

Emotional-distress damages in insurance bad-faith cases

These damages require proving bad faith and that the emotional distress is incidental to economic injury caused by the insurer

By Bill Foster

Insurance is one of the few products that we purchase with the hope of never having to use it. If you're submitting a claim to your insurer, it typically means that something bad has happened. A pipe burst while you were on vacation, you were in a car accident on the commute to work, or a close family member has developed a health condition that requires hands-on care. Whatever the case, it involves stress, urgency, and unexpected expenses. It is emotional and taxing. The last thing that you want to deal with is pushback from your insurer about coverage, much less an outright denial of your claim.

Insureds dealing with the wrongful denial of claims experience a range of negative emotions, from anger to worry to humiliation. The insured is already going through a trying time, experiencing calamity firsthand. When the insurer adds insult to injury by denying the claim, it's easy to feel like a breaking point has been reached. The company that you have paid money to year after year is now refusing to provide the protection and peace of mind that they promised. At the time when they're most needed, the benefits you counted on are being withheld for reasons that make no sense or on a basis that you know is flat-out wrong.

For many years, California law has accordingly recognized that emotional-distress damages are recoverable in bad-faith lawsuits against insurers. Almost every client with a claim against an insurer will have stories to tell about how their insurer's wrongful denial left them unable to pay bills, scrambling to make ends meet, feeling hopeless. As a result, the pursuit of emotional-distress damages will be an early conversation in most insurance bad-faith cases. This article provides an overview of issues that come up in pursuing these claims.

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Damages for wrongful denial of benefits

Insurance policies are contracts between the insured and the insurance company. In exchange for payment of premiums, the insurance company promises to provide certain benefits to the insured. When the insurance company denies these benefits, the insured's primary claim is for breach of contract. The damages that the insured may pursue in a breach-of-contract claim are ordinarily limited to the policy benefits that have been denied, which typically exclude damages for emotional distress. (*Cates Constr., Inc. v. Talbot Partners* (1999) 21 Cal.4th 28, 43.)

But damages are not always limited to policy benefits. In recognition of the special relationship between an insurer and insured, the California Supreme Court has held that every insurance contract contains an implied covenant of good faith and fair dealing that obligates the insurer to refrain from doing anything that prevents the insured from receiving the benefits of the contract. (*Crisci v. Security Ins. Co.* (1967) 66 Cal.2d 425.) An insurer breaches the covenant of good faith and fair dealing when it unreasonably denies an insured's claim for benefits or unreasonably delays in providing benefits due under the policy. If the insurer acts in bad faith, the insured can pursue additional damages, including attorneys' fees, emotional-distress damages, and punitive damages. (*Egan v. Mutual of Omaha Insurance Company* (1979) 24 Cal.3d 809; *Brant v. Superior Court* (1985) 37 Cal.3d 813.)

Establishing bad faith is thus a prerequisite for recovery of emotional-distress damages. But it's not the only requirement: economic loss must also be shown.

The economic-loss requirement

The basic idea behind the economic-loss requirement is that insurance bad-faith claims are fundamentally property-based claims. In alleging an unreasonable denial of benefits, the insured is claiming that the insurer is wrongfully depriving them of their right to property, i.e., benefits owed under the policy. Emotional-distress damages are only recoverable where they are incidental to an economic injury caused by the insurer. As the California Supreme Court has explained, allowing claims against insurers where no economic loss has been shown "would open the door to fictitious claims, to recovery for mere bad manners, and to litigation in the field of trivialities." (*Crisci, supra*, 66 Cal.2d at 434.)

In light of the nature of insurance benefits – which provide protection in the case of misfortune – the denial of benefits alone often results in economic loss. For example, an insured denied long-term care benefits would likely have to pay money out of pocket for medical care that the insurer should be covering. Insureds who are denied disability benefits may struggle to pay their mortgages or maintain car payments. Insureds denied a defense against a lawsuit will have to spend their own money defending themselves. In these cases, the connection between the benefit being denied and the economic harm suffered by the insured is readily apparent.

But economic loss may be less obvious in other situations. The beneficiary of a life insurance policy (e.g., a child) may have certainly appreciated the money they were supposed to receive without necessarily being dependent on it to pay expenses. A homeowner whose claim is delayed for many months before being paid may experience enormous frustration without experiencing obvious economic loss. The general rule is that the "risk of financial loss" is not enough of a predicate for emotional-distress damages. (*Waters v. United Servs. Auto. Assn.* (1996) 41 Cal.App.4th 1063, 1077.) Without more, a delay in payment of benefits does not allow an insured to recover emotional-distress damages, no matter how much frustration the delay may cause.

Waters v. United Servs. Auto. Assn. is the most frequently cited example of the economic-loss requirement. In *Waters*, the insureds spent months negotiating with their insurer over the scope of repairs to their home. The insurer finally agreed to pay the insureds' estimate. Following the payment, the insureds filed suit over the insurer's delays in making payment. While the jury found that the insurer acted in bad faith in delaying its payment, there was no evidence of economic loss because the cost of the repairs had been paid by the insurer before the suit was filed. Although the court acknowledged "the emotional distress [the insureds] suffered as a result of the delay in resolving the dispute," the court explained, "[h]owever real that distress was (and we do not question that it was substantial), it was not 'economic' or 'financial' harm. It did not involve pecuniary loss." (*Waters, supra*, 41 Cal.App.4th at 1080.)

There is one type of economic loss present in almost every bad-faith case: attorneys' fees. Attorneys' fees that an insured incurs in pursuing policy benefits are a form of economic loss sufficient to support an award of emotional-distress damages. (*Delos v. Farmers Group, Inc.* (1979) Cal.App.3d 642, 659.) Thus, regardless of the nature of the benefits being wrongfully withheld, attorneys' fees are a form of economic loss that an insured can point to as a basis for recovering emotional-distress damages. (In *Waters*, the court pointedly noted in a footnote that the plaintiffs had not claimed that the cost of retaining counsel had caused them any economic loss. (*Waters*, *supra*, 41 Cal.App.4th at p. 1081, fn. 15.).)

Insurers' attempts to raise the bar

In likely recognition of the fact that every insured dealing with a wrongful denial of benefits experiences some form of emotional distress, insurers have attempted to raise the bar to limit recovery of emotional-distress damages. Insurers have argued that to be recoverable, the insured must demonstrate that their emotional distress resulted from a substantial economic loss caused by the insurer's conduct. (See, e.g., *Clayton v. United Servs. Auto. Assn.* (1997) 54 Cal.App.4th 1158.) In other words, the insured would not

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only have to prove economic loss, they would also have to show that the economic loss was the direct source of their distress.

Such a showing could significantly raise the bar for recovery of emotional-distress damages. For example, if an insured claimed that their economic loss was primarily in the form of attorneys' fees, they would likely have to show not only their obligation to pay attorneys' fees – which alone should be enough – but also that the obligation to pay attorneys' fees caused some form of hardship that resulted in their emotional distress.

Insurers' attempts to impose this heightened standard have failed. In *Clayton v. United Servs. Auto. Assn.*, the Court of Appeal rejected this very argument. After the jury awarded substantial emotional-distress damages to the plaintiff, USAA appealed, arguing in part that the trial court erred by refusing to instruct the jury that:

> You may award damages for emotional distress only to the extent that you find David Clayton suffered emotion distress as the result of substantial economic loss legally caused by the wrongful conduct of USAA, as required by these instructions.

(*Clayton*, *supra*, 54 Cal.App.4th at 1160, fn. 2.)

In affirming the verdict, the Court of Appeal explained that nothing in California Supreme Court precedent suggested that emotional distress is only compensable where it arises from financial harm directly traceable to the non-payment of benefits. The court explained:

> [P]laintiff in a bad faith case must prove some economic loss as a means of validating the seriousness of his or her emotional distress. Once economic loss is shown, however, the plaintiff is entitled to recover for all emotional distress proximately caused by the insurer's bad faith without proving any causal link between the emotional distress and financial loss.

(*Clayton*, *supra*, 54 Cal.App.4th at 1161.)

In other words, proving that the insurer acted in bad faith and caused economic loss is enough. The insured does not bear the additional burden of connecting their emotional distress directly to the economic loss caused by the insurer's wrongful denial.

Discovery of financial records

Pursuing a claim for emotional-distress damages will invariably lead to discovery requests into the insured's personal finances. Although information related to personal finances is ordinarily protected by constitutional privacy rights, courts generally take the view that the insureds have put this information at issue by seeking to recover emotional-distress damages. Courts often allow the discovery on the theory that the effect of non-payment of benefits differs depending on the financial wherewithal of the insured. (See, e.g., *Welle v. Provident Life & Acc. Ins. Co.* (N.D. Cal. 2013) 2013 WL 5954731, at *2.) As a result, you should expect defense counsel to serve broad discovery relating to your client's financial condition, including statements for bank accounts, credit cards, credit lines, and other documents relating to monthly expenses and income.

This discovery can be quite intrusive, but it's often difficult to limit. In recent years, courts have regularly granted motions to compel production of financial records where insureds make claims for emotional distress. Even where the insured argues that their claim for emotional distress is based only on attorneys' fees, courts have still allowed discovery into the insured's personal finances. (See, e.g., *Brunswick v. Hartford Life & Acc. Ins. Co.* (E.D. Cal. 2011) 2011 WL 5838221, at *2.) Courts have been consistent in limiting discovery of financial information to the time period after the insured made their claim, but when it's been years since the claim was made, even this limitation may still require the insured to produce a considerable amount of documentation. Thus, while you may be able to narrow the requests, it's likely that some form of discovery will be allowed.

In light of the discovery that courts typically allow, it's important to have upfront discussions with your client about what to expect. Some clients decide that they'd rather not disclose years of financial information. Having to turn over the documents feels like too much of an intrusion into their personal privacy. Evidence of wealth can also pose a risk of harm to the case. A client who has significant investment income or owns luxury goods may not be the most sympathetic to the jury. But evidence of hardship that resulted from the insurer's wrongful denial can also be compelling. It may also provide support for a claim for punitive damages by showing that the insured was in a very vulnerable position when their benefits were wrongfully denied. The decision varies by the case, but starting the conversation early on will help you make the best choice.

Payment of past-due benefits

It is not uncommon for a defendant to resolutely maintain that they did nothing wrong, until the lawsuit is filed, at which point they offer an apology. In the case of insurance bad-faith lawsuits, this usually means that the insurer agrees to pay all past-due benefits. To the extent that they are owed under the policy, the insurer may also agree to make monthly payments on an ongoing basis.

At first glance, this tactic may seem to damper a claim for emotional distress. Since the insurer's conduct must have caused an economic loss and the insurer has paid the money owed under the policy, the insured's emotional distress should be water under the bridge, at least according to the insurer. But the decision to pay past benefits most often occurs in cases where the insurer's conduct is especially egregious. And insureds often experience the most acute emotional distress shortly after filing their claim, when the benefits that they expected would be there are wrongfully withheld.

The insurer's claim file will have records of its communications with its insured, and if these records show that the insurer left your client in dire straits, a self-serving apology will get them nowhere. For example, in a recent case, the claim file included emails from our client to her insurer along the lines of:

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"I'm struggling to pay my bills," "I cannot keep up with my expenses," "I really need my payments to start coming to keep up with my medical bills," and "I cannot continue to live at my friend's house." Shortly after we filed suit, the insurer – without having received any new information – suddenly decided to pay all past-due benefits and put our client back on claim. But it was too little, too late. Paying past-due benefits could not make up for the emotional distress that the insurer had already inflicted. And the fact that the insurer reinstated benefits without having received any new information only underscored that it knew all along that what it was doing was wrong. The reinstatement of benefits was only the first step to providing full compensation for all injuries that had been caused by its wrongful denial.

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