



The Insurability Of Liability For Punitive Damages

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Will your liability insurance policy pay for punitive damages? Maybe yes and maybe no. As attorney Paul Banker explains, the answer may depend on where you do business or where a lawsuit is filed.

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By Paul A. Banker

Almost all companies have insurance in place that provides defense and indemnity for claims. Although the average insurance policy does not expressly exclude punitive damages, an additional claim for punitive damages will usually cause an insurer to reevaluate its coverage position. Even the prospect of punitive damages is likely to trigger a letter reserving an insurer's rights. The reflexive position on punitive damages is that they are uninsurable as a matter of public policy. But further analysis is required to determine whether coverage for punitive damages is allowable.

Consider the following hypothetical example. Smith Corporation is a building contractor. It subcontracts the installation of fire alarms to Jones Fire Suppression, Inc. What Smith does not know is that Jones's employee, to save money, deliberately installs fewer fire alarms than called for in the specifications. This is discovered when the building burns down. The building owner sues Smith for personal injury and property damage. Smith, which has a commercial general liability (CGL) policy, tenders the suit to its insurer for defense and indemnity. Plaintiff then amends the complaint to allege direct and vicarious liability for punitive damages. Although defendant Smith's insurer had been defending the suit without a reservation of rights, the expansive nature of an award for punitive damages causes all concerned to reexamine the coverage allowed by Smith's policy.

The question of whether there is coverage for punitive-damages liability is a complex one. Punitive damages are an extraordinary remedy, usually reserved for intentional or willful conduct. Courts permit juries to award punitive damages to punish defendants in appropriate cases. The intent of punitive damages is to make an example of a defendant's wrongdoing and to deter others from following their example.

In recent years there has been an increase in both the magnitude and frequency of punitive damage awards. This is particularly true in claims against wealthy corporate defendants when juries levy large verdicts for punitive damages in an attempt to send the company "a message." Million- and billion-dollar verdicts reported in the media often have a punitive-damages component.

At first glance, it would seem that insurance coverage to protect businesses from liability for punitive damages contradicts public policy. Courts in 20 states have determined, as a matter of law, that insuring against all sums the insured is legally obligated to pay does not include direct-liability coverage for punitive damages. Allowing such coverage, say these courts, would negate the underlying intent of punitive damages to punish and deter. In fact, the courts reasoned, permitting insurance coverage for punitive damages would serve to punish the

insurers more than individual defendants. Other policyholders would ultimately suffer through increased insurance costs. If direct liability for punitive damages were insurable, the only impact a particular defendant might feel would be increased premiums.

Insurance coverage for direct punitive-damages liability is possible in 24 of 50 states. These states see little distinction between negligence and conduct that could support a punitive-damages award. A policyholder's expectation of coverage for unintentional claims thus contemplates insurance for both compensatory and punitive damages.

There is another wrinkle to punitive damages. Most states that disallow insurance for punitive damages differentiate between a defendant's direct and vicarious liability. Direct liability arises out of a defendant's willful wrongdoing. Vicarious liability, on the other hand, arises from the wrongdoing of someone who is the defendant's agent. Businesses generally have the greatest exposure to vicarious liability because of the acts of their employees or, as in our fire case above, a subcontractor.

Courts in 33 of the 50 states have concluded that vicarious liability is insurable. The rationale is that insurance generally covers unintentional and unauthorized wrongdoing by employees. If an employer does not participate in, authorize, or know in advance that its employee is going to commit a wrongful act, the law should not prevent the employer from having insurance coverage for that risk.

Some states address the vicarious-liability question by statute. Minnesota, for example, recently passed a statute that specifically authorizes insurers to insure against vicarious liability for punitive damages. Insurance policies generally incorporate the laws of the jurisdiction at the time and place of their making. Therefore, policies issued or renewed after this statute went into effect would probably not implicitly

Exhibit 1

Insurability of Punitive Damages

STATE	INSURABLE	INSURABLE IF VICARIOUS	DUTY TO DEFEND	TORT REFORM
Alabama	Yes	Yes	Yes	Yes
Alaska	Yes ¹	Yes	Yes	Yes
Arizona	Yes	Yes	Yes	Yes
Arkansas	Yes ²	Yes	Yes	
California	No ³	Yes	Yes	Yes
Colorado	No	Undecided		Yes
Connecticut	Yes ⁴	Yes	Yes	Yes
Delaware	Yes ⁵	Yes	Yes	
District of Columbia	Undecided ⁶	Yes	Yes	
Florida	No	Yes	Yes	Yes
Georgia	Yes	Yes	Yes	Yes
Hawaii	Yes ⁷	Yes ⁷	Yes	Yes
Idaho	Yes ⁸	Yes	Yes	Yes
Illinois	No	Yes		Yes
Indiana	No	Yes	No ⁹	Yes
Iowa	Yes ⁸	Yes	Yes	Yes
Kansas	No	Yes		Yes
Kentucky	Undecided	Yes ¹⁰	Yes	Yes
Louisiana	Yes ⁸	Yes	Yes	Yes
Maine	No	Yes ¹¹		Yes
Maryland	Yes	Yes	Yes	Yes
Massachusetts	Yes ¹²	Undecided		
Michigan	Yes ¹¹	Not applicable	Yes	Yes
Minnesota	Yes ⁴	Yes	Yes	Yes
Mississippi	Yes	Yes	Yes	Yes
Missouri	Yes ¹³	Yes	Yes	Yes
Montana	Yes ¹⁴	Yes ¹⁴	Yes	Yes
Nebraska	Not recognized as common law			Yes
Nevada	Yes ¹⁵	Undecided		Yes
New Hampshire	Yes	Yes	Yes	Yes
New Jersey	No	Yes		Yes
New Mexico	Yes	Yes	Yes	Yes
New York	No	Probably No	Yes	Yes
North Carolina	Yes ¹⁶	Yes	Yes	Yes
North Dakota	Yes ¹⁷	Undecided		Yes
Ohio	No	No		Yes
Oklahoma	No	Yes	Yes	Yes
Oregon	Yes ⁶	Yes	Yes	Yes
Pennsylvania	No	Yes	Limited to claims covered by the policy	
Puerto Rico	Not recognized			
Rhode Island	No	Undecided		Yes
South Carolina	Yes	Yes	Yes	Yes
South Dakota	No	Undecided		Yes
Tennessee	Yes ⁵	Yes	Yes	Abolished joint and several liability by case law.
Texas	Yes	Yes		Yes
Utah	No	Undecided		Yes
Vermont	Yes	Yes	Yes	Yes
Virgin Islands	No ¹⁸	No ¹⁸		Yes
Virginia	Yes ⁶	Not recognized	Yes	Yes
Washington	Not recognized unless provided by statute			Yes
West Virginia	Yes ⁶	Yes	Yes	
Wisconsin	Yes	Yes	Yes	Yes
Wyoming	Yes	Yes	Yes	Yes

¹ For gross negligence, but not for willful misconduct

² Not arising from intentional torts

³ Except possibly for punitive damages imposed in other states for grossly negligent conduct

⁴ If statutorily imposed

⁵ Unless specifically excluded by the policy

⁶ Not for intentional acts

⁷ If specifically included in policy

⁸ Unless specifically excluded

⁹ As to claims for punitive damages

¹⁰ Not for intentional conduct

¹¹ Based on federal court decision

¹² If statutory (not recognized at common law)

¹³ Where insured is government entity

¹⁴ Must be expressly included in contract

¹⁵ An insurer may insure for punitive damages that do not arise from intentional conduct of the insured

¹⁶ Unless specifically excluded (not for intentional acts)

¹⁷ If expressly included in a policy (except for intentional or criminal acts)

¹⁸ Insurable if policy contains language specifically required by VI. ST. T. 22§ 815

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exclude vicarious liability for punitive damages as against public policy. In jurisdictions where either statutes or case law recognize the insurability of vicarious liability for punitive damages, policies probably cover such damages unless the policy explicitly states otherwise that this form of liability is excluded.

A slight majority of states permit insurance for direct liability for punitive damages. Although many states have concluded there can be no insurance for direct liability for punitive damages, a much larger majority of states permit insurance for vicarious liability. Of the 20 states that have considered the question since 1982, all have concluded that vicarious liability for punitive damages is insurable — a trend that is unlikely to reverse itself.

The insurance industry abandoned a standard, industry-wide approach to the exclusion of coverage for punitive-damages liability in 1978 and has not made a coordinated attempt to revisit the issue since.

Becoming a named defendant in a lawsuit is — at best — unpleasant. It can be unpleasantness trebled when punitive damages arise, especially if the defendant finds out after the fact there is no coverage. To avoid surprise and a potentially devastating outcome, organizations should review insurance policies on a regular basis. Coverage analysis should consider the states in which business is conducted. The organization should then compare the laws to their insurance policies to determine whether it is likely to have coverage for direct or vicarious liability for punitive damages. Because of the wide variation in approaches from state to state, the answer may even depend on where a lawsuit arises. A thorough review will enable better protection should the punitive damages arise. ☞

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