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Does *Egan*'s "managing agent" rule survive 40 years later?

MOST INSURANCE BAD FAITH CASES INVOLVE A FIGHT OVER THE MANAGERIAL STATUS OF THE EMPLOYEES WHO DENIED THE INSURED'S CLAIM

Forty years ago, the California Supreme Court upheld a punitive-damage award against an insurer based on the acts of a claims adjuster in denying a single claim. Because the adjuster had the authority to "dispose of insureds' claims with little if any supervision," he was deemed a "managerial" employee whose wrongful acts could be imputed to the insurer for purposes of imposing punitive damages. (*Egan v. Mutual of Omaha Insurance Company* (1979) 24 Cal.3d 809, 823.) The ramifications of this holding were enormous for the insurance industry. Any employee with the authority to deny a claim – of any size – was now considered "managerial" and could subject an insurer to liability for punitive damages.

Increasingly, however, insurers are challenging *Egan*'s precedential value. The addition of the "managing agent" requirement to the punitive damages statute, Civil Code section 3294, and subsequent decisions of the California Supreme Court, they argue, have significantly weakened *Egan* and call into question its conclusion that a claims adjuster's conduct with respect to a single claim can subject an insurance company to punitive-damages liability.

In this article, we examine the validity of these arguments not only to determine if the *Egan* managing agent rule is still good law, but more broadly, to gain some clarity into what a plaintiff in an insurance bad faith case must do to satisfy the statutory "managing agent" requirement in section 3294.

The *Egan* decision

Egan involved an insurance bad-faith claim against Mutual of Omaha Insurance Company ("Mutual") based on the conduct of two employees – McEachen, a claims manager, and Segal, a claims adjuster – in denying an insured's disability income claim. The facts were severe. McEachen was "aware of plaintiff's good faith efforts to work" following back-related disabling injuries but nevertheless visited the plaintiff at his home and told him he was not entitled to any disability payments because he was "a fraud" who was only seeking benefits "because he did not want to return to work." (*Egan*, *supra*, 24 Cal.3d at 821.) When the plaintiff expressed concern that he needed money for the upcoming Christmas holiday and offered to submit to an examination by a physician of Mutual's choice, "McEachen only laughed, reducing plaintiff to tears in the presence of his wife and child." (*Ibid*.)

Segal, meanwhile, departed from company protocol by making no effort to contact the plaintiff's physicians in reviewing his disability claim. Based solely on his own review of the medical records, Segal "told [the plaintiff] that he was not incapacitated from an accidental injury but from a 'sickness' that could not qualify under the policy's total disability provision." (*Ibid*.) Despite the lack of medical support for denying the plaintiff's disability claim, Segal put the plaintiff to the Hobson's choice of a "final check" under the policy's sickness provision "or a larger check if plaintiff would surrender the policy." (*Id*. at 821-822.) On the basis of this evidence, the court had little trouble concluding that Seagal and McEachen satisfied the standard for awarding punitive damages, i.e., they "acted maliciously, with an intent to oppress, and in conscious disregard of the rights of its insured." (*Id*. at 822.)

But Mutual advanced an alternative ground for reversal on the issue of punitive damages, namely, that the actions of McEachen and Segal could not be imputed to it because neither McEachen nor Segal were "managerial employees" involved in "high-level policy making." The Supreme Court rejected this argument, concluding that, under "the Restatement rule regarding assessment of punitive damages against a principal" followed in California at the time, an insurer's liability for punitive damages should not turn on any official title, but on whether either of its two employees acted in a "managerial capacity." This in turn depended on the "degree of discretion the employees possess in making decisions that will ultimately determine corporate policy." (*Egan, supra,* 24 Cal.3d at 822-823.)

The Supreme Court concluded that both McEachen and Segal worked in a managerial capacity and thus that punitive damages were properly assessed against Mutual. The court noted that McEachen's business card identified him as a manager-level employee. Further, McEachen "had ultimate supervisory and decisional authority regarding the

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disposition of all claims . . . processed through the Los Angeles office," including the plaintiff's claim. (*Ibid.*)

Unlike McEachen, Segal, a lower-level claims adjuster, was not employed at the managerial level. But again, Segal's title was not determinative. What mattered was that, as the claims adjuster responsible for the day-to-day handling of the plaintiff's disability claim, Segal possessed "broad discretion" with respect to the disposition of that claim. Such disposition constituted an "ad hoc formulation of policy," and thus Segal's actions, like McEachen's, could be imputed to his employer. (*Ibid.*)

"Ad hoc" is a Latin phrase meaning literally "for this." In English, it generally signifies a solution designed for a specific problem or task, non-generalizable, and not intended to be able to be adapted to other purposes. In using this language, therefore, *Egan* exposed insurers to punitive damage awards not only for the conduct of lower-level claims adjusters like Segal, but for the conduct of such employees *with respect to a single claim or file*.

The addition of the "managing agent" requirement and the Supreme Court's decision in *White*

The year after *Egan* was decided, the Legislature amended section 3294, to add subdivision (b). It reads:

> An employer shall not be liable for [punitive] damages … based upon acts of an employee of the employer, unless the employer had advance knowledge of the unfitness of the employee and employed him or her with a conscious disregard of the rights or safety of others or authorized or ratified the wrongful conduct for which the damages are awarded or was personally guilty of oppression, fraud, or malice. 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.

(Emphasis added.)

The express purpose of subdivision (b) was to "limit[ ] the circumstances under which an employer could be held liable for punitive damages 'based upon acts of an employee.'" (*College Hospital Inc. v. Superior Court* (1994) 8 Cal.4th 704, 712-713.) In particular, with respect to corporate employers, the Legislature's goal was to distinguish ordinary respondeat superior liability from the higher standard of corporate liability for punitive damages. (*Weeks v. Baker & McKenzie* (1998) 63 Cal.App.4th 1128, 1150-1151.)

In the ensuing years, the appellate courts struggled to define which employees counted as "managing agents" for determining corporate punitive-damage liability under subdivision (b). Then, in 1999, the California Supreme Court decided *White v. Ultramar, Inc.* (1999) 21 Cal.4th 563. In *White*, a manager (Salla) fired the plaintiff, a convenience store employee. The jury awarded plaintiff both compensatory and punitive damages.

In affirming, the Supreme Court concluded that, in amending section 3294, "the Legislature intended the term 'managing agent' to include only those corporate employees who exercise substantial independent authority and judgment in their corporate decision making so that their decisions ultimately determine corporate policy." (*White*, *supra*, 21 Cal.4th at 566-567.) Put another way, in order "to demonstrate that an employee is a true managing agent under section 3294, subdivision (b), a plaintiff seeking punitive damages would have to show that the employee exercised substantial discretionary authority over *significant aspects of a corporation's business*." (*Id.* at 577.)

Applying this standard, the Court held that Salla's mere supervision of the plaintiff and ability to fire him did not make Salla a managing agent. However, the Court found that Salla, who was responsible for eight stores, covering sixty-five employees, was a "managing agent." Salla "exercised substantial discretionary authority over vital aspects of Ultramar's business that included managing numerous stores on a daily basis and making significant decisions affecting both store and company policy." (*Ibid.*)

Egan vindicated or a *Major* fizzle?

Egan permitted the imposition of punitive damages against an insurance company based solely on a lower-level claim adjuster's discretionary authority over a single claim. That outcome appears inconsistent, on its face, with *White*'s narrower test for imputing a corporate employee's conduct to the corporation for purposes of punitive damages. Under *White*, only the conduct of those employees who broadly determine "corporate policy" and whose decisions affect "significant aspects of a corporation's business" can be imputed to the corporation. (*White*, *supra*, 21 Cal.4th at 566-567, 577.)

In addition, *Egan* was decided before the punitive damages statute was amended to include the "managing agent" requirement. That amendment was specifically designed to limit corporate exposure to punitive damages, and to distinguish ordinary respondeat superior liability from corporate liability for punitive damages. On the surface, at least, *White* and the new "managing agent" requirement seemed to weaken *Egan*'s conclusion that a claims adjuster's "malicious" mishandling of a single claim could subject an insurance company to punitive damages.

On the other hand, *White* was an employment case, not an insurance bad-faith case. It can be argued that the managing agent issue in the insurance setting is sui generis, that is, it is a unique issue that requires a unique solution given the quasi-public nature of insurance, its protective purpose, and the vulnerability of claimants. "The special relationship between the insurer and the insured illustrates the public policy considerations that may support exemplary damages in cases such as this." (*Egan, supra*, 24 Cal.3d at 820.)

Furthermore, nothing in *White* indicates an intention to overrule *Egan*. To the contrary, *White* cites *Egan* with

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approval and affirms *Egan*'s central holding that punitive damages are properly assessed against a corporate employer "who has vested the offending employee with substantial discretionary authority over decisions that ultimately determine corporate policy." (*White*, 21 Cal.4th at 575-576.) Thus, plaintiffs continued to rely on *Egan*, with success, in the decade after *White* was decided. Insurers sued for bad faith failed to capitalize on *White* and the amendments to the punitive damages statute and in many cases failed to even make the argument that *White* and the amendments worked a departure from *Egan*.

It was not until 2009 that a reviewing court would even formally address *White*'s impact on bad-faith cases. In *Major v. Western Mut. Ins. Co*. (2009) 169 Cal.App.4th 1197, the court was called upon to determine whether a claims adjuster's "discretionary authority to pay or not pay benefits" was "sufficient for the jury to find she was a managing agent." (*Id*. at 1220.)

In concluding that the claims adjuster was a managing agent, the Court of Appeal came down solidly in favor of *Egan*. The court squarely rejected the defendant's contention that *White* and the amendments to the punitive damages statute changed the punitive-damages calculus and rendered *Egan* obsolete. The court noted that *White* itself concluded the amendments to the punitive-damages statute "did *not* alter *Egan's* definition of managing agent as 'those employees who exercise substantial independent authority and judgment over decisions that ultimately determine corporate policy.'" (*Id*. at 1221, quoting *White*, *supra*, 21 Cal.4th at 573). Accordingly, neither *White* nor the amendments to the punitive-damages statute disturbed *Egan*'s holding that "claims managers that exercise substantial discretionary authority to pay or deny claims exercise 'substantial discretionary authority over decisions that ultimately determine corporate policy.'" (*Major*, *supra*, 169 Cal.App.4th at 1221, quoting *White*, *supra*, 21 Cal.4th at 577).

Less than six months after *Major* was decided, the pendulum swung again. In *Roby v. McKesson* (2010) 47 Cal.4th 686, the Supreme Court further refined and narrowed the "managing agent" inquiry in the context of an employment case arising out of allegations of workplace harassment. In concluding that a supervisor who personally participated in the plaintiff's harassment was not a managing agent of the corporate defendant, McKesson, the Court explained:

> When we spoke in *White* about persons having "discretionary authority over . . . corporate policy," we were referring to *formal policies* that *affect a substantial portion of the company* and that *are the type likely to come to the attention of corporate leadership*. It is this sort of broad authority that justifies punishing an entire company for an otherwise isolated act of oppression, fraud, or malice.

(*Id*. at 714-715, citation omitted; emphasis added.)

The Court had little trouble concluding that the supervisor in question, Schoener, lacked the sort of "broad authority" needed to confer "managing agent" status. Critical to the Court's analysis was that, "[a]t the time of [the plaintiff]'s termination, McKesson had over 20,000 employees; Schoener worked at a local distribution center supervising four of them." (*Id*. at 714.) The Court emphasized that "a corporate defendant cannot be punished for harassment merely because one of its employees has harassed another employee in the workplace; rather, the focus of the punitive damages inquiry must be on the corporation's institutional responsibility, if any, for that harassment." (*Ibid*.)

Still, the Court determined that punitive damages were properly assessed against McKesson based on what "McKesson's more senior managers knew and did." (*Id*. at 715.) Specifically, the plaintiff complained about Schoener's harassing conduct to McKesson's "midlevel managers," who "thereafter continued to employ Schoener as [the plaintiff]'s supervisor without taking any corrective measures …, thus warranting punitive damages." (*Ibid*.) McKesson did not dispute that the midlevel managers to whom the plaintiff complained were "managing agents."

More recently, in *Victaulic Co. v. American Home Assurance Co.* (2018) 20 Cal.App.5th 948, the court suggested that a particular managing-agent jury instruction requested by the plaintiff in the insurance context "might be problematic," albeit in dicta. (*Id.* at 960, fn. 1.) The proposed instruction provided that, "[i]f an employee has substantial independent authority to pay or deny a claim for benefits under an insurance policy, then that individual is a managing agent for the purpose of awarding punitive damages.'" (*Id.* at 960.) The court acknowledged that the instruction was supported by *Egan*, but expressed concern that *Egan* could not be reconciled with the Supreme Court's "more recent" pronouncement in *Roby* that "[o]nly persons with discretionary authority to determine *formal* corporate policy affecting a substantial portion of the company are 'managing agents' within the meaning of [Civil Code] §3294(b).'" (*Id.* at p. 960, fn. 1.)

Moving forward: Rely on *Egan* but also look beyond the conduct of claims adjusters

As the foregoing demonstrates, litigation of most insurance bad faith cases will involve a fight over the managerial status of the employees who made the decision to deny the insured's claim. While certain cases may involve denials that result from a truly formalized corporate policy (e.g., a health insurer's formalized position that a given treatment is "investigational" and excluded from coverage), this will be the exception and not the rule. In addressing the managing agent issue, counsel for the insured should take a belt-and-suspenders approach: rely on the continued vitality of *Egan* but also develop facts showing that employees above the claims adjuster, e.g., managers and supervisors, failed to take action or made decisions that affected the claims-handling process.

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A strong argument can be made that the *Egan* rule survives *Roby*. *Roby* is based on and reaffirms *White*. And although *Roby* does not formally cite to *Egan*, its citation to *White* for the proposition that the punitive-damages inquiry should focus on employees who "exercise[s] substantial discretionary authority over decisions that ultimately determine corporate policy" tracks *Egan*'s central holding. (Compare *Roby, supra*, 47 Cal.4th at 714 with *Egan, supra,* 24 Cal.3d at 822-823.)

Additionally, *Egan* and the appellate decision (*Major*) following it, involve the unique insurer/insured relationship and the insurer's obligation to treat its insured fairly and in good faith. ("The insured in a contract like the one before us does not seek to obtain a commercial advantage by purchasing the policy – rather, he seeks protection against calamity." (*Egan* at 819.) The public policy reasons underlying the creation of this obligation and the deterrent nature of punitive damages give strength to the argument that an adjuster's authority to deny a claim is tantamount to the authority to set corporate policy. As cogently explained in *Egan*,

> It must be remembered that we are here concerned with an insurance company dealing in disability insurance, not just any corporation. Manifestly, to plaintiff, (the claims representative's) actions were actions of defendant. (The claims representative) personally managed the most crucial aspects of his employer's relationship with its policyholders. Defendant should not be allowed to insulate itself from liability by giving an employee a nonmanagerial title and relegating to him crucial policy decisions.

(*Egan*, *supra*, 24 Cal.3d at 823, citation omitted.)

Nonetheless, plaintiff's counsel should not ignore *Roby*'s explicit directives on what is meant by the making of "corporate policy." The policy must be "*formal*"; it must affect a *"substantial part of the company"*; it should be of the type "*likely to come to the attention of the corporation's leadership*." (*Roby*, *supra*, 47 Cal.4th at 714-715.) "Formal" policies, by definition, are typically created with the goal of application across a broad scope of situations. (See *Cruz v. HomeBase* (2000) 83 Cal.App.4th 160, 167-168 ["'[C]orporate policy' is the general principles which guide a corporation, or rules intended to be followed consistently over time in corporate operations. A 'managing agent' is one with substantial authority over decisions that set these general principles and rules."].) "Formal" policies, in other words, are the antithesis of what *Egan* defined as "ad hoc formulations of policy" – specific, one-time policy pronouncements made by claims adjusters who "maliciously" mishandle a single claim.

Accordingly, counsel should pay heed to *Roby*'s admonition to examine what the claims adjuster's "more senior managers knew and did." (*Roby*, *supra*, 47 Cal.4th at 715.) That was the approach taken by the plaintiff in *Mazik v. GEICO General Insurance Company* (2019) 35 Cal.App.5th 455. In *Mazik*, the Court of Appeal concluded that a regional liability administrator, who had broad authority over the settlement of a large number of claims, qualified as a "managing agent" to support an award of punitive damages against GEICO General Insurance Company ("GEICO"). The court affirmed the trial court's decision approving punitive damages of one million dollars to the plaintiff for GEICO'S bad-faith conduct in handling an underinsured motorist claim. GEICO was found to have approved unreasonably low settlement offers to the plaintiff that ignored medical records showing the serious and permanent nature of his injuries.

Mindful of *Roby*, the plaintiff in *Mazik* did not attempt to defend the lower court's decision on the ground that the claims adjusters who worked on his file were the managing agents of GEICO. (*Mazik*, *supra*, 35 Cal.App.5th at 457.) Instead, the plaintiff argued that Grothen, a regional liability administrator for GEICO whose territory covered Orange County, Los Angeles, San Bernardino and Alaska, was a managing agent based upon his broad regional authority over adjusters and managers in cases up to $100,000.

The Court of Appeal agreed, concluding that the evidence established that Grothen "exercise[d] substantial independent authority and judgment" in his corporate decision-making such that his "decisions ultimately determined corporate policy." (*Id*. at 458.) The Court noted that Grothen had wide regional authority over claims settlements, over 100 claims adjusters were "funneled up" to him for approval of settlements, and he typically had 18 to 20 meetings per day with claims adjusters seeking his approval or direction for handling claims. (*Id*. at 458-459.) Further, Grothen testified that an extremely important part of his role was to maintain consistency in settlement valuations within his region. (*Id*. at 459.) The Court found that a jury could have "reasonably concluded that this type of broad decision-making responsibility for establishing GEICO's settlement standards ultimately determined corporate policy." (*Ibid*.)

Conclusion

Defense counsel will argue that the addition of the "managing agent" requirement to section 3294 and intervening decisions of the California Supreme Court have eroded the precedential value of *Egan*. Plaintiff's counsel should continue to rely on *Egan* but should also follow the approach taken by the plaintiff in *Mazik* and look closely at the conduct of any managers or supervisors directly involved in the claims-handling process or in setting claims-handling policy. This belt-and-suspenders approach will decrease the chances of losing a punitive-damage verdict in a post-trial motion or appeal.

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