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Bad Faith Case Law in Mississippi - Mired in a Linguistic Bog - Reserve Life Insurance Company v. McGee

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BAD FAITH CASE LAW IN MISSISSIPPI — MIRED IN A LINGUISTIC BOG? *Reserve Life Insurance Company v. McGee*, 444 So. 2d 803 (Miss. 1983).

On February 18, 1980, an agent for the Reserve Life Insurance Company went to the home of Mr. and Mrs. Henry McGee at the request of the McGees, to discuss hospitalization insurance for Mr. McGee.[1] McGee, 61 years old, had a third grade education and assembled lawn mower wheels for a living.[2] The insurance agent filled out an application which McGee signed. The application included fifteen "yes" or "no" questions relating to the physical condition and medical history of the applicant,[3] and there was conflicting testimony at trial as to whether the agent read all of the questions to McGee before checking favorable answers.

McGee contended that the agent asked only one question, about his health in general, and that McGee replied that he was in "good" health and had been examined by a physician within the previous five years. The agent classified the applicant's heath as "excellent." The insurance company was authorized to obtain medical information from the physician named by the applicant. The policy was issued to McGee on March 16, 1980; monthly premiums were paid by bank draft.[4]

McGee was hospitalized in September of 1980 for tests and subsequent surgical removal of a cancerous tumor from his bladder. Later in the month McGee filed a claim with the insurance company. The company at that time began an investigation of McGee's medical history. McGee had follow-up surgery in December 1980, then submitted a second claim to the insurance company. By letter dated February 12, 1981, the insurance company informed McGee that the policy was being rescinded based on medical records which revealed that McGee had made at least ten visits to his physician within five years and had been treated on two occasions for transient ischemic attack (slight stroke). The company then attempted to refund the amount of all premiums paid by McGee.[5]

McGee filed suit on April 1, 1981, contending that his claims were covered by the policy which the insurance company had cancelled *ab initio*.[6] The insurance company averred that McGee made

1. Reserve Life Ins. Co. v. McGee, 444 So. 2d 803, 804 (Miss. 1983).
2. Record at 74.
3. *Magee*, 444 So. 2d at 813-14.
4. *Id.* at 804-05.
5. *Id.* at 805.
6. *Id.* at 806.

false statements on the application for insurance and contended that the alleged false statements materially affected the risk to be assumed by the company, thus giving the company the right to cancel the policy under the authority of Section 83-9-11(3) of the Mississippi Code of 1972.[7] A jury trial resulted in a verdict for McGee and an award of $2,416 as proceeds owed under the insurance policy and $158,000 as punitive damages.[8] The Supreme Court of Mississippi affirmed the decision of the trial court.[9]

BAD FAITH LAW AND PUNITIVE DAMAGES IN MISSISSIPPI

Reserve Life Insurance Company v. McGee is only the third case based on breach of insurance contract in which the Supreme Court of Mississippi has upheld an award of punitive damages.[10] The *Reserve Life* case can be said to fall in the category of actions known as "bad faith" cases.[11] Although the Supreme Court of Mississippi has eschewed use of the term "bad faith,"[12] attorneys have accepted the rubric to apply generally to a cause of action involving the liability of an insurance company for extra-contractual damages, including, most particularly, punitive damages.[13]

California courts have been credited with the origin of bad faith law.[14] In the 1968 decision of *Wetherbee v. United Insurance Company of America*[15] and the 1970 decision of *Fletcher v. Western National Life Insurance Company,*[16] the California Court of Appeals held in each case that the insurer's failure to pay disability benefits was a breach of the insurance contract, that said breach sounded in both contract and tort, and that a jury award of punitive damages was proper.[17] In the 1973 case of *Gruenberg v. Aetna*

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7. *Id.* MISS. CODE ANN. § 83-9-11(3) (1972) states: "The falsity of any statement in the application for any policy covered by §§ 83-9-1 to 83-9-21 may not bar the right to recovery thereunder unless such false statement materially affected either the acceptance of the risk or the hazard assumed by the insurer."

8. *Magee*, 444 So. 2d at 804. The agent for the insurance company was also a defendant in the trial court but was nonsuited at the conclusion of the evidence. Record at 209.

9. *Magee*, 444 So. 2d at 812.

10. *See* Freeland & Freeland, *Bad Faith Litigation: A Practical Analysis*, 53 MISS. L.J. 237, 265 and n.159 (1983), for a review of Mississippi cases in which trial court awards of punitive damages were at issue.

11. For an exhaustive list of Mississippi insurance bad faith/punitive damages cases, *see* Blue Cross & Blue Shield of Miss. v. Campbell, 466 So. 2d 833, 846-47 (Miss. 1984), *reh'g denied*, (1985) (Robertson, J., concurring).

12. *Magee*, 444 So. 2d at 807.

13. *See* W. DENTON & W. WALKER, BAD FAITH LITIGATION IN MISSISSIPPI § 1 (1981).

14. Hughes, *Standard Life Insurance Company of Indiana v. Veal: A Perspective Look at Punitive Damages in Mississippi*, 1 MISS. C. L. REV. 21, 21 (1978).

15. 265 Cal. App. 2d 921, 71 Cal. Rptr. 764 (Cal. Ct. App. 1st Dist. 1968).

16. 10 Cal. App. 3d 376, 89 Cal. Rptr. 78 (Cal. Ct. App. 4th Dist. 1970).

17. These cases were decided in derogation of the traditional concept of limited recovery for breach of insurance contract, wherein damages are limited to the amount of the policy, in other words, only the damages forseeable at the execution of the contract. Miller, *Overview of the Problem of Bad Faith and Punitive Damages*, 15 FORUM 194, 195 (1979).

Insurance Company,[18] the California Supreme Court held that "when the insurer unreasonably and in bad faith withholds payment of the claim of the insured, it is subject to liability in tort."[19] The *Gruenberg* test of reasonableness was adopted by the California courts, and upon proof of unreasonableness (bad faith), a broad range of extra contractual compensatory and punitive damages became available to the California plaintiff-insured. Dollar amounts as high as $630,000 were awarded as punitive damages.[20]

The large verdicts awarded in the California bad faith cases rapidly caught the attention of trial lawyers across the country, and the California cases have undisputedly affected insurance law in this state. It has become customary for a complaint in a case brought by insured against insurer to include a prayer for punitive damages.[21] A manual entitled *Bad Faith Litigation*[22] has been published as a practical handbook for Mississippi attorneys representing potential plaintiffs and defendants in such actions, and the topic is a popular one for articles in professional journals[23] and seminars.[24]

Long before the California bad faith cases were decided, however, it was well established in Mississippi that punitive damages may be awarded in an action based on breach of contract if the breach is accompanied by conduct constituting a tort for which punitive damages are recoverable.[25] The traditional rule in Mississippi is that "[p]unitive damages are not recoverable for breach of contract unless such breach is attended by some intentional wrong, insult, abuse or gross negligence which amounts to an independent tort."[26] Damages in breach of insurance contract cases are generally limited to the amount due under the policy and, in some situations, interest on that amount.[27]

In 1977 the Mississippi Supreme Court recognized for the first time that an insurance company's arbitrary refusal to pay proceeds under an insurance contract could in and of itself be an intentional

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18. 9 Cal. 3d 566, 510 P.2d 1032, 108 Cal. Rptr. 480 (1973).

19. *Id.* at 575, 510 P.2d at 1038, 108 Cal. Rptr. at 486.

20. Allen, *Insurance Bad Faith Law: The Need for Legislative Intervention*, 13 PAC. L.J. 833, 846-47 (1982).

21. Hughes, *supra* note 14, at 22.

22. W. DENTON & W. WALKER, Bad Faith Litigation in Mississippi (1981).

23. *See, e.g.*, Minor, *Proving Bad Faith of An Insurer*, TRIAL, Aug. 1984, at 17; Walker, *Properly Limiting the "Arguable Reason" Defense to the Independent Tort of Bad Faith*, VOIR DIRE, Nov.-Dec. 1982, at 14.

24. *See, e.g.*, P. Minor, *The Tort of Bad Faith, Jewels of the Practice: "Tips of the Trade,"* Miss. Trial Lawyers' Ass'n Seminar (May 31, 1985).

25. D. L. Fair Lumber Co. v. Weems, 196 Miss. 201, 16 So. 2d 770 (1944).

26. Lincoln Nat'l Life Ins. Co. v. Crews, 341 So. 2d 1321, 1322 (Miss. 1977); Progressive Casualty Co. v. Keys, 317 So. 2d 396 (Miss. 1975); D. L. Fair Lumber Co. v. Weems, 196 Miss. 201, 16 So. 2d 770 (1944); American Railway Express Co. v. Bailey, 142 Miss. 622, 107 So. 761 (1926); Hood v. Moffett, 109 Miss. 757, 69 So. 644 (1915).

27. State Farm Mut. Auto. Ins. Co. v. Bishop, 329 So. 2d 670, 673 (Miss. 1976).

wrong constituting an independent tort. In the landmark decision of *Standard Life Insurance Company of Indiana v. Veal*,[28] the court concluded that the insurance company's refusal to pay the legitimate claim in that case amounted to an independent tort, and punitive damages were assessed against the insurance company.[29]

The *Veal* court began its discussion of the question of punitive damages with the admonition that "punitive damages are assessed as an example and warning to others and should be allowed only with caution and within narrow limits."[30] In *Veal,* the insurer denied a claim for credit life insurance proceeds, originally basing its denial on reasons contrary to the express terms of the insurance contract, and the court stated that the insurer had "no reason whatever to justify its action."[31] The court recognized the inequality of bargaining positions of insurer and insured, setting out its philosophy as follows:

> This case demonstrates the necessity of awarding punitive damages when an insurance company refuses to pay a legitimate claim, and bases its refusal to honor the claim on a reason clearly contrary to the express provisions of its own policy. If an insurance company could not be subjected to punitive damages it could intentionally and unreasonably refuse payment of a legitimate claim with veritable impunity. To permit an insurer to deny a legitimate claim, and thus force a claimant to litigate with no fear that claimant's maximum recovery could exceed the policy limits plus interest, would enable the insurer to pressure an insured to a point of desperation enabling the insurer to force an inadequate settlement or avoid payment entirely.[32]

The court added the now often quoted words of caution: "Of course, if an insurance company has a legitimate reason or arguable reason for failing to pay a claim, punitive damages will not lie . . . ."[33]

In 1979 the Supreme Court of Mississippi for the second time upheld a jury award of punitive damages in an insurance bad faith case. In *Travelers Indemnity Company v. Wetherbee,*[34] punitive damages were assessed against a fire insurer for "tortious breach of contract."[35] Alluding to the imbalance in bargaining positions which favors the insurance company in prolonged settlement negotiations, the court concluded that the punitive damages in-

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28. 354 So. 2d 239 (Miss. 1977). It should be noted that this decision was a four-four affirmance; Justice Bowling abstained because he had tried the case below.

29. *Id.* at 248. The court did not name the tort, but the appellation "bad faith tort" has been suggested by interested writers. W. DENTON & W. WALKER, *supra* note 13, at 33-34; Freeland & Freeland, supra note 10, at 238.

30. *Veal*, 354 So. 2d at 247.

31. *Id.* at 248.

32. *Id.*

33. *Id.*

34. 368 So. 2d 829 (Miss. 1979).

35. *Id.* at 833.

was properly granted due to unreasonable delay on the part of the insurance company in arriving at settlement, the delay being in complete disregard for the express terms of the policy.[36] The court surmised that the insurer's nonpayment was based purely on economic gain and, citing *Veal*, labeled the nonpayment "intentional withholding . . . a gross breach, the equivalent of an independent tort."[37]

In both *Veal* and *Wetherbee*, the Mississippi Supreme Court closely analyzed the individual fact situations to determine the sufficiency of the evidence in support of punitive damages. In each case the court found an "independent tort," but without elaboration. The elements of the tort were not defined; neither was the tort given a name. No precise guidelines were set out for the evaluation of the merits of a bad faith insurance claim. Although not articulating a set of rules, the court adopted a method of reviewing independently the facts of each insurance bad faith case to determine justification for the imposition of extra-contractual damages.

Lawyers and legal writers in Mississippi have asked the court to clarify the law in this area,[38] urging the court to delineate the legal principles governing the "arguable reason" test of *Veal*. They have made proposals for the logical trial court analysis of bad faith cases, submitting that the determination of whether the insurance company had an arguable reason for failing to pay the claim is one for the trial court to make.[39] Of primary interest has been the question of when the plaintiff-insured becomes entitled to have the issue of punitive damages submitted to the jury.[40]

ANALYSIS

In *Reserve Life*, Justice Bowling, writing for the court, acknowledged the controversy surrounding the principles announced in *Veal*. He stated that "[t]he difficulty seems to be in determining who makes the decision whether or not the insurance company has a 'legitimate reason' or an 'arguable reason' for failure to pay the claim."[41] He then set out a multiple-step procedure to be followed by trial courts in the resolution of insurance bad faith cases.[42]

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36. *Id.* at 834.
37. *Id.* at 835.
38. *Magee*, 444 So. 2d at 808.
39. *See supra* note 10, § IV.
40. *Magee*, 444 So. 2d at 808.
41. *Id.* at 809.
42. *Id.* at 809-10.

Ideally, according to the majority opinion, the trial court should first determine at the conclusion of the evidence "whether or not, as a question of law, the insurer had a legitimate or arguable reason to deny payment of the claim."[43] If the court determines that the insurer had a legitimate or arguable reason to deny payment, the jury is to be given the sole question of the insurer's contractual liability on the policy. No punitive damages instruction is to be submitted to the jury in that event.

The majority opinion continued by stating that if "the trial court determines that as a matter of law it cannot hold that the insurer had a legitimate and arguable defensive position, but [the trail court can determine] that the evidence constituted disputed facts as to whether or not such situation existed, then the trial court should submit that issue to the jury."[44] Thirdly, the trial court should then "make a determination as to whether or not the evidence is sufficient to submit a punitive damages instruction to the jury under the guidelines set out in *Veal* . . . ."[45]

After setting forth this one-two-three-step procedural approach, the majority elaborated on the decision of the trial court, noting in summary that the evidence on the record of the *Reserve Life* case clearly presented a jury question as to whether the insurance company had an arguable excuse for denial of the insured's claim; that is, whether the insured made a false statement on the insurance application which materially affected the risk to be assumed by the insurer. Additionally, the majority approved the submission of the punitive damages instruction to the jury. The court found that the evidence supported the action of the jury in granting punitive damages to the insured as well as proceeds under the insurance policy.[46]

Justice Robertson, joined by Justice Prather and joined in part by Presiding Justice Walker, specially concurred with the holding of the majority, affirming the punitive damages judgment of the trial court but rejecting the majority view that a jury issue existed on the question of the insurance company's liability under the policy. He concluded that McGee was entitled to a directed verdict on the issue of Reserve Life's liability on the insurance contract, stating that he would hold as a matter of law that where an insurance applicant executes an authorization for his physi-

43. *Id.* at 809.
44. *Id.*
45. *Id.* at 810.
46. *Id.* at 810-12.

cian to release medical information to the insurance company, the company is charged with knowledge of whatever information could be obtained from the physician upon investigation.[47]

Justice Robertson submitted that the majority position was logically inconsistent, creating a "linguistic bog."[48] He stated that if there were a jury question as to the insurer's liability under the policy, it would follow that a defense had been raised which could be classified as legitimate or arguable, and thus the issue of punitive damages should not have been submitted to the jury. Recalling the arguable reason test of *Veal,* Justice Robertson stated, "If the evidence is such that a reasonable *jury* could find facts which would undergird a successful policy defense, the same evidence surely would justify a reasonable *insurance company* in so concluding."[49]

Justice Robertson suggested that the punitive damages issue should be submitted to the jury only in the event that the plaintiff-insured is entitled to a peremptory instruction on his claim on the insurance contract. Stated in simple terms, if doubt as to contractual liability is sufficient to make it a jury issue, there is no reason for the insurer to be punished for delaying payment and presenting a defense. He urged the court to adopt this position, a position to which Alabama subscribes.[50]

He further advocated that in all bad faith tort cases where the trial court holds that there is sufficient evidence to support the submission of the punitive damages issue to the jury, the court should use the special verdict provided under Rule 49(b) of the Mississippi Rules of Civil Procedure. Separate questions should be made of the fact issues of the insurer's policies and defenses and of the tort and punitive damages questions. When this procedure is followed, the supreme court is able to make a final disposition of the case on appeal.[51]

Presiding Justice Walker, joined by Presiding Justice Broom,

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47. *Id.* at 815-16.

48. *Id.* at 815.

49. *Id.* at 816.

50. *Id.* at 817. Justice Robertson quoted from Nat'l. Sav. Life Ins. Co. v. Dutton, 419 So. 2d 1357, 1362 (Ala. 1982):

> In the normal case in order for a plaintiff to make out a prima facie case of bad faith refusal to pay an insurance claim, the proof offered must show that the plaintiff is entitled to a directed verdict on the contract claim and, thus, entitled to recover on the contract claim as a matter of law. Ordinarily, if the evidence produced by either side creates a fact issue with regard to the validity of the claim and, thus, the legitimacy of the denial thereof, the tort claim must fail and should not be submitted to the jury.

For a list of bad faith cases decided in Alabama, *see* Blue Cross & Blue Shield of Miss. v. Campbell, 466 So. 2d 833, 844 (Miss. 1984), *petition for reh'g denied,* (1985) (J. Hawkins on petition for rehearing).

51. *Magee,* 444 So. 2d at 818.

dissented from the majority holding in *Reserve Life,* calling the punitive damages award of $158,000 "wholly unjustified"[52] and further stating that "[i]f there were ever a case where the insurance company had an arguable reason to refuse payment of the claim of $2,416.00, this is one."[53] He joined Justice Robertson in the view that if the issue of the insurer's liability on the policy were one for the jury then as a matter of law the issue of punitive damages should not have been submitted to the jury.[54]

Justice Walker inserted a practical note, stating that the general public as insurance policyholders will eventually bear the cost of punitive damages assessed against insurance companies, and he urged legislative action which would limit the amount of damages awarded to "actual expenses received in bringing suit plus double or triple the sum found to be due under the policy. Such a procedure would provide an adequate remedy to policyholders who had a legitimate claim against a recalcitrant insurance company."[55]

CONCULSION

The right of a plaintiff-insured to collect punitive damages from a defendant-insurer where there is a tortious breach of insurance contract has now clearly been established in Mississippi. The Supreme Court of Mississippi has stated that it will analyze carefully the factual situation in each individual case and will not allow punitive damages if the insurance company has an arguable reason for denying the claim. The *Reserve Life* case is only the third insurance bad faith case in which a judgment of punitive damages has been affirmed by the court. This suggests that punitive damages will be allowed only in those cases where the court finds grossly inequitable conduct on the part of the insurance company sufficient to justify drastic punishment. The result in the *Reserve Life* case was approved by seven justices who obviously believed that the action of the insurance company in withholding payment was clearly wrongful and deserving of punishment.

In *Reserve Life* the Mississippi Supreme Court attempted to delineate the principles of insurance bad faith law as first propounded in the seminal case of *Standard Life Insurance Company of Indiana v. Veal.*[56] In so doing, however, the majority of the court approved a procedural method which could be inter-

52. *Id.* at 819.
53. *Id.*
54. *Id.*
55. *Id.*
56. 354 So. 2d 239 (Miss. 1977).

preted to indicate that the court would allow the jury first to determine the disputed contractual liability and then, if the matter is resolved in favor of the plaintiff-insured, proceed to assess the defendant-insurer with punitive damages for raising a defense to the contractual claim. Such an interpretation would mean that the jury could be in a position to give the unsuccessful insurance company what is referred to in sports circles as the "old one-two punch."

Justices Robertson and Prather criticized the language of the majority opinion and maintained that the rule followed by the Alabama Supreme Court is correct – the court, not the jury, should determine if there are grounds to punish the insurer-defendant. Under these justices' theory, punitive damages should never be considered by the jury unless there is contractual liability *as a matter of law.* Under the Alabama rule, the trial judge stands at the door of the jury room and, having directed a verdict on the contractual claim, determines if the jury is to consider tort liability.

There are now a number of bad faith/punitive damages cases pending before the Mississippi Supreme Court, and trial lawyers look for more procedural discussions from the court regarding this area. Insurance bad faith law continues to be in a state of flux as it develops, and other changes may be expected in the semantics of the court and its procedural methods.[57]

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57. In Blue Cross & Blue Shield of Miss. v. Campbell, 466 So. 2d 833 (Miss. 1984), *petition for reh'g denied,* (1985), a case which interestingly did not involve an award of punitive damages, the Mississippi Supreme Court reviewed and elaborated on the punitive damages guidelines set out in the majority holding in *Reserve Life.* Justice Hawkins, writing for the majority of the court on the denial of the petition for rehearing, summarized the thrust of the *Reserve Life* procedural steps:

> When the presentation of all evidence has been completed by both sides, it is the function and responsibility of the trial court to determine whether the insurance carrier had a reasonably arguable basis, either in fact or in law, to deny the claim. If he finds there was a reasonably arguable basis to deny the claim, then the plaintiff is not entitled to have the jury consider any "bad faith" award against the insurance company.
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> Any plaintiff asking for punitive damages, or any special or extraordinary damages based upon "bad faith" of an insurance company has a heavy burden.

Blue Cross, 466 So. 2d at 842.

Justice Hawkins further stated that "in the vast majority of cases" there will be no bad faith question submitted to the jury unless a directed verdict on the insurance claim is made in favor of the plaintiff-insured, but the majority of the court is not prepared to state that as an absolute rule. *Reserve Life* was cited as an example of the type of case which would not have fallen within such a rule. He stated that the court would also not set forth the converse as an absolute; that is, it does not necessarily follow that when a plaintiff-insured is given a directed verdict on the contractual liability, he will automatically be entitled to a punitive damages instruction to the jury. *Id.* at 843.

Justice Robertson, joined by Justices Prather and Anderson, wrote a concurring opinion to the denial of the petition of rehearing, calling the majority opinion in *Blue Cross* a "substantial step out of the murky bog of the Step One-Two-Three formulations of *Reserve Life.*" *Id.* at 856. He set out what he believes the bad faith law ought to be in Mississippi, basically reiterating his concurring opinion from *Reserve Life* and urging the court to go further in setting out the substantive and procedural guidelines for trial judges to follow in bad faith cases.