beyond Truck's own net worth. This gave the jury a prejudicially distorted and unfair impression of what size punitive damage award it would take in order to punish and deter Truck.

The error took place at Phase Three of the trial, where the only topic for the jury was the amount of punitive damages—whether to award them and, if so, how much. As a prerequisite to any punitive damage award, Hanstad had the burden of proof of establishing the defendant's financial condition. (*Adams v. Murakami, supra*, 54 Cal.3d at p. 119.) The only defendant in this lawsuit is Truck, and Hanstad did not purport to try any issue of alter ego. Over Truck's objections (e.g., RT 4303, 4330, 4331), however, the trial court allowed Hanstad's expert forensic CPA, Henry Stotsenberg, to present evidence not only of Truck's financial condition, but of the interrelationship of the various exchanges with which Truck has entered into pooling agreements, as well as the relationship of these entitites with their ultimate owner, and the net worth of one and all. (See RT 4322-4351 [Stotsenberg testimony], 4400-4401 [Hanstad's argument to the jury].)

This was prejudicial error.

*Tomaselli v. Transamerica Ins. Co.* (1994) 25 Cal.App.4th 1269 is directly on point. There the court reversed a punitive damage award because of the introduction of the financial condition of the defendant's parent company, which was not a party to the litigation. Absent proof of alter ego, the parent's financial condition was irrelevant: "Here, alter ego was not litigated or decided, nor is there any significant showing of unity of interest. More importantly, there is nothing to suggest how an 'injustice' would befall Tomasellis [*sic*] if the punitive damage award were limited to

a percentage of appellant's value rather than that of the parent company." (*Id.* at pp. 1285-1286; see *Institute of Veterinary Pathology, Inc. v. California Health Laboratories, Inc.* (1981) 116 Cal.App.3d 111, 119 ["A parent corporation is not liable for the torts of its subsidiaries simply because of stock ownership. (Citation.) Liability may be imposed only where the parent controls the subsidiary to such a degree as to render the latter the mere instrumentality of the former"].)[10]

The same is true here. Hanstad didn't sue anyone but Truck and he didn't allege, litigate or request a decision on an alter ego theory. He thus failed to assert or establish any ground for basing punitive damages on the financial condition of anyone other than Truck, and the trial court therefore erred in admitting evidence concerning the financial wherewithal of the other entities, and in permitting argument that the punitive damage award *against Truck alone* should be formulated with those other entities' holdings in mind.

The prejudice from this error is palpable. Evidence indicated Truck's own net worth was roughly $400 million. (RT 4347.) But the jury was also told, for example, that the consolidated net worth of the property and casualty group of which Truck is a member is $4.5 billion (RT 4346), that the collective exchanges have surplus dollars ranging between $2.6 billion and $5.2 billion (RT 4335), and that Truck's pooling arrangements with other entities would result in Truck itself paying only a small percentage of any punitive award assessed against it (RT 4348).[11]

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10/ See also *HCA Health Services of Midwest, Inc. v. National Bank of Commerce* (1988) 294 Ark. 525, 531-532 [745 S.W.2d 120, 124]; *Walker v. Dominick's Finer Foods, Inc.* (1980) 92 Ill.App.3d 645, 649 [415 N.E.2d 1213, 1216-1217, 47 Ill.Dec. 900, 903-904].

11/ Even in states that, unlike California, allow insurance of punitive damage awards, the fact that the defendant is insured (which is essentially what pooling would accomplish from Hanstad's perspective) may not be used to inflate the punitive award. (E.g., *Liberatore v. Thompson* (Ariz.App. 1988) 157 Ariz. 612, 621 [760 P.2d 612, 621] ["It is a defendant's own wealth, not his insurer's wealth, that bears on the proper

(continued...)

Hanstad exhorted the jury to take these factors into consideration in calculating punitive damages (RT 4399-4401), and the jury was instructed that it must take financial condition into consideration in fashioning an appropriate punitive damage award (CT 6199).

Where, as here, a jury is allowed to consider improper evidence in deciding a point, a reviewing court cannot speculate whether or not such evidence drove the decision. (E.g., *Henderson v. Harnischfeger Corp.* (1974) 12 Cal.3d 663, 670; *Cobbs v. Grant* (1972) 8 Cal.3d 229, 238.) Here, the jury returned a $40 million punitive damage verdict— roughly 10% of Truck's net worth, and 18.72 times the original amount of compensatory damages. (See, e.g., *Pacific Mut. Life. Ins. Co. v. Haslip* (1991) 499 U.S. 1, 23-24 [111 S.Ct. 1032, 1046, 113 L.Ed.2d 1] [4 to 1 ratio of punitive to compensatory damages is "close to the line" imposed by federal due process limitations].) There is more than a tenfold difference between the net worth of Truck and that of the aggregate entities about which Hanstad introduced evidence. There is at least a reasonable chance, and probably more than that, that this enormous award (adopted by a bare 9-3 vote) was influenced by the improperly admitted inflated financial evidence. (See *College Hospital, Inc. v. Superior Court* (1994) 8 Cal.4th 704, 715 [error is prejudicial where there is "a *reasonable chance*, more than an *abstract possibility*" that it affected the verdict].)

Truck was entitled to have the jury formulate punitive damages based solely on its own net worth. Because the trial court admitted evidence of other entities' worth and permitted argument improperly eliciting an inflated assessment of the punitive damage question, the $40 million punitive damage award must be reversed.

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11/(...continued)
level of punitive damages"].)

## III.

## THE PUNITIVE DAMAGE AWARD MUST BE REVERSED AND THE ENTIRE BAD FAITH CASE RETRIED BECAUSE THE TRIAL COURT IMPROPERLY USURPED THE JURY'S ROLE IN DECIDING THE MANAGING AGENT ISSUE.

Reversal of the punitive award is required for another set of related reasons as well.

In order for Hanstad to recover punitive damages from Truck, he was required to prove and the jury was required to find that an officer, director, or managing agent on behalf of Truck personally committed, authorized or ratified the conduct found to constitute fraud, oppression, or malice. (Civ. Code, § 3294, subd. (b).) That never happened here.

The trial court improperly short-circuited the process. Specifically, it refused to submit the managing agent issue to the jury and instead decided it against Truck as a matter of law.

This was prejudicial error. It tainted the ensuing punitive damage award in two ways: Truck was deprived its constitutional right to a jury determination as to whether a Truck managing agent personally committed, authorized or ratified the particular conduct the jury found to constitute malice, oppression and fraud, and Hanstad failed to prove these essential elements of his punitive damage case.

### A. The Issue Whether Wrongful Conduct Is Committed By A Managing Agent Is A Question Of Fact And Must Be Determined By The Jury.

In *White v. Ultramar, Inc., supra,* 21 Cal.4th at p. 567, our Supreme Court held that the issue of whether an employee is a managing agent is a fact question. The Court declared:

"The scope of a corporate employee's discretion and authority under our test is . . . a question of fact for decision on a case-by-case basis." (*Ibid.*)

Fact issues, obviously, must be decided by the factfinder. Where, as here, the factfinder is the jury, the managing agent issue must be decided *by the jury*. That's why there are BAJI instructions on the topic. (See BAJI No. 14.73 [Punitive Damages Against Principal For Acts Of Agent—When Permitted (Non-Bifurcated Trial)], BAJI No. 14.73.1 [Punitive Damages Against Principal For Acts of Agent—When Permitted (Bifurcated Trial—First Phase)], BAJI No. 14.74 (2000 Revision) [Managing Agent—Defined].) Below, Hanstad—knowing this was an essential part of his case to prove—requested a special verdict and jury instructions that addressed the managing agent issue and tried strenuously to dissuade the trial court from taking the issue from the jury. (RT 4140-4143; CT 5974, 6062-6063.)

### B. The Trial Court Prejudicially Erred In Taking The "Managing Agent" Issue Away From The Jury And Deciding It As A Matter Of Law.

Despite the crystal clear governing law, the trial court declined to submit the managing agent issue to the jury. The court gave the jury no instructions on the issue, and the special verdict failed to elicit any "managing agent" finding. (See CT 6204-6207 [special verdict].) The jury thus was left completely oblivious to the issue, even though a finding of managing agent involvement was a prerequisite to punitive damage liability.

Instead, in complete contravention of governing law, the trial court ruled that the managing agent issue was a question of law and that it was not necessary to submit it to the jury. (RT 4140-4141.)[12] Adding insult to

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12/ An issue of fact can be decided as a matter of law only when the evidence is uncontroverted or permits drawing but a single conclusion. (continued...)

injury, the trial court then ruled, again in flat contravention of governing law (see Section IV, *infra*), that anybody who makes a coverage determination is a managing agent and, on that erroneous basis, decided the issue against Truck. (See RT 4140-4143.)

This was flat-out prejudicial error—of constitutional magnitude. "The trial court may not . . . usurp the jury's ultimate factfinding power." (*People v. Rodriguez* (1986) 42 Cal.3d 730, 766; see, e.g., *People v. Hawkins* (1995) 10 Cal.4th 920, 948 [same]; *Hoch v. Allied-Signal, Inc.* (1994) 24 Cal.App.4th 48, 59 [neither trial court nor appellate court can invade province of the jury]; cf. *Summers v. A.L. Gilbert Co.* (1999) 69 Cal.App.4th 1155, 1182, 1185 [expert's testimony is inadmissible if it "invades the province of the jury to decide a case"].)

The absence of instructions or special verdict findings on the managing agent issue fatally undermines the punitive damage award. Truck was constitutionally entitled to a jury trial on the issue — a trial it might have won — and the trial court deprived it of that right. For this reason alone, the punitive damage award must be vacated.

### C. The Trial Court's Prejudicial Errors Regarding The Managing Agent Issue Precluded Entry Of A Viable Punitive Damage Award.

It was Hanstad's burden to prove every element of his punitive damage claim. (*Roddenberry v. Roddenberry* (1996) 44 Cal.App.4th 634, 654 ["Whatever plaintiff is obligated to plead, plaintiff is obligated to prove"]; Evid. Code, § 500 [a party has the burden of proving all facts

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12/(...continued)
(E.g., *Flowers v. Torrance Memorial Hospital Medical Center* (1994) 8 Cal.4th 992, 1000; *Martinez v. Scott Specialty Gases, Inc.* (2000) 83 Cal.App.4th 1236, 1249.) As we demonstrate in Section II, *infra*, the evidence was insufficient to permit any managing agent finding. Thus, the only way the issue could have been decided as a matter of law was in *Truck's* favor. What the court could not do on this record was to usurp the jury and decide the issue for Hanstad.

essential to the relief sought].) That burden included proof and jury determination that a "managing agent" of Truck personally committed, authorized or ratified the particular conduct that the jury found to constitute fraud, oppression and malice. (See, e.g., *White v. Ultramar, Inc.*, *supra*, 21 Cal.4th at p. 572 ["the wrongful act giving rise to the exemplary damages be committed by an 'officer, director, or managing agent'"]; Civ. Code, § 3294, subd. (b) [requiring, as prerequisite to imposition of punitive damages on an employer, commission, authorization or ratification of "the wrongful conduct for which the damages are awarded"]; BAJI No. 14.73 (2001 Revision) [Punitive damages permissible against an employer ". . . if, but only if" the employer "[authorized] [or] [ratified] the conduct which is found to be [oppression] [malice] [or] [fraud]"]; see BAJI No. 14.73.1 (2001 Revision) [same].)

The trial court's failure to have the jury decide the managing agent issue precluded determination of the essential prerequisite to the imposition of punitive damages.

First, the jury was prevented from deciding whether anyone identified by the evidence even acted as a managing agent of Truck.

Second, the factfinder, oblivious to the whole issue, cannot possibly have made the required determination that a managing agent (if, indeed, the evidence identified one) personally committed, authorized or ratified the particular acts that the jury found to constitute fraud, oppression or malice.

True, the jury found Truck had committed malice, oppression, and fraud. However, because of the trial court's erroneous ruling, it cannot be said that the jury found that any Truck managing agent personally committed, authorized or ratified the particular acts found to support punitive damages.

This is fatal to the punitive damage recovery. What the managing agent must commit, authorize or ratify is *the particular conduct* found to constitute oppression, malice, or fraud. No such finding was made (nor could it possibly have been made) here. The failure to find on a material

issue is reversible error. (E.g., *Rabago v. Unemployment Ins. Appeals Bd.* (1978) 84 Cal.App.3d 200, 212.)[13]

Once the managing agent issue was taken from the jury, the required proof of identity between managing agent and malicious conduct became impossible. Since that essential element is missing, the punitive damage award cannot stand.

## IV.

## THE $40 MILLION PUNITIVE DAMAGE AWARD MUST BE REVERSED WITH DIRECTIONS TO ENTER JUDGMENT IN TRUCK'S FAVOR BECAUSE HANSTAD FAILED TO INTRODUCE EVIDENCE THAT ANY PERSON HAVING AUTHORITY TO MAKE CORPORATE POLICY FOR TRUCK COMMITTED OR RATIFIED ACTS OF MALICE, OPPRESSION OR FRAUD.

Even if the court had instructed the jury concerning the managing agent issue, the punitive damage award still could not stand. Hanstad failed to prove this essential element of his punitive damage case. There was no evidence that an officer, director or managing agent on behalf of Truck committed or ratified acts of malice, oppression or fraud against him.

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13/ Nor can the necessary findings be inferred from the jury's fragmentary verdict. Even had the jury been properly instructed on the "managing agent" issue, that would not permit drawing an inference in lieu of the required finding of fact. (E.g., *Myers Building Industries, Ltd. v. Interface Technology, Inc.* (1993) 13 Cal.App.4th 949, 961 ["(W)ithout an actual verdict by the jury . . . , [even proper] instructions and [substantial] evidence cannot support the punitive damage award"].)

### A. There Can Be No Punitive Damage Award Against Truck Absent Evidence That An "Officer, Director Or Managing Agent" Personally Was Guilty Of Oppression, Fraud, Or Malice.

Punitive damages are governed by statute and are available only in select conditions. Civil Code section 3294, subdivision (a), provides that in a tort action "where it is proven by clear and convincing evidence that the defendant has been guilty of oppression, fraud, or malice, the plaintiff, in addition to the actual damages, may recover damages for the sake of example and by way of punishing the defendant."

However, there can be no award of punitive damages against any employer unless it "was personally guilty of oppression, fraud, or malice," and, "with respect to a corporate employer, the advance knowledge and conscious disregard, authorization, ratification or act of oppression, fraud, or malice must be on the part of an officer, director, or managing agent of the corporation." (Civ. Code, § 3294, subd. (b).) The statute explicitly so requires.

Hanstad bore the burden of proving the managing agent issue. (*Roddenberry v. Roddenberry, supra*, 44 Cal.App.4th at p. 654; Evid. Code, § 500.) He was required to do so by clear and convincing evidence. (E.g., *White v. Ultramar, Inc., supra*, 21 Cal.4th at p. 566, fn. 1; *PPG Industries, Inc. v. Transamerica Ins. Co.* (1999) 20 Cal.4th 310, 318-319.)

He failed to carry that burden. He introduced no evidence concerning involvement in this matter by any officer or director on behalf of Truck. Thus, the punitive damage award against Truck hinges exclusively on whether Hanstad proved that a "managing agent" of Truck acted with malice, oppression or fraud in handling Hanstad's claim. But he failed to do that, too.

### B. A "Managing Agent" Is An Employee With Authority To Establish Corporate Policy.

The purpose of Civil Code section 3294, subdivision (b), is to make sure that punitive damages are inflicted only on entities that truly deserve punishment. The statute codified decisional law holding that "[a]though a corporation could be liable for compensatory damages for an employee's tort under the respondeat superior doctrine, the corporation was not responsible for punitive damages where it neither personally directed nor ratified the wrongful act." (*White v. Ultramar, Inc., supra*, 21 Cal.4th at p. 569.)

As our Supreme Court explained in *White*: "'The entire basis of the doctrine of vindictive [punitive] damages is that the *person*, himself, *who is sued* has been guilty of recklessness or wickedness which amounts to a criminality that should be punished for the good of society, and as a warning to the individual; but to award such damages against the master for the criminality of the servant is to punish a man for that of which he is not guilty.'" (*Ibid.*, quoting *Warner v. Southern Pacific Co.* (1896) 113 Cal. 105, 112, original italics; cf. *Beck v. State Farm Mut. Auto. Ins. Co.* (1976) 54 Cal.App.3d 347, 355 ["The law does not favor punitive damages and they should be granted with the greatest caution"].)

By limiting the imposition of punitive damage liability against corporate employers to cases where an officer, director or managing agent was directly involved in the wrongful conduct, both the statute and our Supreme Court sought to limit the imposition of punitive damages to the narrow circumstances where an entity itself is guilty of punishable wrongdoing. This requires a high level of involvement by management.

To assure that punishment is limited to true management involvement situations, the focus is on managers who "were vested with a degree of discretion over decisions that would ultimately *determine corporate policy*." (*Id.* at p. 571, emphasis added.) Stated otherwise, "The drafters' goals" in enacting the "managing agent" provision "were to avoid imposing punitive damages on employers who were merely negligent or reckless and to distinguish ordinary respondeat superior liability from

corporate liability for punitive damages." (*Id.* at p. 572.) As the Supreme Court declared in *White*, the Legislature intended to limit punitive damage liability against a company to those cases where there is involvement in malicious conduct by "those *employees who exercise substantial independent authority and judgment over decisions that ultimately determine corporate policy.*" (*Id.* at p. 573, italics added.)

This Court recently examined and correctly applied the *White* rule in *Cruz v. HomeBase, supra*, 83 Cal.App.4th 160. In *Cruz*, punitive damages of $400,000 had been awarded against HomeBase based on the acts of an individual store's supervisory director of security, Kinsel, who had detained and roughed up a patron. This Court reversed the punitive damage award with directions to enter judgment in HomeBase's favor because the evidence was "insufficient, as a matter of law, to show that Kinsel was a managing agent." (*Id.* at p. 168.)

After observing that "[t]here was not a hint of evidence that he exercised authority over corporate principles or rules of general application in the corporation" (*ibid.*), this Court held:

> "A corporation is not deemed to ratify misconduct, and thus become liable for punitive damages, unless its officer, director, or managing agent *actually knew* about the misconduct and its malicious character. A 'managing agent' is an employee with authority to establish corporate policy, that is, the broad principles and rules of general application which govern corporate conduct." (*Id.* at p. 163, emphasis added.)

Because there was no such evidence in *Cruz*, this Court properly reversed the punitive damage award with directions. As we now demonstrate, Hanstad's evidence here suffers the same fatal deficiency.

### C. Hanstad Failed To Introduce Substantial Evidence That Any Managing Agent On Behalf Of Truck Was Involved In Handling His Claim.

Hanstad's punitive damage claim necessarily can survive only if a "managing agent" was involved in the punishable conduct. But that theory is unsupported.

First, none of the seven individuals who testified to having handled this claim was proven to be an employee of Truck Insurance Exchange, which is the only defendant in this lawsuit. Rather, uncontroverted evidence established that they were all employees of Farmers Insurance Exchange.[14] As this Court declared in *Cruz v. HomeBase*, *supra*, 83 Cal.App.4th at p. 163: "A 'managing agent' is *an employee* with authority to establish corporate policy, that is, the broad principles and rules of general application which govern corporate conduct." (See *White v. Ultramar, Inc.*, *supra*, 21 Cal.4th at p. 573 ["Thus, by selecting the term 'managing agent,' and placing it in the same category as 'officer' and 'director,' the Legislature intended to limit *the class of employees* whose exercise of discretion could result in a corporate employer's liability for punitive damages" (italics added)]; BAJI No. 14.74 (2000 Revision) ["The term 'managing agent includes *only those corporate employees* who exercise substantial independent authority and judgment in their corporate decision making so that their decisions ultimately determine corporate policy" (italics added)].)

The only defendant in this lawsuit, and the only target of punitive damages, is Truck. (See CT 6103 [Jury Instructions: "In this trial, the plaintiff is Perry Hanstad, and the defendant is Truck Insurance Exchange"].) Since none of the witnesses who testified at trial was employed by Truck, Hanstad was obliged to introduce evidence to

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14/ RT 3763 [Reilly], 1868-1869 [Colgrove], 1999 [Lundblad], 2765, 2769 [Hirsch], 2340 [Whitson], 2177, 2196 [Stettler], 3475-3476 [Lapierre].

demonstrate how these employees of *other* entities promulgate (not merely implement) *Truck's* corporate policy. He failed to do that.[15]

Even if Hanstad had not left this gaping hole in his punitive damage proof, the evidence on "managing agent" would still come up short. The trial court concluded that anybody who processes a claim is a managing agent (see RT 4142), but that is not the law. Rather, the test is whether anyone who committed the acts that are found to be oppressive, fraudulent or malicious had authority to establish—not merely implement—Truck's claims handling policy.

Not one of the seven people who handled this claim fits that description. There was no evidence that any of them was responsible for fashioning Truck's company policies regarding claims handling. Six of them recounted responsibilities strictly limited to processing claims, with no hint of involvement in fashioning company policy.[16] Only the seventh,

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15/ Hanstad did not prove the workings or parameters of Truck's affiliation with Farmers Insurance Exchange at Phase Two of the trial, which included trial of the issue of "oppression, fraud, or malice." Only at Phase Three (addressing the amount of punitive damages) did evidence come in that even touched upon these topics. Without such evidence, neither the claims witnesses nor the companies by whom they were employed could possibly qualify as "managing agents" for purposes of imposing punitive damage liability *on Truck*.

16/ Here's what the record shows for these non-Truck employees: Paul Colgrove first handled the claim; he investigated claims assigned to him and made recommendations; he thought DeMay's original tender should be denied, but his recommendation was rejected. (RT 1873, 1886, 1921, 1962-1963.) Robert Lundblad handled the claim next; he sent the file to Lance Labelle for coverage analysis and authorized Labelle to send out the superseding reservation of rights letter. (RT 2005, 2010-2012, 2018-2023, 2138.) Howard Hirsch handled the file after Lundblad; he recalled the claim only vaguely. (RT 2025, 2128, 2771.) Chuck Whitson took over after Hirsch left the company; he was involved in handling Hanstad's tender of the bankruptcy nondischargeability action and recommended to superiors that it be denied. (RT 2349-2352.) George Stettler supervised the work of claims representatives in his office (RT 2133, 2180-2184); he needed approval from Lori Reilly in the Zone

(continued...)

Lori Reilly, like the others, a Farmers Insurance Exchange employee, described a level of responsibility approaching any type of significant supervisory authority, but Hanstad did not establish she was a managing agent for Truck.

Reilly, like the other witnesses, testified to her role in the claims handling process generally.[17] The evidence showed she was involved at various points in handling this claim.[18] But Hanstad failed to introduce evidence that Reilly *established* Truck corporate policy or "the broad principles and rules of general application which govern corporate conduct." (*Cruz v. HomeBase, supra*, 83 Cal.App.4th at p. 163; *White v. Ultramar, Inc., supra*, 21 Cal.4th at p. 573; BAJI No. 14.74.) At most, the evidence showed that Reilly had some degree of responsibility in determining the handling of *particular* claims.

Even in terms of implementing policy, which *Cruz* held could not trigger punitive liability, Reilly testified to a circumscribed role. All of her decisions were subject to reversal by her superiors, Frank Brooks and Tom

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16/(...continued)
Office before he could deny any claim or effect most settlements. (RT 2181, 2254, 2268, 2777-2778.) Adam Lapierre was office manager in the claims office where this claim was handled; he reviewed the work of claims representatives and supervisors who worked in his office; he needed authority from the Zone Office to deny a claim, to buy back a policy or to settle a claim. (RT 3478-3479, 3481-3489, 3503.)

17/ Lori Reilly became a Zone Major Claims Manager of Farmers Insurance Exchange on January 1, 1994. Her territory was the California Commercial Claims Zone, which included six commercial general liability offices, each of which she supervised. (RT 3765.) Each of those offices employed a couple of branch claims supervisors and anywhere from five to 18 claims representatives. (RT 3765-3770.) She had authority to deny claims and to extend settlement authority in many cases. (RT 3773-3775.) Many of her normal responsibilities were suspended for a period following the Northridge earthquake, during which time she was involved in adjusting thousands of earthquake-related claims. (RT 3772-3773.)

18/ Reilly was involved in the policy buy-back, the payment of funds to the Shafers, and the denial of a defense to Hanstad in the bankruptcy nondischargeability action. (RT 3771-3772.)

Smith. (RT 3806.) But there is simply no evidence concerning those individuals. Whether Brooks or Smith or anyone else established Truck's corporate policy, and whether they knew anything whatsoever about this claim, is completely unknown on the Phase Two trial record.

It may be that each of the seven individual claims witnesses who participated in handling the Shafer claim had power to make or did make decisions having significant impact on Hanstad's particular claim. But that in itself is *not* enough to lay the foundation for a punitive damage award against Truck. In *Cruz*, this Court explained why not:

> "It is true that, despite his limited sphere of authority, Kinsel's decisions could have significant consequences, as the present case shows. But, then, every corporate employee's reckless or malicious conduct has the potential to cause serious injury. Whether the corporation will be liable for punitive damages depends, not on the nature of the consequences, but rather on whether the malicious employee belongs to the leadership group of 'officers, directors, and managing agents.'"

(*Cruz v. HomeBase*, *supra*, 83 Cal.App.4th at p. 168; see *White v. Ultramar, Inc.*, *supra*, 21 Cal.4th at p. 575 [that employee has power to hire and fire in individual cases does not make him or her a managing agent].)

Hanstad made no showing that anyone who handled the Shafer claim belonged to the key leadership group. The evidence therefore is insufficient as a matter of law to establish that any Truck "managing agent" committed, authorized or ratified any act of malice, oppression, or fraud. Accordingly, the $40 million punitive damage award must be reversed.

### D. Hanstad's Failure Of Proof Entitles Truck To Reversal With Directions To Enter Judgment In Truck's Favor On The Punitive Damage Claim.

Hanstad had free rein to prove his punitive damage claim at trial, but he failed to do so. There simply is no evidence in the record establishing commission of fraud, malice, or oppression by any Truck *managing agent.*

Because Hanstad failed to make his case at a full trial on the merits, this Court should reverse the $40 million punitive damage award with directions to strike the award permanently from the judgment. Numerous cases dictate this result.[19]

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19/ E.g., *Cassista v. Community Foods, Inc.* (1993) 5 Cal.4th 1050, 1066 ["Having thus received a full and fair opportunity to prove her case, she is not entitled to a new trial"]; *McCoy v. Hearst Corp.* (1991) 227 Cal.App.3d 1657, 1661 ["when the plaintiff has had full and fair opportunity to present his or her case, a reversal of a judgment for the plaintiff based on insufficiency of the evidence should place the parties, at most, in the position they were in after all the evidence was in and both sides had rested. A judgment for the defendant would then be entered . . ."]; *Bank of America v. Superior Court* (1990) 220 Cal.App.3d 613, 624 [reversal for insufficiency of the evidence concludes the litigation]; see also *Selma Auto Mall II v. Appellate Department* (1996) 44 Cal.App.4th 1672, 1683-1684 ["When a court grants relief which it has no authority to grant, its judgment is to that extent void"; "The mere fact that the court has jurisdiction of the subject matter of an action before it does not justify . . . a grant of relief to a party that the law declares shall not be granted"].

## V.

## THE PUNITIVE DAMAGE AWARD SHOULD BE REVERSED WITH DIRECTIONS BECAUSE THE LEGISLATURE HAS MANDATED THAT PUNITIVE DAMAGES ARE PRECLUDED IN AN ACTION (SUCH AS A BAD FAITH ACTION) ARISING OUT OF A CONTRACT.

Hanstad sued Truck for bad faith breach of the covenant of good faith and fair dealing implied in the insurance policy issued to Jay DeMay dba Tri County Builders. Hanstad's bad faith cause of action required the existence of a contract — the insuring agreement — and thus the breach of an obligation arising from contract. In fact, it was the trial court's determination in Phase One of the trial that Hanstad was entitled to be treated as an insured under the contract that laid the foundation for pursuing the bad faith claim. (See RT 1212-1221.)

Indeed, any insured's action for bad faith breach of the implied covenant of good faith and fair dealing necessarily requires the existence of a contract — the insuring agreement — and thus the breach of an obligation arising from contract. (See *Waller v. Truck Ins. Exchange, Inc.* (1995) 11 Cal.4th 1, 36 ["In sum, the covenant is implied as a supplement to the express contractual covenants, to prevent a contracting party from engaging in conduct that frustrates the other party's rights to the benefits of the agreement. (Citation.) . . . Absent that contractual right, however, the implied covenant has nothing upon which to act as a supplement, and 'should not be endowed with an existence independent of its contractual underpinnings'"]; see also *Harris v. Lammers* (2000) 84 Cal.App.4th 1072, 1076 ["The phrase 'arising out of' has a well-established legal meaning. Numerous cases have ruled that it refers to origin, such as whether something grows out of or flows from an event"].)

Civil Code section 3294, however, explicitly makes punitive damages available only "for the breach of an obligation *not arising from contract.*" (Civ. Code, § 3294, subd. (b), italics added.) Accordingly, the statute on its face precludes punitive damages in this or any other bad faith case.

Despite extensive research, we have found no California case squarely deciding this foundational issue of statutory application. The legislative directive in Civil Code section 3294, however, could hardly be clearer. An insured's action against an insurer for bad faith necessarily is premised on an obligation arising from contract. Thus, it does not meet the threshold statutory limitation that punitive damages are available only in an action that does *not* arise from contract. (Civ. Code, § 3294, subd. (b).)

Truck recognizes that *Egan v. Mutual of Omaha Ins. Co.* (1979) 24 Cal.3d 809, 819-821, may perhaps be read as implicitly establishing that punitive damages are available for an insurer's breach of the implied covenant of good faith and fair dealing. However, the majority opinion in *Egan* does not address or decide the statutory issue we raise, and "[c]ases are not authority for propositions not considered." (*In re Tartar* (1959) 52 Cal.2d 250, 258.)

We also acknowledge the passage in *Cates Construction, Inc. v. Talbot Partners* (1999) 21 Cal.4th 28, 43-44, indicating that punitive damages have been allowed in insurance bad faith actions for policy reasons. However, *Cates Construction* was not an insurance case and the passage in question is merely dicta.

The Legislature's will on this issue is controlling. It should be enforced here. This Court should enforce the clear statutory language declaring punitive damage unavailable in lawsuits that arise out of contract. For this reason in addition to those already expressed, the punitive damage award should be reversed with directions to dismiss Hanstad's punitive damage claim.

## VI.

## THE *BRANDT* FEE AWARD IS UNPROVEN AND EXCESSIVE AND MUST BE REVERSED WITH DIRECTIONS TO ENTER JUDGMENT FOR TRUCK ON THE *BRANDT* CLAIM.

*Brandt* fees (see *Brandt v. Superior Court*, *supra*, 37 Cal.3d 813) are compensatory damages. They are awarded for one reason only: to compensate an insured for an economic loss he actually suffers, namely, the attorneys' fees the insured incurs to obtain contractual policy benefits tortiously withheld. They are limited to fees actually incurred to obtain a *contract* recovery and do *not* include fees incurred in pursuing tort liability and damages.

That the attorneys may have poured more resources into the litigation than their client will ever have to pay is immaterial. Since *Brandt* fees are designed solely to *compensate an insured* for damages—actual economic losses—in the form of legal fees he incurs, such fees can never exceed the amount the insured must pay *under his fee agreement* for obtaining *the contractual recovery*. What the attorney claims to be fair compensation is beside the point.

Here, the amended judgment includes a $404,000 *Brandt* fee, an amount that reflects the hypothesized total value of Hanstad's counsel's complete services calculated through trial, at hourly rates. (RT 3743-3750, 4046-4047, 4253.)[20] This award is illegal in two fatal respects: It is not proven to be limited to the amount Hanstad actually owes counsel, and it is not proven to be limited to the fees incurred in obtaining Hanstad's *contract* recovery (as opposed to his tort recovery). Hanstad failed altogether to introduce evidence —indeed, he prevented the introduction of evidence— that would have established how much he actually owes his counsel.

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20/ Hanstad's stipulated reduction of the economic damages on the bad faith claim (CT 6501, 6711; RT 4455-4456) reduced those economic damages to precisely the $865,897 that Hanstad had asked the jury to award, and that amount included $404,000 in *Brandt* fees. (See RT 4253.)

For these reasons, the *Brandt* fee award must be stricken from the judgment. Since Hanstad failed to sustain his burden of proving a *Brandt* fee entitlement, he is not entitled to retry these damages.

### A. The *Brandt* Fee Award Must Be Reversed Because Hanstad Failed To Prove That It Reflects The Amount He Actually Owes His Attorneys.

*Brandt* held that the attorney's fees an insured incurs to obtain contract benefits due under an insurance policy are an element of compensatory damages recoverable in a tort action for bad faith. The Court reasoned that the insured's legal bills are an expense analogous to medical bills incurred by the plaintiff in a personal injury action:

> "*The attorney's fees are an economic loss — damages — proximately caused by the tort.* [Citation.] These fees must be distinguished from recovery of attorney's fees *qua* attorney's fees, such as those attributable to the bringing of the bad faith action itself. *What we consider here is attorney's fees that are recoverable as damages* resulting from a tort in the same way that medical fees would be part of the damages in a personal injury action." (*Brandt v. Superior Court*, *supra*, 37 Cal.3d at p. 817, italics added.)[21]

A personal injury plaintiff isn't allowed to recover what his doctor *might* have charged, justifiably *could have* charged, or the hypothesized

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21/ As *Brandt* declares:

> "'When a pedestrian is struck by a car, he goes to a physician for treatment of his injuries, and the motorist, if liable in tort, must pay the pedestrian's medical fees. Similarly, in the present case, an insurance company's refusal to pay benefits has required the insured to seek the services of an attorney to obtain those benefits, and the insurer, because its conduct was tortious, should pay the insured's legal fees.'" (*Brandt v. Superior Court*, *supra*, 37 Cal.3d at p. 817, quoting *Austero v. Washington National Ins. Co.* (1982) 132 Cal.App.3d 408, 421.)

value of or going rate for his doctor's services, but only what the doctor did, in fact, charge. So too, an insurance bad faith plaintiff may not recover what his attorney might have charged, justifiably could have charged, or the hypothesized value of or going rate for the attorney's services. Recovery is available only for what the attorney *did in fact charge*.

Here, Hanstad sought and obtained recovery based not on how much he proved he owed his attorneys, but rather on how much time and resources his attorneys put into the case. (RT 3743-3750, 4046-4047, 4253.) That isn't what *Brandt* permits.

Not only did Hanstad fail to prove his *Brandt* case, he precluded proof as to his actual obligation. He successfully resisted Truck's efforts to introduce into evidence the contingency fee agreement between himself and his attorneys. (See RT 3761-3762, 4042-4044.)[22] The result is that Hanstad failed to establish any evidentiary foundation demonstrating any amount he actually incurred for attorneys fees.

*Andre v. City of West Sacramento* (Sept. 25, 2001) 01 Daily Journal D.A.R. 10369 is highly instructive. The court there overturned an award of attorney's fees obtained under Code of Civil Procedure section 1036. The plaintiff, like Hanstad here, had failed to introduce the contingency fee agreement that governed her payment obligations to her

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22/ Truck had the contingency agreement marked for identification, over Hanstad's objection. (RT 4070-4071.) However, Hanstad successfully precluded its receipt in evidence. (RT 4042-4044.) Because the agreement was not received, there is no evidentiary basis for calculating the fees now. Indeed, such a calculation would be precluded because calculating the amount of *Brandt* fees is a matter for the *jury* unless the parties stipulate otherwise, which they have not done here. (See *Brandt v. Superior Court*, *supra*, 37 Cal.3d at p. 819 [*Brandt* fees must be determined by the jury unless the parties stipulate otherwise]; *Campbell v. Cal-Gard Surety Services, Inc.* (1998) 62 Cal.App.4th 563, 571-572 ["The determination of the *amount* of fees must be made by the trier of fact, generally the jury"].) In this case, it would be an exclusive function of the jury to apportion fees between those expended in obtaining contact recovery (recoverable under *Brandt*) and those expended in obtaining tort recovery (not recoverable under *Brandt*).

lawyers. In overturning the award, the Court noted that "Plaintiff did not introduce any evidence at trial to establish the amount of attorney fees she was obligated to pay." (*Id.* at p. 10369.) "To receive an award of fees under section 1036, the court must first determine what fees were actually incurred." (*Id.* at p. 10370.) Without evidence establishing what Andre owed, she was not entitled to an attorney's fee award. (*Id.* at p. 10371.)

The result here should be the same. Since *Brandt* fees are supposed to reflect compensatory economic damages, they must be based on what the plaintiff *actually owes*, something that cannot be determined without the actual fee agreement.

*Brandt*'s purpose is to compensate the insured, not the insured's attorney; it is the *insured* who is the plaintiff; and it is the *insured* (not his counsel) who must be made whole for the fees he incurred in obtaining contract benefits. Hanstad failed to prove the amount he owed.

For this reason, the *Brandt* fee award cannot stand. It must be reversed for failure of proof; this requires a reversal with directions to enter judgment in favor of Truck on the *Brandt* claim.

### B. The *Brandt* Award Must Be Reversed Because Hanstad Failed To Break Out The Fees He Incurred In Obtaining His Contract Recovery, The Only Fees Recoverable Under *Brandt*.

The $404,000 award in *Brandt* fees also is indefensible because Hanstad failed to prove that it reflects the amount of fees incurred in obtaining his contract recovery.

Attorney's fees incurred in obtaining a tort recovery are not recoverable under *Brandt*. As *Brandt* explicitly holds, the recoverable fees are limited to the amount the insured incurs to obtain policy benefits; legal efforts directed at pursuing the tort bad faith claim cannot be awarded:

> "The fees recoverable, however, may not exceed the amount attributable to the attorney's efforts to obtain the rejected

payment due on the insurance contract. Fees attributable to obtaining any portion of the plaintiff's award which exceeds the amount due under the policy are not recoverable."

(*Brandt v. Superior Court, supra*, 37 Cal.3d at p. 819; see *id.* at p. 817 [attorney's fees attributable to bringing the bad faith action are not recoverable].)[23]

Hanstad failed to prove what portion of the fees he incurred were for obtaining recovery of his contract benefits. Indeed, he eschewed any effort to limited his *Brandt* recovery in this required fashion. (See RT 4043, 4070.) Rather, his attorney testified solely to a gross amount he asserted represented the value of his *full* services in the lawsuit to that point (i.e., including prosecution of the $1.3 million tort claim and of the "oppression, fraud, or malice" foundation for the $40 million punitive damage claim) calculated at hourly rates. (RT 3743-3750, 4046-4047, 4253.) When Truck challenged the *Brandt* award in post-trial motions (CT 6737-6759), Hanstad insisted he was entitled to the gross amount and more (CT 6392-6463 [cost memorandum], 6799-6819 [opposition to motion to tax costs]; RT 4450-4454, 4477-4478, 4489-4503).

Hanstad's failure to prove the amount attributable to the recovery of contract benefits renders the *Brandt* fee award invalid. (See *Slottow v. American Cas. Co.* (9th Cir. 1993) 10 F.3d 1355, 1362 [failure to allocate amount of fees allocable to contract recovery as required by *Brandt* equals failure of proof].) Hanstad had every opportunity at trial to introduce evidence directed at proving his permissible *Brandt* entitlement; he refused to prove his case. This mandates that $404,000 be stricken from the

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23/ See, e.g., *Campbell v. Cal-Gard Surety Services, Inc., supra*, 62 Cal.App.4th at p. 571 ["The court (in *Brandt*) cautioned that the recoverable fees do not extend to fees incurred in pursuing the bad faith claim itself"]; *Burnaby v. Standard Fire Ins. Co.* (1995) 40 Cal.App.4th 787, 792 ["the court made it clear that it was authorizing the recovery of only those fees incurred to obtain the policy benefits that would not have been incurred but for the insurer's tortious conduct, and *not* the fees incurred in prosecuting the tortious breach of covenant claim"].)

judgment, with directions that judgment be entered in Truck's favor as to the *Brandt* claim.

For all the reasons expressed, the $404,000 *Brandt* fee award must be reversed with directions, since Hanstad failed to prove his entitlement to *Brandt* fees in any amount. Moreover, since Hanstad was free to prove (but failed to prove) his claim at trial, he should not be permitted to try again. (See Section II(D), *supra.*) Rather, the *Brandt* fees should be stricken from the judgment and, if any part of this lawsuit is retried, Hanstad should not be permitted to seek *Brandt* fees at the new trial.

## VII.

## BECAUSE BAD FAITH LIABILITY AND COMPENSATORY AND PUNITIVE DAMAGES ARE INEXTRICABLY INTERTWINED, THE ENTIRE TORT BAD FAITH CASE MUST BE RETRIED.

As we have demonstrated, neither the punitive damage award nor the compensatory damage award can stand. In the previous trial, the jury premised its punitive damage award on a finding that Hanstad suffered $2,136,973.20 in compensatory damages. As previously explained, however, the compensatory damage award was unlawfully inflated by $1,173,477.20, consisting of $239,176.20 (duplicative contract damages), $530,301 (conceded reduction in economic tort damages), and $404,000 (*Brandt* fees).

The conjunction of erroneously-determined punitive and compensatory damages requires a retrial of *all* issues, including bad faith liability. A *jury* must determine the appropriate relationship between punitive damages and compensatory damages. (*Liodas v. Sahadi*, *supra*, 19 Cal.3d at p. 284; *Auerbach v. Great Western Bank*, *supra*, 74 Cal.App.4th at p. 1190.) In order to do that meaningfully, the jury must make the determination as to what compensatory damages, if any, are appropriate, and then measure the appropriate punishment based on that calculation.

This compels reversal of the bad faith cause of action in its entirety, i.e., liability as well as damages. It is difficult to conceive how a jury could

intelligently formulate compensatory damages here without redetermining issues going to the heart of the liability question, including, e.g., the reasonableness of Truck's conduct. Whether Truck's conduct was reasonable, unreasonable, mistaken, or something more, is a critical factor in determining whether tort damages, as opposed to merely contract damages, are proper. (E.g., *Chateau Chamberay Homeowners Assn. v. Associated Internat. Ins. Co.* (2001) 90 Cal.App.4th 335, 347 ["before an insurer can be found to have acted tortiously (i.e., in bad faith), for its delay or denial in the payment of policy benefits, it must be shown that the insurer acted *unreasonably* or *without proper cause*" (original italics)]; *Medo v. Superior Court* (1988) 205 Cal.App.3d 64, 68 [punitive damages "must be tied to oppression, fraud or malice *in the conduct which gave rise to liability in the case*" (original italics)].) Oppression, fraud and malice, too, obviously must be retried in light of such evidence, especially since Truck can be subjected to punitive damages only if an officer, director, or managing agent personally committed, authorized or ratified the particular conduct that the jury finds to constitute oppression, fraud, or malice. (Civ. Code, § 3294, subd. (b).)

Here, "the matter of liability is substantially inseparable from that of damages in the present posture of this case. A partial new trial would be prejudicial to [Truck]. A new trial on all issues is thus required." (*Liodas v. Sahadi, supra,* 19 Cal.3d at p. 286; see *id* at pp. 285-286, quoting *Leipert v. Honold* (1952) 39 Cal.2d 462, 466-467 ["even when it appears that the issue of liability was correctly determined, a new trial limited to damages 'should be granted . . . only if it is clear that no injustice will result. [Citations.] . . . [I]t has been held that a request for such a trial should be considered with the utmost caution [citations] and that any doubts should be resolved in favor of granting a complete new trial'"]; *Hamasaki v. Flotho* (1952) 39 Cal.2d 602, 608 [where liability and damages are "inextricably interwoven," a new trial limited to damages would be unfair to defendant].)

## CONCLUSION

The judgment in this case is riddled with prejudicial error. Neither the $40 million punitive damage award nor the $404,000 *Brandt* fee award can stand. Since Hanstad failed to prove he is entitled to punitive damages or *Brandt* fees, the reversal must be coupled with directions to enter a new judgment in Truck's favor as to these claims. Should the Court decide to remand the punitive damage claim for retrial, the remand should encompass the bad faith cause of action (including liability and compensatory damages) in its entirety.

Dated: October 15, 2001

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