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Punitive Damage Control

by Philip Willson

In April of 2003, the U.S. Supreme Court decided a punitive damage case that should go a long way in controlling punitive damage judgments. The case involved an insured who caused an accident killing one person and permanently disabling another. His insurer, State Farm, rejected an offer to settle for the $50,000.00 policy limit and ignored its own investigator's advice. The jury awarded a verdict for over three times the policy limit and State Farm refused to appeal. State Farm paid the entire judgment after the Utah Supreme Court denied the appeal filed by the insured. The insured then sued for bad faith.

Previously, the remedy available for an excess award of punitive damages was for the court to order a plaintiff to remit a portion of the punitive damages or accept a new trial. However, the U.S. Supreme Court used a different approach by using a constitutional analysis and held that the due process clause of the Fourteenth Amendment prohibits grossly excessive or arbitrary punishments. The Court held that a grossly excessive award of punitive damages furthers no legitimate purpose, constitutes an arbitrary deprivation of property and is prohibited by the due process clause of the Fourteenth Amendment. Rather than order a plaintiff to remit or accept a new trial, the Court evaluates what the proper award of punitive damages should be and enters judgment for that amount. The Supreme Court ordered the Utah Courts to apply those concepts and stated that under the facts in that case, "... especially in the light of substantial compensatory damages awarded (a portion of which contained a punitive element), likely would justify a punitive award at or near the amount of compensatory damages." The Court also stated that "in practice, few awards exceeding a single-digit ratio between punitive and compensatory damages will satisfy due process."

The decision of the Supreme Court will have substantial influence on state court decisions. However, not every decision that fails to follow these

Are Standard MPCI Arbitration Clauses Enforceable in Iowa?

by Bruce B. Green

In the recent case of <u>Heaberlin Farms, Inc. v. IGF Insurance Company</u>, the Iowa Supreme Court ruled that the arbitration provisions contained in federally-reinsured MPCI policies are enforceable in Iowa. This decision should aid federal crop insurers in compelling arbitration of factual disputes in Iowa and elsewhere.

In <u>Heaberlin</u>, the producer filed a prevented planting claim with IGF. IGF denied the claim after determining the cause of loss was the annual flooding of the Red Rock Reservoir, a condition excluded from coverage under the standard MPCI policy language. The producer sued in state district court.

IGF filed a motion to compel arbitration, relying on the policy language. The district court refused to compel arbitration. IGF appealed. On appeal, the case turned on whether the Federal Arbitration Act (FAA) preempted Iowa law, which prohibits the enforcement of arbitration agreements contained in "adhesion contracts".[1] Adhesion contracts are standardized contracts drafted by a more economically powerful party and offered to a weaker party on a "take it or leave it" basis. The FAA requires courts to enforce arbitration provisions in contracts "involving commerce". There is no exception under the FAA for adhesion contracts.

The Iowa Supreme Court found that the FAA applied since the sale of federal crop insurance involves interstate commerce. Since the FAA makes no exceptions for adhesion contracts, the FAA preempts Iowa law on this issue. Thus, the arbitration clause contained in the standard MPCI policy is enforceable.

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The Department of Labor Proposes New Wage and Hour Rules

by M. Brett Ryan

Many wage and hour claims brought under the federal Fair Labor Standards Act (FLSA) focus on the employers' classification of employees as exempt from minimum wage and overtime requirements. Specifically, the employee demands overtime pay, while the employer says the employee's position is exempt. Both employers and employees should be aware that the United States Department of Labor (DOL) has proposed new regulations that, if implemented, would change the rules for classifying employees as exempt or non-exempt.

The DOL introduced the proposed regulations on March 31, 2003, and sought comments until June 30, 2003. The DOL is currently considering the comments before enacting the final form. At this time, the proposed regulations are not yet enacted, and the extent to which they may be changed before enactment is unknown.

Most employer-employee relationships are governed by the FLSA as well as applicable state laws. Under the FLSA, all hours worked in excess of 40 in any workweek are overtime hours and must be compensated at a rate of not less than 1½ times the employee's regular rate of pay -- unless the employe is exempt from the FLSA's overtime requirements. The FLSA lists five primary types of employees who are exempt from minimum wage and overtime rules. Three of them, the so-called "white collar exemptions," are for "executive," "administrative," and "professional" employees. The two other exemptions are for "outside sales persons" and "computer professionals."

Under current law, to be exempt, an employee's job must satisfy a salary level requirement and be a job with duties and responsibilities consistent with exempt status (generally an employee with "decision making" authority). Under the proposed regulations, the three white collar exemptions, the compensation test, and duties test would be modified.

According to the DOL, if the proposed regulations are implemented, 1.3 million employees currently exempt would no longer qualify for an exemption. As a result, those employees would be entitled to overtime pay for all hours worked in excess of 40 hours.

The most significant change could be an increase in the salary threshold to be eligible for a white collar exemption. Currently, one of the requirements for exempt status is having a salary of at least $250.00 per week, or roughly $13,000.00 per year. The proposed regulations would raise the threshold to $425.00 per week, or roughly $22,100.00 per year. Therefore, an employee receiving a salary of less than $22,100.00 could not qualify for a white collar exemption and would be entitled to overtime pay for hours worked in excess of 40 per week.

The proposed regulations also include other changes to the currently law. First, there are new provisions regarding application of the exemptions to what the DOL refers to as "borderline occupations, such as pilots, athletic trainers, funeral directors, insurance salespersons, loan officers, stock brokers, and hotel sales and catering managers.

Second, executive employees, in order to be exempt, must have authority to hire or fire other employees, or at least have authority to make suggestions that are given particular weight by supervisors who make hiring, firing, or other decisions regarding employment.

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guidelines can be reviewed by the U.S. Supreme Court. Thus, in cases where there is a substantial risk of runaway punitive damages, it is probably advisable to remove the case to federal court, if possible, since federal courts are bound by the U.S. Supreme Court decision.

Two recent court decisions have considered the U.S. Supreme Court analysis of punitive damages. In April, a Federal District Court in Cedar Rapids reviewed a jury verdict in a case claiming fraud by Amana Company in connection with termination of a distributor. The Court reduced the award of $18,000,000.00 in punitive damages to $10,000,000.00, representing 4.76 times compensatory damages and 3% of the manufacturer's net worth. Similarly, in May, the Arkansas Supreme Court considered a punitive damage award of $63,000,000.00 in a wrongful death suit against a nursing home on behalf of a 93 year old woman with Alzheimer's disease who was a patient in the defendant nursing home. The compensatory damage award of $15,000,000.00 was reduced to $5,000,000.00 and the punitive damage award of $63,000,000.00 was reduced to $21,000,000.00. These two cases show that courts have considerable discretion in determining an appropriate ratio between compensatory and punitive damages.

It is assumed that after this U.S. Supreme Court decision, the ratios between compensatory and punitive damages will be much smaller than what

An Insurer's "Right" to Reimbursement of Defense Costs

by Jamie L. Cox

The general rule is that, absent an agreement to the contrary, an insurer that defends under a traditional reservation of rights (i.e., where the insurer agrees to defend the insured but reserves its right to contest coverage and deny indemnification) may not recover defense costs from its insured upon a later determination of no coverage. However, a novel issue arises of whether a defending insurer can reserve not only its right to contest coverage, but also its "right" to recoup the amounts it paid to defend the insured prior to the determination of no coverage? Iowa courts have not considered the issue. However, several courts have decided the issue, creating excepting to the general rule.

California courts were the first to consider the issue, finding that the existence of an "agreement" to reimburse defense costs where an insurer simply asserted its right to reimbursement in a reservation of rights letter issued upon acceptance of the defense, and the insured accepted payment of its legal fees without comment. North Atlantic Casualty & Surety Ins. Co. v. William D. One court even found the requisite "agreement" where, although the insured objected to the purported reservation, the insured impliedly agreed to it by accepting payment of defense costs. Walbrook Ins. Co. Ltd. v. Goshgarian. Courts in several other states, including Colorado and Minnesota, have adopted this broad exception. First Fed. Svgs. & Loan Ass'n of Fargo v. Transamerica Title Ins. Co.; Knapp v. Commonwealth Land Title Ins. Co., Inc.

However, in Buss v. Superior Court, the California Supreme Court put an end to the notion that by virtue of a reservation of rights letter, an insurer could create a right to be reimbursed for defense costs. The Buss court distinguished between covered and uncovered claims, holding: (1) an insurer may not seek reimbursement for potentially covered claims; (2) an insurer may seek reimbursement for claims that are not even potentially covered, if the insurer expressly reserves the right to seek such reimbursement; and (3) the insurer bears the burden of proving which specific defense costs it is entitled to recover.

Buss thus limited the right of reimbursement to the scope of the duty to defend. The court reasoned that under a comprehensive general liability (CGL) policy, the insurer has a duty to defend the insured against claims that are at least potentially covered because the insurer has been paid premiums and bargained to bear the defense costs. By contrast, the insurer has not duty under the policy to defend against claims that are not even potentially covered because the insurer was not paid premiums and did not bargain to bear the defense costs. When an insurer defends against those claims, it is entitled to restitution for the unjust enrichment of the insured, who obtained a free defense of uncovered claims.

The reaction to Buss has been mixed. For example, in Shoshone First Bank v. Pacific Employers Ins. Co., the Wyoming Supreme Court declined to follow Buss and held that because an insurer ahs a duty under a CGL policy to defend the entire action, it is liable for all defense costs. In Texas Ass'n of Counties County Gov't Risk Mgt. Poll v. Matagorda County, the Texas Supreme Court followed Shoshone, and rejected Buss, in the course of denying an insurer's claim for reimbursement of the costs of settling an uncovered claim.

Curiously, some courts, while purporting to follow Buss, have acted like Buss didn't change anything. Citing both Buss and pre0Buss California case law, an Illinois court held that an insurer's reservation of rights letter created a right to reimbursement of all defense costs. Grinnell Mutual Reinsurance Co. v. Shierk. A Florida court mixed the reasoning of Buss and other cases in finding that a reservation of rights letter, combined with the insured's acceptance of the defense, created an agreement to reimburse the insurer for the defense of clearly uncovered claims. Colony Ins. Co. v. G & E Tires & Service, Inc. Finally, other courts, including Connecticut, have correctly interpreted Buss and followed it. See, e.g., Ranger Ins. Co. v. Covach.

Whether Buss's distinction between potentially covered and clearly uncovered claims will become the rule in Iowa remains to be seen.

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Third, the current reqquirement that administrative employees regularly exercise discretion and independent judgment would be eliminated. A new provision would require that administrative employees hold a "position of responsibility."

Finally, to qualify for the professional exemption, an employee would not be required to have completed specific minimum educational requirements, such as earning a specialized four-year degree, but could instead possess and use equivalent knowledge acquired through work experience.

It is important to keep in mind that the proposed regulations are not final. You should contact your attorney for more information.

However, the question that remains unanswered in Heaberlin is whether the standard arbitration language is "unconscionable". If it is, it may be unenforceable, even under the FAA.

Unconscionable contract terms are terms that a person in his or her right mind (and not under any delusions), would not agree to, and no honest person would accept. They are so lopsided that they are harsh or oppressive to the other party to the contract.

Recently, Judge Bennett of the U.S. District Court for the Northern District of Iowa refused to compel arbitration under the FAA because the arbitration clause was both procedurally and substantively unconscionable (Faber v. Menard, Inc.). Specifically, Judge Bennett ruled that an arbitration clause contained in an employment agreement was unconscionable because the employee had to pay his or her attorney fees as well as one half of the arbitration fees.

At first blush, this ruling may seem to pose problems for crop insurers (since producers are responsible for hiring their own attorneys and paying a share of the arbitration costs). However, the anti-discrimination statutes at issue in Faber provided for the shifting of litigation costs and attorney fees from successful employees to unsuccessful employers. In other words, the court would not permit the employer to override the remedies recoverable under federal law through an arbitration clause. The Federal Crop Insurance Act (FCIA) and regulations, however, contain no fee or cost shifting provisions. In fact, the standard policy language and regulations prohibit the recovery of attorney fees and costs under most circumstances. Thus, the Faber decision most likely will not limit enforcement of the standard MPCI arbitration provision.

Practice Tip: When moving to compel arbitration of MPCI disputes, insurers should argue preemption under the FAA **and** the FCIA. The FCIA may prevent the insured from arguing that the arbitration clause is unconscionable. However, the insurer should still be ready to address claims of unconscionability, especially claims attacking the insureds' obligation to pay filing fees, attorney fees and costs.

1 Surprisingly, IGF did not argue to the trial court that the Federal Crop Insurance Act preempted Iowa law and, thus, the Iowa Supreme Court refused to address this issue on appeal.

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