Insurability of Punitive Damage Awards

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1. Current Status of Insurability of Punitive Damage Awards

Once a defendant is subjected to an award of punitive damages, it may choose to look to its insurance carrier to pay that award on its behalf. In assessing whether or not the insurer has a duty to indemnify its insured against such damages, the natural inclination would be to ask whether or not the state has decreed whether it is against public policy to insure against punitive damages. However, as with any insurance coverage analysis, the starting point should be the insurance contract itself. If the policy specifically states that there is no coverage for an award of punitive damages, the inquiry stops there. It is only when the policy is silent on that issue that the decisions, statutes and public policy declarations become relevant.

In that regard, whether or not its insurer will have a duty to indemnify its insured against an award of punitive damages depends on the specific jurisdiction in which coverage for the award is sought. At the time of this writing, there is a split in jurisdictions between those states whose courts hold that punitive damages are insurable versus those who hold they are not insurable. In addition, there are a variety of nuances which complicate the issue such that a clean dividing line is not always possible. As the Supreme Court of Texas noted in 2008:

> The cases defy easy categorization, but it appears that: 19 states generally permit coverage of punitive damages; 8 states would permit coverage of punitive damages for grossly negligent conduct, but not for more serious conduct; 11 states would permit coverage of punitive damages for vicariously-assessed liability, but not directly-assessed liability; 7 states generally prohibit an insured from indemnifying himself against punitive damages; and the remainder have silent, unclear, or otherwise inapplicable law. States may fall into more than one category.

Fairfield Ins. Co. v. Stephens Martin Paving, L.P., 246 S.W.3d 653, 688 (Tex. 2008)

Some states have addressed this issue by statute.[1] But as noted above, one must consider the language of the insurance policy itself – some policies expressly provide coverage for punitive damages while others do not. The policy language will prevail, so long as it is not inconsistent with any statute. But what if the policy is silent on the insurability of punitive damages? If a policy covers an insured for "losses" or "damages" in general, without specific reference to

[1] See, e.g., Montana Code Annotated 33-15-317: "Insurance coverage does not extend to punitive or exemplary damages unless expressly included by the contract of insurance." Ohio Revised Code Section 3937.182 states that no insurance policy for automobiles, motor vehicles, casualty, or liability insurance covered by sections 3937.01 through 3937.17 of the Revised Code shall provide coverage for judgments or claims against an insured for punitive or exemplary damages.

punitive damages, a court is likely to hold that there is coverage for such damages to the extent permitted by law.

Further, there is an additional nuance which forces one to look at the state's substantive law concerning the basis for a punitive damage award as that too may impact the insurability issue. It is of course beyond the scope of this paper to offer an in-depth analysis as to how the courts of each state have addressed this issue. Instead, the focus will be on relevant recent decisions of various jurisdictions.

A. Punitive Damages Held Insurable

The majority rule appears to be that unless expressly prohibited by the terms of the insurance contract itself, or by statute, an award of punitive damages is insurable. In at least 18 states, the highest court has determined that insurance coverage for punitive damages does not violate public policy. Those states are: Arizona, Arkansas, Delaware, Georgia, Idaho, Iowa, Kentucky, Maryland, Mississippi, Montana, New Mexico, North Carolina, Oregon, Tennessee, Vermont, West Virginia, Wisconsin and Wyoming. Case law in North Carolina is clear that punitive damages are insurable unless there is specific language excluding punitive damages rather than a general exclusion of "penalties." The North Carolina statute also specifically permits the exclusion of punitive damages from insurance policies. G.S. 58-41-50(a) states that "with respect to liability insurance policy forms, an insurer may exclude or limit coverage for punitive damages awarded against its insured."

In 11 states, and the District of Columbia, courts and/or legislatures have held that punitive damages assessed directly against a policyholder, as opposed to an agent or employee, are insurable. Those states are: Alabama, Alaska, Connecticut, Hawaii, Louisiana, Michigan, Missouri, New Hampshire, South Carolina, Texas and Virginia (see, e.g., Virginia Code §38.20227: "It is not against public policy of the Commonwealth for any person to purchase insurance providing coverage for punitive damages arising out of the death or injury of any persons as the result of negligence, including willful and wanton negligence, but excluding intentional acts.")

In general, the courts that have found in favor of insurance coverage for punitive damages have done so on the basis that (1) the presence of insurance coverage has no impact on the deterrent effect of punitive damages, (2) the expectation of the insured that the policy will cover all awarded damages must be honored, and (3) the acceptance of the premium estops the insurer from denying coverage that arguably exists in the insurance contract.

B. Punitive Damages Held Not Insurable

A large number of jurisdictions hold the view that punitive damages are not insurable. In most cases, this is due to public policy concerns, specifically, the reluctance to allow a tortfeasor to escape personal responsibility for reprehensible conduct by shifting the loss to the insurer. Usually, punitive damages are awarded only if there has been proof of intentional bad acts, and

most insurance policies also exclude coverage for damages caused by intentional acts of the insured. This is usually accomplished by a straight-forward exclusion or by defining an "occurrence" to exclude damages that are "expected or intended from the standpoint of the insured." If the conduct that caused the damages was intentional, then any damages related to that conduct are excluded, including both compensatory and punitive damages.

In Wolfe v. Allstate Prop. & Cas. Ins. Co., 790 F.3d 487 (3d Cir. 2015), the court noted Pennsylvania's longstanding rule that a claim for punitive damages against a tortfeasor who is personally guilty of outrageous and wanton misconduct is excluded from insurance coverage as a matter of law. Public policy does not permit a tortfeasor to shift the burden of punitive damages to his insurer. This rule is based on the view that punitive damages are not intended as compensation. They are, rather, a penalty, imposed to punish the defendant and to deter him and others from similar outrageous conduct. Socially irresponsible drivers who are guilty of reckless and grossly offensive conduct on the highways should not be allowed to escape the personal punishment of punitive damages. To permit insurance against the sanction of punitive damages would be to permit such offenders to purchase a freedom of misconduct altogether inconsistent with the theory of civil punishment which such damages represent. Furthermore, shifting punitive damages to insurers would result in insurers pricing up policies to factor in drivers who behave egregiously.

California, Colorado, and New York have similar prohibitions on the indemnification of punitive damages, and those states' highest courts have similarly held that an insured cannot shift to the insurance company its responsibility for a punitive damages award entered against it.

In California, there is no statute which *per se* excludes coverage for a punitive damage award. Rather, one must reach that conclusion through the following analysis. Punitive damages can only be imposed pursuant to the standards set forth in Civil Code §3294:

> (a) In an action for the breach of an obligation not arising from contract, where it is proven by clear and convincing evidence that the defendant has been guilty of oppression, fraud, or malice, the plaintiff, in addition to the actual damages, may recover damages for the sake of example and by way of punishing the defendant.

The statute then goes on to describe what is meant by "malice" (conduct which is intended by the defendant to cause injury to the plaintiff or despicable conduct which is carried on by the defendant with a willful and conscious disregard of the rights or safety of others); "oppression" (despicable conduct that subjects a person to cruel and unjust hardship in conscious disregard of that person's rights) and "fraud" (an intentional misrepresentation, deceit, or concealment of a material fact known to the defendant with the intention on the part of the defendant of thereby depriving a person of property or legal rights or otherwise causing injury.)

From there, we move to Insurance Code §533: "An insurer is not liable for a loss caused by the wilful act of the insured; but he is not exonerated by the negligence of the insured, or of the insured's agents or others." California courts have thus pieced this mosaic of statutes together to reach the conclusion that punitive damages are not insurable because by statute, such an award

can only be based on a wilful act of the insured (see, e.g., PPG Industries, Inc. v. Transamerica Ins. Co., 20 Cal. 4th 310 (1999)).

New York law clearly prohibits insurers from indemnifying punitive damages assessed against insured entities (see, e.g., Zurich Ins. Co. v. Shearson Lehman Hutton, Inc., 84 N.Y.2d 309, 319, 642 N.E.2d 1065, 618 N.Y.S.2d 609 (N.Y. 1994) (discussing "New York's unambiguous policy against insurance coverage for punitive damages").

C. Conduct-Related Issues

In some jurisdictions, whether or not an award of punitive damages is insurable depends on the underlying basis for the award. For example, in Williamson-Green v. Interstate Fire & Cas. Co., 2017 Mass. Super. LEXIS 70, 2017 WL 3080559 (Mass. Super. 2017), the trial court noted that while the common-law rule had long been that an insurance policy indemnifying an insured against liability due to an intentional wrong was void as against public policy, that rule has been modified and superseded by statute. The general insurance statute now provides "that no company may insure any person against legal liability for causing injury, other than bodily injury, by his deliberate or intentional crime or wrongdoing." (G.L.c. 175, §47, cl. Sixth (b)). Thus, the statute allows insurers to indemnify insureds for liability arising from grossly negligent or reckless misconduct, and thus would allow insurers to pay for punitive damages based on a defendant's gross negligence or recklessness.

Despite the statutory prohibition against insurability of punitive damage awards, multiple Ohio state and federal courts have ruled that "Ohio law does not prohibit insurance coverage of punitive damages in all cases." Foster v. D.B.S. Collection Agency, No. 01-CV-514, 2008 WL 755082 (S.D. Ohio, March 20, 2008) (citing The Corinthian v. Hartford Fire Insurance Company, 143 Ohio App.3d 392 (8th Dist. 2001). The determination of whether a punitive damages award is insurable is based on the grounds upon which punitive damages were awarded. For example, if the award is based on a finding of malice or ill will, public policy prohibits insurance coverage of those damages. Ohio courts also have consistently held that because punitive damages are assessed for punishment and not compensation, "a positive element of conscious wrongdoing is always required."

The decision reached by a Texas Court of Appeal in Tesco Corp. (US) v. Steadfast Ins. Co., 2014 Tex. App. LEXIS 9682 provides an interesting analytical framework. There, punitive damages were imposed on an insured as a result of its gross negligence. The court noted that in order to determine whether punitive damages for gross negligence are insurable, it must consider whether (1) the plain language of the policy covers the punitive damages awarded in the underlying lawsuit and (2) Texas public policy allows or prohibits coverage under the circumstances of the case. As to the language of the policy, the court observed that under the CGL liability policy issued to Tesco, Steadfast agreed to pay "those sums that [Tesco] becomes legally obligated to pay as damages because of 'bodily injury' or 'property damage' to which this insurance applies." The coverage applied to "bodily injury" caused by an "occurrence" that takes place within the "coverage territory," during the "policy period." Thus, the policy obligated Steadfast to pay "those sums" that Tesco "becomes legally obligated to pay as damages" arising out of bodily-injury claims. The court then concluded: "There is no language in the Policies making any

distinction as to the types of damages covered or expressly excluding coverage for punitive damages. Steadfast could have included an express exclusion from liability for punitive damages, but it did not. [citation]. Thus, we conclude that the plain language of the policies covers the punitive damages awarded against Tesco in the underlying lawsuit."

The court then turned to the public policy issues. In that analysis, the court focused on the purpose behind prohibiting insurance coverage for punitive damages – permitting a wrongdoer to escape from the consequences of his abhorrent conduct. The court then applied that public policy to situations in which punitive damages are imposed against a corporation – does it make sense to "punish" a corporation by forcing it pay a punitive damage award in every situation, without exception? When the insured is a corporation, courts applying Texas law have rejected, on public policy grounds, allowing insurance coverage for punitive damages where the facts of the case demonstrate "extreme circumstances" where "avoidable conduct" by one or more corporate employees causes injury. On the other hand, "when the insured is a corporation or business that must pay exemplary damages for the conduct of one or more of its employees," and "other employees and management are not involved in or aware of an employee's wrongful act, the purpose of exemplary damages may be achieved by permitting coverage so as not to penalize the many for the wrongful act of one." This being a summary judgment case, the case was remanded for further proceedings relevant to the degree of the corporate insured's culpability.

A final issue to consider is that some states that prohibit insurance for punitive damages distinguish between direct and vicarious liability. Those states that disallow insurance for punitive damages often do not apply the public policy prohibition to punitive damages imposed on a person or organization for the actions of another. In other words, punitive damages vicariously imposed may not be against public policy to insure, even in those states that have concluded that punitive damages are uninsurable for direct liability.

In Minnesota, for example, insurance coverage for punitive damages is not available as a matter of public policy. However, there is a statutory exception for insuring vicarious liability for punitive damages. (Minn. Stat. § 60A.06, subd. 4.) Thus, it is possible that an agent could be left uninsured for its punitive damage award, while leaving its principal protected. Under Connecticut law, direct punitive damages are uninsurable, while vicariously assessed punitive damages are insurable Bodner v. USAA, 610 A.2d 1212 (Conn. 1992). In Florida, public policy prohibits insurance coverage for a punitive damage award based on an insured's active wrongdoing, yet not for its vicarious liability First Specialty Ins. Co. v. Caliber One Indemnity Co., 988 So.2d 708, 712-713 (Fla. 2d DCA 2008).

2. Impact of Punitive Damage Allegations on Defense Issues

When a complaint contains allegations of punitive damages against an insured, and the insurer agrees to provide its insured with a defense due to the potentially covered claims which do not trigger a right to punitive damages, a number of issues are raised concerning that defense.

One issue is whether or not the mere allegation of punitive damages triggers the right for the insured to be defended through "independent counsel," in those states which recognize that right. The California Legislature has addressed that head on – the mere allegation of punitive damages

does not, in and of itself, create a right to independent counsel. Civil Code §2860, California's independent counsel statute, provides: ". . . [n]o conflict of interest shall be deemed to exist as to allegations of punitive damages or be deemed to exist solely because an insured is sued for an amount in excess of the insurance policy limits." Thus, the insurer may appoint "panel counsel" to defend the insured in the action, even though the insured will be personally responsible for satisfying any punitive damage award. Alaska has a similar statute (Alaska Stat. § 21.89.100 (1997)).

The general consensus is that despite the fact that a punitive damage award may not be insurable, the interests of the insured and the insurer are nevertheless aligned for the purpose of completely defeating the plaintiff's claim. See, e.g., 1 Windt, Insurance Claims & Disputes §4.20 at 376-77, noting that since, under those circumstances, the interest of the insured and the insurer would parallel each other with respect to the plaintiff's claims for compensatory damages, the fact that the insured might be liable for additional damages would not create a conflict of interest between the insured and the carrier.

This was the view taken by the court in Pennbank v. St. Paul Fire & Marine Ins. Co., 669 F. Supp. 122 (W.D. Pa. 1987), where the insured argued that the request for punitive damages mandated the appointment of independent counsel. The court rejected that argument:

> The interests of insurer and insured in defense of the underlying suits were the same -- prevent a finding of liability or failing that, minimize damages. Punitive damages can only be awarded where compensatory damages have been awarded and the punitives must have some relation to the compensatory award. [citation] For St. Paul to admit outrageous, intentional and reckless conduct on the part of its insured, or to fail to vigorously defend such charges, would guarantee a large award of compensatory damages as well as punitive damages.
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> Any award of punitive damages would necessarily occasion the overwhelming likelihood of a large compensatory award. Both parties shared the desire to prevent a finding which would justify punitive damages. For this reason, the rationale in Cumis is inapplicable here.

A similar result was reached in National Cas. Co. v. Forge Indus. Staffing, Inc., 567 F.3d 875 (7th Cir. 2009), wherein the court noted that "in defending Forge's actions generally, NCC would necessarily be protecting Forge's interests with respect to both compensatory and punitive damages. See Vill. of Lombard v. Intergovernmental Risk Mgmt. Agency, 288 Ill. App. 3d 1003, 681 N.E.2d 88, 95, 224 Ill. Dec. 106 (Ill. App. Ct. 1997) ("the compensatory and punitive damages sought in the underlying suit arise out of the same factual occurrence" and did not present a actual conflict). Thus, the court held that the potential for massive punitive damages requests in future litigation did not give rise to an actual conflict warranting the appointment of independent counsel.

Courts in both New York and New Jersey appear to reach a contrary conclusion, as exemplified by the recent federal court decision in Med-Plus, Inc. v. Am. Cas. Co. of Reading, 2017 U.S. Dist. LEXIS 123553. In that case, the insured was sued in a trade dress infringement case which included a claim for punitive damages. The insurer agreed to appoint counsel to defend the insured and to indemnify it "against all causes of action," but denied any obligation to indemnify the insured against an award of punitive damages. The insured argued that that position triggered its right to be defended by independent counsel of its choice. The insurer argued that at the pleading stage, the mere prayer for punitive damages was simply theoretical and did not present a current conflict of interest. The court, applying both New York and New Jersey law, disagreed, holding that "the possibility of punitive damages creates a conflict of interest that entitles policyholders to independent counsel." It rejected the insurer's "merely theoretical" argument after reviewing the evidence supporting the punitive damage claim and concluding that there was a "legitimate possibility" of a punitive damage award which meant there was no longer a "unity of interest" between the insurer and its insured.

Courts in Illinois have also recognized that independent counsel is necessary when the underlying lawsuit seeks punitive damages that would dwarf compensatory damages and the insurance policy does not cover punitive damages, creating the possibility that an insurer might find it more economically efficient to put forth a less than vigorous defense of the compensatory damages, leaving the insured exposed to high punitive damages. See DHR Int'l, Inc. v. Travelers Cas. & Sur. Co. of Am., 2016 U.S. Dist. LEXIS 17719; Nandorf, Inc. v. CNA Ins. Co., 134 Ill. App. 3d 134, 479 N.E.2d 988, 992, 88 Ill. Dec. 968 (Ill. App. Ct. 1985).