Texas Supreme Court Sets Punitive Damages Standards

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Texas Supreme Court sets punitive damages standards

In *Transportation Insurance Co. v. Moriel*, 1994 WL 246568 (Tex.), the Supreme Court of Texas clarified standards governing the imposition of punitive damages awards in bad faith insurance cases. The court held that insurers will be liable for punitive damages only if bad faith is accompanied by gross negligence. In addition, the court explained that a plaintiff must show to establish gross negligence, and announced new procedural standards for punitive damages awards. The court required courts to separate the determination of the amount of punitive damages from the other issues at trial, and mandated that courts of appeals which review the factual sufficiency of punitive damages awards explain why the evidence does or does not support the award.

Insurance carrier delays paying bills

In March 1986, Juan Moriel was injured when a stack of countertops fell on him. He sustained fractures of the wrist, pelvis, and ribs. Transportation Insurance Company (Transportation), Moriel’s employer’s workers’ compensation carrier, paid his hospitalization costs. Several days after his discharge from the hospital, Moriel experienced periods in which he was unable to move his leg. He returned to the hospital for testing. Six weeks following his accident, Moriel discovered he was impotent. After tests conducted in El Paso revealed no physical cause for the impotence and hormone therapy failed to cure the problem, doctors advised Moriel to undergo additional testing at a Houston hospital. Doctors in Houston found Moriel’s impotence to be at least partially physical. They also recommended that Moriel seek counseling for emotional problems. Moriel did so and eventually was able to resume sexual relations with his wife.

Transportation delayed paying four of Moriel’s bills. The company received a $3,155 bill for Moriel’s Houston tests in November 1986. Although Transportation had authorized the tests in advance, it did not pay Moriel’s bill for more than two years, on the ground that Moriel’s impotence was unrelated to his work injury. Second, Transportation delayed paying Moriel’s $2,075 psychiatric counseling bill for more than a year, claiming that it had never received the psychiatrist’s report. Third, the company delayed paying a $382.25 bill for outpatient testing. It paid only after the hospital filed a collection action against Moriel. Finally, Transportation did not pay the bill for the El Paso tests until after Moriel filed his lawsuit. Evidence indicated, however, that because the El Paso company had mailed the bill to the wrong address, Transportation did not receive it until after the lawsuit commenced.

While he was undergoing testing and treatment, Moriel filed a workers’ compensation claim against Transportation. In July 1987, he received an award of $30,022.77 from the Industrial Accident Board. When Transportation appealed, Moriel counterclaimed for additional compensation, unpaid medical bills, and bad faith claims practices. In July 1988, Moriel and Transportation settled the workers’ compensation claim.

At the trial on the bad faith claim, the jury found that Transportation had no reasonable basis to delay paying Moriel’s medical bills, and that Transportation had “acted with heedless and reckless disregard” of Moriel’s rights. The jury awarded Moriel $1,000 in actual damages, $100,000 in mental anguish damages, and $1 million in punitive damages. The trial court entered judgment on the verdict, and denied Transportation’s motions for judgment notwithstanding the verdict, remittitur,
and a new trial. The court of appeals affirmed the trial court’s decision.

**Court rules punitive damages not precluded by Workers’ Compensation settlement**

The partial judgment setting forth the settlement of the workers’ compensation claim stated that the extent of injury and liability for compensation or medical expenses was uncertain. Transportation argued that this statement prevented the trial court from finding conscious indifference on Transportation’s part. The company claimed that because of this, Moriel’s right to pursue a claim for punitive damages was extinguished.

The Texas Supreme Court disagreed. The court found the partial judgment to indicate only that Transportation’s total liability was uncertain. The statement did not constitute a finding that Transportation’s liability for any or every medical bill was uncertain. In addition, Moriel’s bad faith contentions were primarily related to the delay in paying the bills. Furthermore, the court found that the partial judgment expressly preserved Moriel’s bad faith and punitive damages claims.

The Texas Supreme Court began its analysis of Moriel’s punitive damages claim by explaining the difference between punitive and compensatory damages. Compensatory damages are awarded to make a plaintiff “whole” for losses incurred as a result of the defendant’s interference with the plaintiff’s rights. Punitive damages, on the other hand, are awarded “to punish the defendant for outrageous, malicious, or otherwise morally culpable conduct.” In addition, unlike compensatory damages, punitive damages are a private windfall to the recipient. Punitive damages therefore require safeguards to minimize the risk that a defendant will be punished excessively or unjustly.

The supreme court next examined the relationship of a claim for punitive damages with underlying claims for breach of contract and bad faith. The court noted that a bad faith case may involve claims for three types of damages: 1) benefit of the bargain damages for a breach of contract claim; 2) compensatory damages for the tort claim of bad faith; and 3) punitive damages for intentional, fraudulent, malicious, or grossly negligent conduct.

Bad faith occurs when a breach of contract is accompanied by an independent tort. One may not establish a bad faith claim merely by showing that there is a dispute about an insurer’s liability on a contract. In addition, bad faith is not established when a jury having the benefit of hindsight decides that the insurer was wrong about the factual basis for denying the claim, or wrong in its interpretation of its policy. To prove a claim of bad faith, the plaintiff must establish that the insurer had no reasonable basis for denying a claim or delaying payment of it, and that the insurer knew or should have known it had no such basis.

The court maintained that even if the insurer had no reasonable basis for denying or delaying payment on the claim, the plaintiff may not recover punitive damages on that basis alone. Bad faith on the part of an insurer justifies an award solely for compensatory damages. Punitive damages are appropriate only when bad faith is accompanied by fraudulent, malicious, intentional, or grossly negligent conduct.

**Court finds punitive damages inappropriate in this case**

The court next analyzed whether Moriel’s evidence sufficiently supported his claim for punitive damages. First, the court examined the definition of gross negligence. The Texas Legislature defined gross negligence as “more than momentary thoughtlessness, inadvertence, or error of judgment. It means such an entire want of care as to establish that the act or omission was the result of actual conscious indifference to the rights, safety, or welfare of the person affected.” Tex. Civ. Prac. & Rem. Code Ann. §41.001(5) (Vernon Supp. 1994). The court stated that gross negligence has two components: 1) the defendant’s act or omission; and 2) the defendant’s mental state.

A finding of gross negligence is warranted only if the evidence indicates that the act was likely to result in serious harm and that the defendant was consciously indifferent to the risk of harm. Conscious indifference may be established by direct or circumstantial evidence. Furthermore, the court declared that in deciding whether a defendant’s act or omission involved a risk of serious harm, the trier of fact must view events from the defendant’s viewpoint at the time the events occurred. A defendant’s behavior, which at the time of its occurrence appeared to create no great danger, will not lead to an award of punitive damages even if grave injuries result.

The court next applied the rules concerning gross negligence to bad faith insurance disputes. It articulated that it is bad faith, but not gross negligence, for an insurer to delay or refuse payment of a claim, even when there is no reasonable basis for doing so. An insurer will be liable for punitive damages only if bad faith is accompanied by gross negligence. An award of punitive damages is justified if it is shown that the insurer was actually aware that its action would likely lead to harm that is not ordinarily associated with breach of contract or the bad faith denial of a claim. Examples of such harm include: death, grievous physical injury, or a genuine likelihood of financial catastrophe.

After applying these two concepts to Moriel’s case, the court determined that the lower court’s award of punitive damages to Moriel was inappropriate. Transportation had conceded that the evidence supported the jury’s conclusion that it acted without any reasonable basis and was therefore liable for bad faith. The court held, however, that
Transportation was not grossly negligent. To establish gross negligence, Moriel was required to prove that 1) Transportation’s actions created a genuine and unjustifiable likelihood that serious harm would befall him; and 2) Transportation was actually aware of this risk. The court found that the evidence supported neither contention.

The only harm that Moriel suffered as a result of Transportation’s delay in payment was the anxiety of knowing that his bills were not paid until the hospital filed a collection action. Though Moriel’s anxiety was legitimate, it did not constitute the serious harm required to justify the award of punitive damages. In addition, the court found that even if Moriel had shown serious harm, he failed to introduce any evidence indicating that Transportation was aware of the probability of it occurring. The court remanded the case for a new trial because the trial in this case occurred before the Texas Supreme Court addressed the standards governing punitive damages in bad faith cases.

*Court announces new procedural standards for punitive damages awards*

The supreme court continued its clarification of Texas law by announcing procedural standards to be applied to all punitive damages cases. In doing so, the court articulated a goal of ensuring that punitive damages awards “are not grossly out of proportion to the severity of the offense and have some understandable relationship to compensatory damages.” In announcing two changes to the procedures by which punitive damages may be sought, the court expressed its belief that the new standards would enhance the fairness and predictability of punitive damage awards, and eliminate some of the arbitrariness of the former system.

First, the court noted that evidence of a defendant’s net worth is generally relevant only to the issue of the amount of punitive damages to be awarded. However, the court recognized that such evidence has the potential to prejudice juries in their determination of other issues in tort cases. Therefore, the court concluded that trial courts, if presented with timely motions, should separate the determination of the amount of punitive damages to be awarded from the other issues in the trial. Using this approach, a jury would first hear evidence relevant to a defendant’s liability for actual damages, the amount of actual damages, and liability for punitive damages. Only if the jury found the defendant liable for punitive damages, would it then be allowed to hear evidence relevant to the amount to be awarded to the plaintiff.

Second, the court emphasized that appellate courts must carefully scrutinize punitive damages awards to ensure that such awards are supported by the evidence. The court had previously held that when reversing a punitive damages award on grounds of insufficient evidence, the court of appeals was required to explain in detail the evidence and its reasons for finding the award erroneous. The Texas Supreme Court stated that a similar type of review was appropriate when affirming punitive damages awards. As a result, it now requires courts of appeals conducting factual sufficiency reviews of punitive damages awards to detail relevant evidence in their opinions and explain why the evidence does or does not support the punitive damages award.

The court then addressed the question of whether trial courts should also be required to articulate reasons for upholding or refusing to uphold punitive damages awards. The court recognized that such a practice would facilitate post-verdict review of punitive damages awards, and urged that such findings be made to the extent feasible. It declined to require the practice, however, citing severely overworked and understaffed trial courts.

*Concurring justices would broaden liability*

The concurrence argued that the majority’s announcement, that punitive damages would be appropriate against an insurance company only in the most drastic of circumstances, gives insurance companies little incentive to provide care and promptness in processing claims. The opinion specifically addressed the majority’s conclusion that “an insurance carrier’s refusal to pay a claim cannot justify punishment unless the insurer was actually aware that its action would probably result in extraordinary harm not ordinarily associated with breach of contract or bad faith denial of a claim.” The concurrence concluded that the practical effect of the majority’s holding would be to eliminate liability for all insurance company conduct, no matter how morally reprehensible or intentionally harmful. The concurrence attacked the vagueness of the term “extraordinary harm,” claiming that courts could interpret it in whatever way necessary to achieve the desired outcome. Furthermore, the concurrence criticized the majority for adding the term “extreme degree of risk” to the definition of gross negligence. The concurrence argued that in adding this new twist, the majority took on a role that is rightly reserved for the legislature.

Additionally, the concurrence criticized the majority for its statements concerning issues which were not raised by the parties. While agreeing that it is prudent to separate the issue of amount of punitive damages from the rest of the issues at trial, the concurrence maintained that this issue was not brought before the court. The same was true for the issues surrounding bad faith. Transportation did not timely challenge its liability on this ground, yet the majority discussed at great length evidentiary requirements for bad faith claims.

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