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Payment of Punitive Damages by Insurance Companies

*Martin G. Lentz**

THE CONCEPT OF PUNITIVE DAMAGES has become firmly entrenched in American tort history. As early as 1910 punitive damages were awarded for gross negligence in the operation of an automobile.¹ Since that date a constantly increasing number of jurisdictions has allowed their recovery.²

The award of punitive damages is generally based upon the concept of deterrence of, and punishment for, conduct of an outrageous nature. To justify punitive damages the circumstances surrounding a tort must indicate such socially unreasonable conduct as to constitute a wilful or wanton, almost deliberate, disregard of the legally protected interests of another.³

The Controversy

Originally the chief controversy about punitive damages centered around the question of whether or not they might be awarded in a vicarious liability situation wherein the master, through no wrongful conduct of his own, is responsible for the misconduct of his servant. The vast majority of the courts have held the employer liable for such damages. This is particularly true where there is a corporation involved since it is capable of acting only through its agents.⁴

In recent years a persuasive and prevailing view has been

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¹ *Buford v. Hopewell*, 140 Ky. 666, 131 S. W. 502 (1910).

² 62 A. L. R. 2d 813 (1958).

³ *McCormick, Damages*, 278 (1935); *Oleck, Damages to Persons & Property*, c. 26 (rev. ed., 1961).

⁴ *D. L. Fair Lumber Co. v. Weems*, 196 Miss. 201, 16 So. 2d 770 (1944); *Sovereign WOW v. Roland*, 232 Ala. 541, 168 So. 576 (1936); *Peterson v. Western Union Telegraph Co.*, 75 Minn. 368, 77 N. W. 985 (1899); *Knoblock v. Morris*, 169 Kan. 540, 220 P. 2d 171 (1950); *Bush v. Watkins*, 224 Miss. 238, 80 So. 2d 19 (1955); *Planters Wholesale Grocery v. Kincaide*, 210 Miss. 712, 50 So. 2d 578 (1951); *Teche Lines Inc. v. Pope*, 175 Miss. 393, 166 So. 539 (1936); *Dickson v. Inter-Carolinas Motor Bus Co.*, 161 S. C. 297, 159 S. E. 625 (1931).

followed in the awarding of punitive damages against intoxicated drivers.⁵

Assuming that both of these views continue to be held, we can expect an ever increasing storm of disputation centering around whether or not a liability insurer must respond for punitive damages awarded against an insured tortfeasor. This renewed controversy is inevitable with the universal acceptance of liability insurance coverage in recent years.

The Vexing Question

The insurance industry's argument is that if an irresponsible wrongdoer were permitted to shift the burden of punitive damages to an insurance company, then no useful purpose would be served.⁶ It has been further argued that a liability insurer can be held responsible for punitive damages only under two conditions. These conditions are as follows: (1) as a matter of contract or policy construction the carrier has undertaken such an obligation, and (2) if so, the contract is not void as against public policy.

The more valid of the two arguments advanced by the insurance companies and their proponents is that of contract or policy construction.

Most personal and auto liability policies expressly exclude coverage for intentional misconduct, without mentioning punitive damages specifically. Typical among the auto liability policies is that issued by the Progressive Mutual Insurance Company of Cleveland, Ohio.⁷ On the face of the policy, bodily injury or property damage caused intentionally by, or at the direction of, the insured is specifically excluded.⁸ In the absence of any state statute controlling or regulating the subject matter of the contract, the instrument would therefore be a contract.⁹

⁵ Sebastian v. Wood, 246 Ia. 94, 66 N. W. 2d 841 (1954); Lazenby v. Universal Underwriters Ins. Co., 214 Tenn. 639, 383 S. W. 2d 1 (1964); General Casualty Co. v. Woodby, 238 F. 2d 452 (6th Cir. 1956).

⁶ Appleman, Insurance and Practice, 4312 (1962); McNeely, Illegality as a Factor in Insurance, 41 Col. L. Rev. 26 (1941); Oleck, *op. cit. supra*, n. 3, at Sec. 275C.

⁷ Progressive Mutual Auto Policy (Form AFC-100 2-65).

⁸ *Id.* at Part 1—Liability, Exclusions (b).

⁹ Buffalo Pressed Steel Co. v. Kirwan, 138 Md. 60, 113 A. 628, (1921); Mexican Petroleum Corp. of Louisiana v. North German Lloyd, D. C. La., 17 F. 2d 113, 114 (La. 1926).

The Distinction in the Line of Contract Cases

In order to intelligently evaluate the validity of the arguments advanced on the contract basis by the insurance industry proponents we must understand that the cases most frequently cited by them fall into the category of intentional torts, such as assault and battery, which require a specific intent on the part of the defendant to interfere with the plaintiff's person.¹⁰

Typical among these cases is that of *Abbott v. Western National Indemnity Co.* in which the insurer was not held liable for the payment of punitive damages awarded against an insured who while in a drunken state thoroughly trounced the victim.¹¹ The policy expressly excluded coverage for intentional misconduct.

It is conceded that the assault and battery type tort requires intent of a nature which constitutes an exclusion under the intentional misconduct clause in the policy.

The Fallacy in the Argument

It is when the proponents of the non-payment of punitive damages attempt to extend the sound reasoning of the intentional tort exclusion, as it applies to the contract interpretation, to other factual situations that their arguments become illogical and misleading.

In *Morrell v. LaLonde*, a malpractice case, a doctor while attempting surgery did an unbelievably bad job; and to make matters worse, he discharged the patient from his private hospital while she was still desperately in need of medical care.¹² Rhode Island procedure permitted the insurance carrier to be properly joined with the doctor as a defendant. The jury apparently became outraged at the unprofessional conduct of the defendant and they awarded compensatory and punitive damages in a vengeful fashion. Although the insurance company had specifically agreed to indemnify against loss from liability imposed by law, it denied that it was legally responsible to pay punitive damages. The court held that the insurance company was obligated to pay the damages in dispute under the terms of the policy.

¹⁰ Prosser, Torts, 40 (3d ed. 1964).

¹¹ 165 Cal. App. 302, 331 P. 2d 997 (1958).

¹² 45 R. I. 112, 120 Atl. 435 (1923).

The facts of the *Morrell* case indicate the type of outrageous wrongdoing that evidences such a conscious and deliberate disregard of the interests of others that it may properly be termed wilful, wanton, or reckless.¹³

There is a distinction between specific intent as required to constitute assault and battery and so called quasi-intent.¹⁴ The latter establishes the type of negligence which is known as wilful, wanton, or reckless.¹⁵ Specific intent, being an intentional tort, is excluded under the intentional misconduct clause in most policies,¹⁶ whereas wilful, wanton, or reckless conduct supports the awarding of punitive damages.¹⁷

In *Pennsylvania Thresherman and Farmers Mutual Casualty Company v. Thornton*, the court, recognizing this distinction, held that wilful or wanton negligence supporting punitive damages is not the same as wilful conduct such as is present in assault and battery.¹⁸

Having Established the Distinction

Once it is recognized that there is a difference between specific intent constituting intentional misconduct (wherein a person intends a result and acts for the purpose of accomplishing it), and wilful, wanton, or reckless misconduct (sometimes termed quasi-intent) wherein a person acts under the actual or constructive realization that he is causing great risk to another, then insight into the question of whether the contract or policy construction excludes the payment of punitive damages is greatly enhanced.¹⁹

It seems to be well settled, under contract construction, that the insurance company does not have to pay punitive or "exemplary" damages when under the exclusion section of the policy such damages are specifically named and it is clearly stated that there is no obligation for indemnification.²⁰ It is

¹³ *Sebastian v. Wood*, *supra* note 5 (Driving While Intoxicated); Prosser, *Torts*, 10 (3d ed. 1964).

¹⁴ Prosser, *Torts*, 188 (3d ed. 1964).

¹⁵ *Ibid.*

¹⁶ Notes 10 and 11 *supra*.

¹⁷ McCormick, *op. cit. supra* note 3; Oleck, *op. cit. supra* n. 3, at Sec. 275C.

¹⁸ 244 F. 2d 823 (4th Cir. 1957); also see *Lazenby v. Universal Underwriters Ins. Co.*, *supra* note 5.

¹⁹ Elliot, *Degrees of Negligence*, 6 *So. Calif. L. Rev.* 91 (1933) for a good discussion of the subject.

²⁰ See discussion *supra*.

equally settled that punitive damages which are returned against an insured in connection with intentional misconduct (such as assault and battery, malicious prosecution, conversion and seduction) are not required to be paid by the insurance carrier. Injury or property damage caused intentionally by or at the direction of the insured is specifically excluded in the standardized liability policy as discussed above.

On the positive side of the standard liability insurance contract, noting the exclusion above, the insurance carrier agrees to indemnify the insured for all sums that he shall become legally obligated to pay by reason of the liability imposed upon him by law, for damages sustained by any person.²¹

The distinction between simple negligence and negligence upon which an award for punitive damages can be made is a delicate one. Compensatory damages can be based on the same type of negligence that supports punitive damages. If an insured had a judgment returned against him for *compensatory* damages based on wilful, wanton, or reckless misconduct, there is no question that the insurance company would be obligated to pay.²²

Under the contract interpretation of the standardized insurance policy, which excludes coverage for intentional misconduct but does not specifically mention punitive damages, there is a consensus among the courts that as a matter of contract construction and interpretation such provision indemnifies the insured for punitive as well as compensatory damages.²³

The insurance industry and its proponents argue that public policy absolutely prohibits indemnification against liability for punitive damages whether or not they are expressly covered by the insurance contract. Some jurisdictions have adopted this view.²⁴

²¹ Progressive Mutual Auto Policy, *op. cit. supra* note 7; also, Appleman, *Insurance Law and Practice*, 4312, at 132 (1962).

²² Lazenby v. Universal Underwriters Ins. Co., *supra* note 5.

²³ Appleman, *op. cit. supra* note 6; also Carroway v. Johnson, 245 S. C. 200, 139 S. E. 2d 908 (1965); Ohio Cas. Ins. Co. v. Welfare Finance Co., 75 F. 2d 58 (8th Cir. 1934); U. S. Fed. & Guar. Co. v. Janich, 3 F. R. D. 16, 19 (Cal. 1943): For a contra holding see Universal Indem. Ins. Co. v. Tenery, 96 Colo. 10, 17, 39 P. 2d 776, 779 (1934).

²⁴ Northwestern National Cas. Co. v. McNulty, 307 F. 2d 432 (5th Cir. 1962); Tedesco v. Maryland Casualty Co., 127 Conn. 533, 18 A. 2d 357 (1941).

Public Policy

Having considered the contract or policy construction phase of the problem we are confronted with a very important consideration, this being whether or not public policy prohibits the indemnification of the insured for punitive damages when the contract construction is not a bar.

Public policy embraces the principle that no person can lawfully do that which is injurious to, or against the public good. Included in this is the principle under which the ability to contract is limited by law for the good of the community.²⁵

Typical of the arguments against insurance companies paying punitive damages is that advanced by the court in *Northwestern National Cas. Company v. McNulty*.²⁶ The court, in reversing a summary judgment against the insurer, decided that the law of Virginia, where the policy was issued, governed the question whether insurance against punitive damages was against public policy. The character of the damages had been determined in Florida which was the state in which the accident occurred and where the judgment for punitive damages had been rendered. The court in the case at hand made it clear, however, that the decision would have been the same if Florida or Virginia law governed, as Florida and Virginia law are in harmony concerning the theory that punitive damages should be awarded for punishment and deterrence (emphasis) and should rest ultimately as well as nominally on the party actually responsible for the wrong. The court then went on to say that such damages do not compensate the plaintiff for his injuries since he has already been made whole by compensatory damages.

In regard to the question of public policy the court felt that to allow punitive damages would (1) produce a serious conflict of interest between the insurance carrier and the insured in regard to settlement negotiations and trial tactics, (2) tend to nurture a conflict between the rule that insurance may not be referred to in the presence of the jury and the fact that the financial standing of the defendant may be considered by the jury in assessing punitive damages, and (3) permit extravagant and unreal results which would have no relation to making the injured party whole.

²⁵ See Black's Law Dictionary, 1317 (4th ed., 1951).

²⁶ *Supra* note 24.

The court in pursuing the public policy argument against insurance carriers being liable for punitive damages cited the cases of *Edwards v. Nulsen* and *Livesy v. Stock* as examples of the unrealistic results arrived at by juries when they go beyond the area of compensatory damages.²⁷ In both of those cases the plaintiff was awarded a nominal amount for compensatory damages as compared with the much larger amount for punitive damages. Along this same line of reasoning an even more extreme example of the punitive damage award being far in excess of the compensatory award, although not cited by the court in the *Northwestern* case, is that of *Finney v. Lockhart*²⁸ wherein a verdict of one dollar actual and two thousand in punitive damages was returned in an unfair competition action.

The opponents of the idea of insurance carriers being liable for punitive damages cite the results arrived at in the *Edwards*, *Livesy*, and *Finney* cases as sound reasons for the justification of such damages when the wrongdoer is the one who pays.²⁹

Since public policy embraces the principle that no person can lawfully do that which is injurious to or against the public good, we must carefully weigh the validity of the insurance industry's arguments as they apply to the best interest of the public.

In the *Northwestern Casualty Co.* case the court, in the consideration of public policy, went on to say that the end-object of punitive damages, punishment and deterrence of outrageous conduct on the part of potential defendants, would be frustrated if the accused were allowed to shift his burden to the innocent insurance carrier and ultimately to the public, since the added cost imposed by this liability would be passed along to the premium holders.³⁰ According to this court, society would then in a sense be punishing itself for the tortious conduct of the insured. The doctrine regarding public policy adopted by the court in the *Northwestern* case is unreal in that it does not take into consideration the injured party to whom the question of public good also applies.

²⁷ 347 Mo. 1077, 152 S. W. 2d 28 (1941); and 208 Cal. 315, 281 P. 70 (1929).

²⁸ 35 Cal. 2d 161, 217 P. 2d 19 (1955).

²⁹ *Edwards v. Nulsen*; *Livesy v. Stock*, *supra* note 27; *Finney v. Lockhart*, *supra* note 28.

³⁰ *Northwestern National Cas. Co. v. McNulty*, *supra* note 24.

In the case of *Pennsylvania Thresherman and Farmers Mutual Casualty Company v. Thornton*³¹ the court reasoned that public policy properly analyzed reveals that liability insurance is as much for the protection of the injured party as for the protection of the insured. The court based its decision on sound reasoning. For the court to have arrived at a contrary holding would lead to an untenable position. One must consider the purpose and spirit of insurance policies which are designed not only to indemnify the insured against loss, but also to protect members of the public.³² To allow the insurance carrier to escape payment of punitive damages under the guise of public policy would in essence adhere to a doctrine that the more extreme the recklessness the more likely the carrier to escape liability.³³

In a recent case, *Lazenby v. Universal Underwriters Insurance Company*,³⁴ Justice Dyer ruled that an insurance carrier is obligated to pay both compensatory and punitive damages claims against an insured who had an accident while driving in an intoxicated state and that the insurance contract so construed was not against public policy.

The reasoning of that court is in accordance with that of the court in the *Pennsylvania Thresherman Casualty Company* case.³⁵

In both the *Lazenby* and *Pennsylvania Thresherman* cases the treatment of public policy given by the courts is praiseworthy. The courts came to grips with the problem and declined to follow contrary authority. Both of these decisions have fortified the growing and persuasive view that public policy does not prohibit insurance carriers from paying punitive damages.

Conclusion

The logic and validity of the public policy argument that to require insurance companies to pay punitive damages would place a burden upon the innocent insurance carrier, and ultimately the public itself, is weak and indefensible.

³¹ 244 F. 2d 823 (4th Cir. 1957).

³² McNeely, *Illegality as a Factor in Insurance*, 41 Col. L. Rev. 26 (1941).

³³ See *Huntington Cab Co. v. American Fidelity and Casualty Co.*, 155 F. 2d 117 (4th Cir. 1946).

³⁴ *Supra* note 5.

³⁵ *Supra* note 31.

Juries are never required to give punitive damages; and even when they may properly award them, they must be charged that they are at liberty to withhold them entirely. Some lawyers even refrain from requesting a punitive damage instruction, based on the calculated risk that the awarding of them might constitute reversible error. There does not seem to be a growing trend for juries to award such damages with a vengeance and in a heedless fashion. On the contrary, the trend seems to be for juries to award punitive damages only when the facts of the case indicate that they are well deserved.

Insurance rates are spiraling and this certainly can not be attributed to the small number of cases in which insurance carriers have been required to indemnify an insured for punitive damages.

If the passion of the jury is inflamed by the outrageous conduct of the defendant, even when it has not been charged on punitive damages, it will be inclined to reflect its outrage in the award given under the guise of actual or compensatory damages.

Since the insurance rates are based on total cost figures, it is reasonable to assume that in a sense punitive damages are already part of the rate structure.

The concern for not wanting to punish the insurance carrier, an innocent party, is not logical since any insurance company is an innocent party. The involvement is based on the contractual relationship of indemnification.

If an insurance company does not wish to indemnify for punitive damages, then it should specifically exclude such coverage in the policy. In the absence of such a specific exclusion, public policy properly analyzed requires it to pay.