THE CONSTRUCTION AND ADMISSIBILITY OF INSURANCE POLICIES THAT PROVIDE COVERAGE FOR PUNITIVE DAMAGE AWARDS

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I. INTRODUCTION

In *Shane v. Rhines,*[1] four current justices[2] of the Alaska Supreme Court noted that evidence of insurance coverage may be relevant to the appropriate measure of punitive damages in a civil lawsuit.[3] In so doing, the *Shane* court implicitly adopted the view that at least some insurance liability contracts could be construed to provide insurance coverage for punitive damage awards,[4] although it did not address the question of whether such coverage would be consistent with insurance contract law or public policy in the state of Alaska.

This article explores several issues raised in *Shane v. Rhines.* Section II of this article discusses the *Shane* decision in detail, outlining the positions of the various justices in the per curiam opinion, as well as in the concurring and dissenting opinions. Section III addresses the propriety of insurance coverage for punitive damage awards under insurance contract law, as well as the public policy implications of insurance coverage for punitive damage awards. Finally, Section IV briefly explains the rationale for, and manner in which, insurance coverage for punitive damage awards should be considered by the fact finder.

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1. 672 P.2d 895 (Alaska 1983).

2. The case was heard before Chief Justice Burke, Justice Compton, Justice Matthews, Justice Rabinowitz and Alaska Court of Appeals Judge Singleton. Judge Singleton was sitting by assignment pursuant to section 16 of article IV of the Alaska Constitution. ALASKA CONST. art. IV, § 16 (1959, amended 1970). Judge Singleton has since been appointed to the federal district court for Alaska.

3. *Shane,* 672 P.2d at 900.

4. *Id.*

II. *SHANE V. RHINES*

A. Factual Background

Shane arose out of an auto accident in October of 1978.[5] At trial, the defendant Rhines admitted that he had been drinking prior to the accident and that he was "responsible" for the accident;[6] thus, his liability for wrongful conduct was not at issue. The plaintiff Shane had sued Rhines for both compensatory and punitive damages, but the jury determined that Shane was not entitled to punitive damages.[7] On appeal, Shane challenged, inter alia, the trial court ruling that Rhines's insurance coverage was inadmissible as evidence of Rhines's financial condition.[8] Shane challenged this exclusion of evidence in part because Rhines had himself presented evidence of his limited financial resources to demonstrate his inability to pay a punitive damage award.[9] Shane argued that, likewise, the purpose of his introducing the policy would have been "to establish Rhines's ability *to pay* punitive damages."[10]

Against this backdrop the Alaska Supreme Court implied that insurance coverage may be relevant to the appropriate measure of punitive damage awards.

B. Per Curiam Implications of *Shane*

In its analysis of the contentions of Shane regarding insurance coverage, the per curiam portion of *Shane* raised two significant issues about insurance coverage for punitive damage awards.

First, and perhaps most significant to those representing insurance companies, *Shane* implied that insurance coverage for punitive damage awards is not per se violative of insurance contract law, or public policy. This view allowed the *Shane* court to reach the express issue regarding the admissibility of such policies, because the *Shane* court could not even address the issue of admissibility without first accepting that some insurance policies provide coverage for punitive damage awards.

At the trial court level, the jury was given a special verdict form that asked two separate questions: (1) whether Shane was entitled to punitive damages, and (2) the appropriate amount of those damages.[11]

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5. *Id.* at 897.
6. *Id.*
7. *Id.*
8. *Id.*
9. *Id.* at 899.
10. *Id.* (emphasis added).
11. *Id.*

The jury answered "no" to the threshold question, effectively rendering the remaining question of "amount" irrelevant.[12] As to liability for punitive damages, *Shane* held that the admission of insurance coverage for punitive damages was precluded *in that context.*[13] "Although evidence of insurance arguably is relevant to the appropriate measure of punitive damages, it is not relevant to the threshold question of whether a party's conduct is so reprehensible that punishment is necessary or whether punitive damages will deter others from engaging in similar conduct."[14] This conclusion implicitly demonstrates the court's view that insurance coverage for punitive damage awards is consistent with Alaska insurance contract law.

The *Shane* court's second conclusion is that insurance coverage for punitive damage awards is relevant to the "appropriate measure"[15] of punitive damages. This conclusion, analyzed in Section IV, probably has more significance to those representing plaintiffs in personal injury actions, and has the potential to alter radically the fact finder's task in determining the *size* of punitive damage awards when insurance coverage for such awards exists.[16]

C. Concurring and Dissenting Opinions

Justice Compton wrote a concurrence to the *Shane* per curiam opinion.[17] Justice Burke wrote a partial concurrence/partial dissent to the per curiam decision, in which Justice Matthews joined.[18] Each of the separate opinions, however, actually provides further support for the per curiam conclusions outlined above, with relatively minor differences as to procedure and application of the principles in the trial court context.

In his concurrence, Justice Compton further emphasized the portion of the opinion dealing with the admission of insurance policies: "[W]hen punitive damages are at issue, evidence of the defendant's wealth, including any insurance, is relevant to determining what amount should be awarded so as to fulfill the purposes of punishment

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12. *Id.*

13. The court cited Alaska Rule of Evidence 411. Rule 411 provides in part:

> Evidence that a person was or was not insured against liability is not admissible upon the issue whether he acted negligently or otherwise wrongfully. This rule does not require the exclusion of evidence of insurance against liability when offered for another purpose, such as proof of agency, ownership, or control, or bias or prejudice of a witness.

ALASKA R. EVID. 411.

14. *Shane,* 672 P.2d at 900.

15. *Id.*

16. *See infra* text accompanying notes 59-66.

17. *Shane,* 672 P.2d at 901-02 (Compton, J., concurring).

18. *Id.* at 902-03 (Burke, C.J., and Mathews, J., concurring in part, dissenting in part).

and deterrence."[19] This statement buttresses the admissibility of insurance coverage for punitive damage awards, and also implicitly concedes, as did the per curiam majority, that such coverage is permissible under Alaska law.[20]

The partial dissent written by Justice Burke provides further support for the per curiam opinion as it relates to the admission of insurance policies and the policy reasons behind such admission:

> The purpose of introducing the insurance policy was to establish Rhines' ability to pay punitive damages. Evidence of the defendant's financial condition is admissible to determine how large a punitive damage must be to achieve the purposes of punishment and deterrence. A defendant's insurance policy is a part of his financial resources and will obviously affect the degree to which a defendant is punished by a punitive damage award.[21]

Thus, the conclusions of the per curiam majority are emphasized and supported by the separate opinions of Chief Justice Burke and Justice Matthews. Indeed, the concurrences to the per curiam decision provide stronger support for the court's conclusions regarding the construction and admissibility of insurance coverage for punitive damage awards.

D. Summary

A close reading of *Shane v. Rhines* reveals that four current justices[22] of the Alaska Supreme Court are willing to accept the proposition that insurance coverage for punitive damages is relevant to the appropriate measure or size of the punitive damage award. The remaining sections of this article will examine insurance contract law and other evidentiary implications of this proposition.

III. The Insurability of Punitive Damage Awards: The Tension Between Insurance Contract Law and Public Policy

A. Introduction

As was discussed in Section II, the Alaska Supreme Court implicitly accepted in *Shane v. Rhines* the idea that insurance coverage for punitive damage awards is consistent with insurance contract law and

19. *Id.* at 901 (Compton, J., concurring).

20. The primary emphasis of Justice Compton's concurrence regarded the issue of bifurcation of the punitive damage and compensatory damage components at trial pursuant to Alaska Rule of Civil Procedure 42(b). The bifurcation issue is addressed in detail *infra* notes 72-73.

21. 672 P.2d at 902 (emphasis added) (citations omitted) (Burke, C.J., dissenting in part).

22. *See supra* note 2.

public policy in the state of Alaska. There are sound reasons to support a conclusion that insurance coverage for punitive damage awards is proper under Alaska law. This Section will now address each of the components of the insurance coverage issue in detail.

The question of whether liability insurance coverage extends to conduct that may lead to potential punitive damage awards has been the subject of much debate and commentary throughout the country.[23] Although no uniform rule is applied across jurisdictions, there does appear to be a consistent methodology used by courts in addressing this insurance coverage issue. First, courts typically examine the language of the insurance policy in light of insurance contract law to determine whether there is an unambiguous exclusion of coverage for punitive awards. Second, courts then determine whether the public policy of the subject forum, notwithstanding the language of the insurance contract, allows coverage for punitive damage awards.[24]

The remainder of the Section will analyze the question of coverage for punitive awards under the methodology used by most courts that have addressed this issue.

B. Under Alaska Law, a Failure to Expressly Exclude Punitive Damage Awards Should Lead to a Finding of Coverage for Such Awards Under the Insurance Contract

One of the fundamental principles of Alaska insurance law regarding insurance coverage is that "provisions of [insurance] coverage should be construed broadly while exclusions are interpreted narrowly against the insured."[25] The most significant terms of an insurance contract for the purpose of this article relate to the kinds of damages covered by the policy, and whether the policy contains an express exclusion for punitive awards.

The Alaska Supreme Court has held that insurance policy provisions that require an insurer to "pay on behalf of the insured all sums which the insured shall become legally obligated to pay as damages" can include the payment of punitive damage awards.[26] In *Providence Washington Insurance Co. v. City of Valdez,* the court held:

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23. *See, e.g.,* King, *The Insurability of Punitive Damages: A New Solution to an Old Dilemma,* 16 WAKE FOREST L. REV. 345 (1980); Annotation, *Liability Insurance Coverage as Extending to Liability for Punitive or Exemplary Damages,* 16 A.L.R. 4th 11 (1982) [hereinafter *Liability Insurance Coverage*].

24. *See generally* 2 L. SCHLUETER & K. REDDEN, PUNITIVE DAMAGES § 15.2(B) (2d ed. 1989) (outlining methodology of courts addressing this issue).

25. Hahn v. Alaska Title Guar. Co., 557 P.2d 143, 145 (Alaska 1976).

26. Providence Washington Ins. Co. v. City of Valdez, 684 P.2d 861, 863 (Alaska 1984); *accord* LeDoux v. Continental Ins. Co., 666 F. Supp. 178, 180 (D. Alaska 1987).

> Punitive damages, where reduced to judgment, constitute a "sum" that the insured is obligated to pay as a result of its wrongful eviction. Under the terms of the policy Providence has not specifically excluded punitive damages. We therefore conclude that the liability policy Providence issued to Valdez provides coverage for punitive damages.[27]

Thus, under Alaska law, an insurer's promise to pay "damages" includes the promise to pay punitive damages, unless otherwise expressly excluded.

An insurer's promise to pay all "damages" may nevertheless contain certain exclusions involving various kinds of conduct by the insured. For instance, most insurance policies include exclusions for conduct "by or at the direction of the insured,"[28] that is, intentional conduct. A policy may also exclude "malicious, criminal or fraudulent conduct."[29] Significantly, however, many insurance policies *do not* contain exclusions related to unintentional or reckless conduct.[30]

The distinction between intentional and unintentional conduct as related to the construction of an insurance policy's coverage for punitive damages was analyzed in detail in *LeDoux v. Continental Insurance Co.*[31] *LeDoux* involved an auto accident in which the plaintiffs alleged that the defendant had failed to keep a proper outlook, had failed to stop at a stop sign and was speeding.[32] The plaintiffs in *LeDoux* sought a declaratory judgment that their policy provided coverage for punitive damages for "gross negligence."[33] The Federal District Court for the District of Alaska, applying Alaska law, considered whether conduct alleged to be "outrageous, [and] of reckless indifference," or demonstrating "gross negligence" was covered by an liability insurance policy.[34] Judge Boochever, sitting from the Ninth Circuit Court of Appeals by designation, stated:

> The policy excepts injury "that is expected or intended" by the insured. Here there is no allegation that Curt LeDoux expected or intended to injure the Van Scoyks. If Continental wished to exclude

27. *Id.* at 863 (footnote omitted).

28. King, *supra* note 23, at 359 n.61.

29. *Id.*

30. Under Alaska law, wrongful conduct need not be intentional in order to justify a punitive damage award. *See* Tommy's Elbow Room, Inc. v. Kavorkian, 727 P.2d 1038, 1048-49 (Alaska 1986) (holding that punitive damages will be awarded where wrongdoer's conduct can be characterized as outrageous: malicious, done with bad motive or recklessly indifferent to interests of another); Zeman v. Lufthansa German Airlines, 699 P.2d 1274, 1286 (Alaska 1985) (holding that to support an award of punitive damages, the conduct must be outrageous: malicious acts, or acts done with reckless indifference to the interest of another).

31. 666 F. Supp. 178 (D. Alaska 1987).

32. *Id.*

33. *Id.*

34. *Id.* at 179.

> all coverage for punitive damages it would have been a simple matter to express that intention. At best the clause is ambiguous, and Alaska, like the vast majority of jurisdictions, construes an ambiguous provision against the insurer.[35]

Based upon the *LeDoux* reasoning, an insurance contract that does not expressly exclude coverage for reckless conduct and/or gross negligence will also lead to a finding of coverage for punitive damage awards.

Under the above methodology, the language of the insurance policy must be looked at to determine the precise nature of damages against which it insures, as well as whether there is an unambiguous exclusion for all punitive awards. Thus, it is very likely that within the current trend of Alaska insurance law, reckless conduct which leads to a punitive damage award will be covered by a liability insurance policy that does not expressly exclude coverage for such behavior.

C. Public Policy Should Not Eliminate Coverage for Punitive Damages in the Absence of an Express Exclusion for Such Damages

Once a court determines that the language of the insurance policy does not exclude coverage for punitive awards, it must then determine whether such coverage violates the public policy of Alaska.[36]

A leading case in favor of the position that allowing insurance coverage for punitive damages violates public policy is *Northwestern National Casualty Co. v. McNulty.*[37] In *McNulty,* Judge Wisdom, writing for the Fifth Circuit Court of Appeals, analyzed an insurance contract that obliged the insurer "[t]o pay on behalf of the insured all sums which the insured shall become legally obligated to pay as damages . . . ."[38]

Judge Wisdom reasoned that if such language provided insurance coverage for punitive damage awards, the provision would violate public policy:

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35. *Id.* at 180 (citing Hahn v. Alaska Title Guar. Co., 557 P.2d 143, 144-45 (Alaska 1976)).

36. In McKnight v. Rice, Hoppner, Brown & Brunner, the Alaska Supreme Court reaffirmed that otherwise valid contracts will be unenforceable when they are found to violate public policy: "To determine whether an agreement is inoperative on grounds of public policy requires that a balance be struck between public policy interests against enforcement and the interests favoring enforcement." 678 P.2d 1330, 1334 (Alaska 1984) (footnote omitted). *See* RESTATEMENT (SECOND) OF CONTRACTS § 178 (1981).

37. 307 F.2d 432 (5th Cir. 1962), *cited in* Providence Washington Ins. Co. v. City of Valdez, 684 P.2d 861, 863 n.5 (Alaska 1984) (using substantially similar language).

38. *Id.* at 433. Judge Wisdom did not address the contract interpretation issue analyzed *supra* at Section III.B.

> The policy considerations in a state where . . . punitive damages are awarded for punishment and deterrence, would seem to require that the damages rest ultimately as well [as] nominally on the party actually responsible for the wrong. If that person were permitted to shift the burden to an insurance company, punitive damages would serve no useful purpose. Such damages do not compensate the plaintiff for his injury, since compensatory damages already have made the plaintiff whole. And there is no point in punishing the insurance company; it has done no wrong. In actual fact, of course, and considering the extent to which the public is insured, the burden would ultimately come to rest not on the insurance companies but on the public, since the added liability to the insurance companies would be passed along to the premium payers. Society would then be punishing itself for the wrong committed by the insured.[39]

Substantial support can be found for the *McNulty* rationale in other jurisdictions.[40]

The *LeDoux* decision, discussed above, held that coverage for punitive awards resulting from *unintentional torts* does not violate the public policy of Alaska.[41] The majority of courts that have addressed this issue have held similarly.[42]

A number of reasons support the conclusion in *LeDoux* that insurance coverage for punitive damages is compatible with Alaska public policy. First, in the absence of a clear legislative or constitutional declaration of public policy, Alaska law does not interfere lightly with contractual rights because the judicial enforcement of contracts as written is itself an important public policy. Second, because most insurance policies exclude coverage for intentionally tortious conduct, any public policy arguments that normally might justify voiding provisions in insurance contracts related to intentional conduct are substantially diminished. Third, the failure to enforce an insurance contract

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39. *McNulty,* 307 F.2d at 440-41.

40. *See, e.g.,* Wojciak v. Northern Package Corp., 310 N.W.2d 675, 679-80 (Minn. 1981); Public Serv. Mut. Ins. Co. v. Goldfarb, 53 N.Y.2d 392, 400, 475 N.E.2d 810, 814, 442 N.Y.S.2d 422, 426 (1981); and cases cited in *Liability Insurance Coverage, supra* note 23. In Providence Washington Ins. Co. v. City of Valdez, the Alaska Supreme Court expressly refused to decide the public policy component of insurance for punitive damages when it reasoned: "Assuming, without deciding, that public policy in Alaska would prohibit liability insurance coverage for punitive damages, we hold that such a policy would not prohibit municipal corporations from insuring against punitive damage awards." *Id.* at 863 (Alaska 1984) (footnote omitted).

41. *LeDoux,* 666 F. Supp. at 180.

42. *See, e.g.,* General Casualty Co. v. Woodby, 238 F.2d 452 (6th Cir. 1956); Southern Farm Bureau Casualty Ins. Co. v. Daniel, 246 Ark. 849, 440 S.W.2d 582 (1969); Mazza v. Medical Mut. Ins. Co., 311 N.C. 621, 319 S.E.2d 217 (1984); Dayton Hudson Corp. v. American Mut. Liab. Ins. Co., 621 P.2d 1155 (Okla. 1980); Harrell v. Traveler's Indem. Co., 279 Or. 199, 567 P.2d 1013 (1977); Carroway v. Johnson, 245 S.C. 200, 139 S.E.2d 908 (1965); Hensley v. Erie Ins. Co., 168 W. Va. 172, 283 S.E.2d 227 (1981).

as written presents an unwarranted windfall to insurance companies. Insurance policies are typically form contracts provided by the insurer; therefore, insurance companies should be forced to bear the risk of failing to expressly exclude punitive damage award coverage. Finally, the dual purposes of punitive damages, that is, punishment and deterrence, are not impeded substantially by insurance coverage for punitive awards that apply only to unintentional torts. Each of these reasons supporting the *LeDoux* rationale is discussed separately below.

1. *The Public Policy Behind Judicial Enforcement of Contract Rights Should Not Be Overridden.* When one considers the public policy reasons for voiding a contract or contractual provision, it must be emphasized that, by necessary implication, there has *already* been a determination that a valid agreement between the parties exists. This determination is significant because important public policy reasons require judicial enforcement of contracts valid as written. The Alaska Supreme Court has emphasized this point in the following manner:

> In considering this first question [of whether a contract provision is void as against public policy] we start with the basic tenet that competent parties are free to make contracts and that they should be bound by their agreements. *In the absence of a constitutional provision or statute which makes certain contracts illegal or unenforceable, we believe it is the function of the judiciary to allow men to manage their own affairs in their own way.* As a matter of judicial policy the court should maintain and enforce contracts, rather than enable parties to escape from the obligations they have chosen to incur.[43]

There is no constitutional provision or statute in Alaska that makes the coverage of punitive damages by insurance policies void on the basis of public policy.[44] Therefore, these contracts should, at the outset, be presumptively valid and enforceable.

In the punitive damage/insurance contract context, the Oregon Supreme Court framed the same point as follows:

> It is important to bear in mind at the outset that this case does not involve the application of any settled and established rule of contract "public policy," but the adoption in Oregon of a proposed new rule of "public policy" under which both existing and future insurance contracts which undertake to provide protection from liability for punitive damages would be held to be invalid.
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> It has been said of "public policy" as a ground for invalidation by the courts of private contracts that "those two alliterative words

43. Inman v. Clyde Hall Drilling Co., 369 P.2d 498, 500 (Alaska 1962) (emphasis added) (footnotes omitted). *See also* Horton v. Hanson, 722 P.2d 211, 216 (Alaska 1986).

44. *See LeDoux,* 666 F. Supp. at 180.

> are often used as if they had a magic quality and were self-explanatory . . ." and that for a court to undertake to invalidate private contracts upon the ground of "public policy" is to mount "a very unruly horse, and when you once get astride it, you never know where it will carry you."[45]

In Alaska it is settled and well established that public policy favors the enforcement of contracts as written.[46] In the absence of a legislative, or similarly objective determination of public policy demonstrating otherwise, that policy should not be overridden.[47]

2. *Coverage for Punitive Damage Awards Based Upon Unintentional Torts Should Not Be Considered a Violation of Public Policy.* Many courts that have considered the public policy implications of insurance coverage for punitive damages have found determinative the question of whether the conduct insured against was intentional or unintentional. In *St. Paul Mercury Insurance Co. v. Duke University,*[48] for example, the court found that insurance coverage for intentional wrongdoing would be violative of public policy.[49] The *LeDoux* court similarly examined intent and held that coverage for *un*intentional torts would not violate public policy.[50]

A focus on intent is appropriate because it goes to the heart of the justification for allowing insurance coverage for *un*intentional conduct in general. The terms of liability policies normally are not rendered void simply because the policy insures against negligent or grossly negligent conduct. Professor Corbin has argued:

> Liability insurance policies, taken out by employers, owners of automobiles, and others, are contracts for indemnity against consequences of tortious negligence on the part of servants and employees. Such contracts are not made illegal by the fact that they

45. Harrell v. Travelers Indem. Co., 567 P.2d 1013, 1016 (Or. 1977) (en banc) (footnotes omitted) (quoting 6A CORBIN ON CONTRACTS § 1375 (1962), and 14 WILLISTON ON CONTRACTS § 1629 (3d ed. 1972)).

46. *Inman,* 369 P.2d at 500 (Alaska 1962).

47. *LeDoux,* 666 F. Supp. at 180-81. "Another question would be presented if Alaska's legislature were to declare such insurance provisions invalid. But the legislature of this state has not enacted a provision . . . that bars recovery from an insurer for intentional harm caused by an insured." *Id.*

48. 670 F. Supp. 630, 636 (M.D.N.C. 1987), *aff'd in part and rev'd in part,* 849 F.2d 133 (4th Cir. 1988).

49. *Id.* The court also noted that "[t]he notion of spreading the risk of punitive damages through insurance is more palatable in the arena of negligent conduct than in the arena of intentionally tortious conduct, which by definition requires the intent to cause the tortiously proscribed result with its concommitant heightened level of culpability." *Id.*

50. 666 F. Supp. at 180.

> provide for indemnity against consequences of the negligent conduct of the employer or owner himself. It is not believed that harmful negligence is made more probable by such indemnification . . . .[51]

A number of strong policy concerns may compel a court to void coverage for punitive awards based upon *intentional* conduct.[52] These concerns, however, do not transfer into the area of unintentional torts. As the *LeDoux* court said, "[i]n the absence of a defendant intending or expecting to injure another or to damage property, the public policy favoring punishment and deterrence is not sufficiently strong to justify nullification of contractual rights."[53]

3. *The "Nullification" of Contractual Rights Between the Insurer and the Insured Creates an Unjustified Windfall to Insurers.* Even if a sound basis could be found in public policy for disregarding the insurance contract that provides for punitive damages, there is nevertheless an important reason for enforcing the contract between insurer and insured as written: insurance companies should be required to honor their obligations and should not be allowed to reap windfalls at the expense of their insureds.[54] When a premium for insurance has been paid by the insured, and protection has been tendered by the insurer, denial of coverage (by courts *or* the insurance company) constitutes nothing less than a windfall to insurance companies for failing to exclude punitive damages from coverage:

> It is one thing for an insurance company to write a policy with provisions which exclude liability for punitive damages and to ask that this court construe and apply such policy provisions. It is quite another thing, however, for an insurance company which has written and issued an insurance policy in terms which include coverage for punitive damages — presumably at a premium which the insurance company believed to be sufficient as consideration for such coverage — to ask . . . [a] court to relieve it from such liability under its own insurance contract by a judicial declaration that the contract is void for reasons of "public policy."[55]

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51. 6A CORBIN ON CONTRACTS § 1421 (1962). *See also* Harrell v. Travelers Indem. Co., 567 P.2d 1013, 1016 (Or. 1977) (en banc).

52. Indeed, coverage for such conduct seems to undercut the policy that underlies punitive damages. *See* King, *supra* note 23, at 345.

53. 666 F. Supp. at 180.

54. *See, e.g.,* Price v. Hartford Accident and Indem. Co., 502 P.2d 522, 525 (Ariz. 1972) (noting that one component of a public policy inquiry is that an insurance company which takes a premium to cover all liability for damages should honor its obligations).

55. Harrell v. Travelers Indem. Co., 567 P.2d 1013, 1021-22 (Or. 1977) (en banc) (footnote omitted). *See also LeDoux,* 666 F. Supp. at 180 ("In the absence of a provision excluding punitive damages the insurance company is receiving premiums to cover these claims. Contracts should be enforced unless there is a strong public policy to the contrary.").

If the insurer drafts an insurance contract that does not exclude coverage for punitive damages, and further fails to exclude coverage for reckless conduct, Alaska law should require the insurer to pay for such an award. The simple alternative to this proposition is that insurance companies draft their contracts to exclude *all* punitive damage exposure under the policy.

4. *The Goals of Punishment and Deterrence Are Not Diminished by Coverage for Punitive Damage Awards Based Only Upon Unintentional Conduct.* The twofold purpose of punishment and deterrence is not vitiated by the coverage of punitive awards for unintentional torts. As the *LeDoux* court noted: "There are . . . collateral consequences of punitive damage awards that still further these objectives. Such an award carries with it a degree of opprobrium, affects the ability of the insured to obtain automobile liability insurance, and is apt to increase the rates tortfeasors are charged for insurance in the future."[56] The collateral consequences of punitive damage awards, in combination with the strong public policy behind enforcing contracts, further support the enforcement of the insurance contract.

D. Conclusion

Sound policy reasons to support *LeDoux* persist even in light of the *McNulty* rationale for voiding insurance provisions on the basis of public policy. Although the Alaska Supreme Court has not addressed directly this public policy issue, the *Shane v. Rhines* decision supports, at least implicitly, the *LeDoux* conclusion that insurance coverage for punitive damage awards is not per se violative of public policy.[57]

IV. THE RATIONALE AND MANNER IN WHICH INSURANCE COVERAGE FOR PUNITIVE DAMAGE AWARDS SHOULD BE CONSIDERED BY THE FACT FINDER

If indeed an insurance contract can be interpreted to provide coverage for punitive damage awards,[58] *Shane v. Rhines* demonstrates

56. 666 F. Supp. at 180. *See also Price,* 502 P.2d at 524.

57. *See supra* text accompanying notes 11-16.

58. Given the relatively clear guidelines in Alaska law regarding interpretation of insurance contracts, the insurance company's failure to expressly exclude punitive damage awards, for the reasons discussed *supra* text accompanying notes 43-56, should render the insurance contract presumptively enforceable as written. A plaintiff may nevertheless seek declaratory relief as to this issue when the insurance contract is ambiguous. *See* Jefferson v. Asplund, 458 P.2d 995, 999 (Alaska 1969) (Declaratory action is limited to no particular class of cases, and is confined to no special type of litigation. Its scope is pervasive.); ALASKA STAT. § 22.10.020(g) (1988) ("[T]he superior court . . . may declare the rights and legal relations of an interested party seeking

that such coverage is relevant to the appropriate *measure* of punitive damages.

A. The Relevance of Insurance Coverage to Punitive Damage Awards

The purpose of punitive damages under Alaska law is to punish the wrongdoer and deter others like him from repeating the offensive act.[59] Evidence of a defendant's financial condition normally is admissible to aid the fact finder in determining the size of a punitive damage award.[60] For this reason, a defendant's tax returns are admissible as evidence of a defendant's wealth in order to assist the fact finder in determining the size of the punitive damage award.[61]

As a general rule, however, the existence of the terms of an insurance policy are not admissible regarding the threshold issue of whether an individual acted negligently or wrongfully.[62] When not offered to demonstrate liability, the existence of the terms of the policy are indeed admissible.[63] Several commentators have argued that Federal Rule of Evidence 411 allows the admission of an insurance policy to determine the wealth of the defendant in the punitive damage setting. For instance, Professor Rothstein has said that "in cases coming within the exception expressed by the last sentence of [Rule 411], a judgment has been made that the benefits of admitting the evidence may outweigh the dangers . . . ."[64] Therefore, argues Professor Rothstein, "financial condition, including insurance, may be allowed to be shown on the issue of punitive damages (*i.e., to allow the damages to be tailored properly to "sting").*"[65]

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the declaration, whether or not further relief is or could be sought. The declaration has the force and effect of a final judgment or decree and is reviewable as such.").

59. Providence Washington Ins. Co. v. City of Valdez, 684 P.2d 861, 863 (Alaska 1984).

60. *See, e.g.,* Clary Ins. Agency v. Doyle, 620 P.2d 194, 205 (Alaska 1980) (noting that factors determining size of punitive damage awards are, inter alia, the wealth of the defendant).

61. *See, e.g.,* Leidhold v. District Court, 619 P.2d 768, 769-71 (Colo. 1980) (holding that gross income as shown by defendant's tax returns is discoverable regarding wealth of defendant when prima facie proof of triable issue on issue of liability for punitive damages is established by the plaintiff).

62. ALASKA R. EVID. 411; *see supra* text accompanying notes 11-14.

63. Shane v. Rhines, 672 P.2d 895, 900 (Alaska 1983). *See also* ALASKA R. EVID. 411.

64. P. ROTHSTEIN, FEDERAL RULES OF EVIDENCE 131, (1978).

65. *Id.* at 133 (emphasis added). *See also* C. WRIGHT & K. GRAHAM, FEDERAL PRACTICE AND PROCEDURE § 5364 (1981) ("Finally Rule 411 does not prohibit the use of evidence of insurance where it is relevant to the question of damages or punitive damages . . . .") (footnote omitted).

Under the above rationale, insurance coverage for punitive damage awards, similar to a defendant's tax returns, are properly admissible because it demonstrates the defendant's wealth for the purpose of assessing punitive damages.[66]

Under this rationale for the admission of insurance coverage for punitive damages, the implications of the Alaska Supreme Court's conclusion in *Shane v. Rhines* are far-reaching indeed. For instance, if one assumes that insurance coverage for punitive damage awards does not violate public policy, a persuasive argument could be made by the plaintiff in a personal injury action that, unless the jury *exhausts* the policy limits of the insurance policy, the jury will literally fail to punish the individual defendant for his wrongful conduct. For this reason, *Shane v. Rhines* provides plaintiffs in personal injury lawsuits with a great deal of leverage against insurance companies. Because of the potential exhaustion of the policy limits of the insurance policy in order to "reach" the individual defendant, insurance companies may be much more likely to settle a punitive damage-oriented case.

This result, however, need not necessarily be the case. As the *LeDoux* court emphasized, there are collateral consequences to punitive damage awards that further the objectives of punishment and deterrence.[67] A jury may well determine that the moral "opprobrium"[68] of the punitive damage award is sufficient to justify *not* exhausting the policy limits of the insurance policy. Moreover, defense lawyers may choose to argue the *McNulty* rationale[69] to the jury: i.e., that the insurance company has done nothing wrong, that higher insurance premiums will result from exhaustion of the policy limits and that punitive damages are essentially a windfall to the plaintiff.

In this way, the fact finder *itself* becomes the arbiter of public policy, depending upon the specific facts and circumstances of the case before it.[70] Thus, under the rationale offered by the Alaska Supreme

66. Very few decisions throughout the country appear to be expressly in accord with this conclusion. Indeed, with the exception of the commentators, *supra* note 65, only the Kansas Supreme Court has reached a conclusion similar to that of the Alaska Supreme Court regarding the relevance of insurance coverage for punitive damages. *See* Ayers v. Christenson, 564 P.2d 458, 461 (Kan. 1977) ("Here, plaintiffs sought punitive damages. The liability and damage issues were tried together. Evidence of the defendant's financial condition — of which insurance was a part — was relevant to punitive damages.").

67. 666 F. Supp. at 180.

68. *Id.*

69. Northwestern Nat'l Casualty Co. v. McNulty, 307 F.2d 432, 440-41 (5th Cir. 1962). *See also* text accompanying notes 37-40.

70. No court appears to have suggested this approach as a way to resolve the public policy dilemma analyzed *infra* in Section III(C). It would seem, however, that such an approach offers defendants a way in which to mitigate (or eliminate) what otherwise would be the consistent exhaustion of policy limits in cases where punitive

Court for the admission of such insurance coverage, the propriety, or public policy implication, of using such coverage to assess punitive damages could still be argued to the fact finder.

B. The Bifurcation of Punitive and Compensatory Damages as an Approach to the Admission of Insurance Coverage for Punitive Damage Awards

Once the issue of coverage for punitive damage awards has been determined, there remains the more practical question of how actually to admit the insurance policy into evidence. As the court noted in *Shane,* Alaska Rule of Evidence 411 generally bars the admission of evidence of whether the defendant is or is not insured against liability: "The danger that evidence of insurance will persuade a jury to alter its view on the threshold question of entitlement is precisely why Evidence Rule 411 requires exclusion of that evidence."[71] There are thus potentially serious practical problems with the admission of an insurance policy into evidence prior to the jury's determination of the threshold issue of whether punitive damages are warranted.

In his concurrence in *Shane,* Justice Compton suggested a solution to this evidentiary problem:

> The issue of the proper amount of punitive damages to award can simply be bifurcated from the other issues in the case. In this fashion the liability issues could be determined without the possibility of the jury's decision being tainted by evidence of the defendant's wealth. If the jury decides in the first phase of the trial that an award of punitive damages is appropriate, a second phase of the trial, using the same jury, could then be held to determine the proper amount of the award. At this separate phase, the needed evidence of the defendant's wealth, including evidence of any insurance coverage, could be presented.[72]

Justice Compton's approach to the evidentiary issue of insurance coverage for punitive damages is an appealing one.[73]

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damages are warranted, while at the same time allowing the plaintiff to argue that the contract of the insurer should be enforced.

71. *Shane,* 672 P.2d at 900.

72. *Id.* at 902 (Compton, J., concurring).

73. To test the validity of Justice Compton's reasoning regarding bifurcation, all of the Alaska district court and superior court judges, as well as the federal district court judges, were "polled" as part of the preparation of this article to determine whether bifurcation of the kind suggested by Justice Compton had been allowed in their courtrooms. The results of this poll were largely inconclusive because few of the judges had been asked to bifurcate the compensatory and punitive damage inquiries. *See, e.g.,* Letter from Judge Niesje J. Steinkruger to author (Feb. 14, 1990); Letter from Judge Richard D. Savell to author (Feb. 5, 1990); Letter from Judge Thomas E. Schulz to author (Jan. 31, 1990); Letter from Judge Duane Craske to author (Jan. 23, 1990); Letter from Judge Michael I. Jeffery to author (Jan. 23, 1990); Letter from Judge Rodger W. Pegues (Jan. 22, 1990); Letter from Judge Walter L. Carpeneti to

It would thus seem that the bifurcation of the punitive and compensatory damage inquiries reflects a practical solution to the evidentiary hurdles posed by Alaska Rule of Evidence 411. Moreover, this procedure does not appear to add undue length to the trial as is generally feared.

V. CONCLUSION

The decisions in *Shane* and *LeDoux* providing, either implicitly or explicitly, that some insurance policies can be construed to provide coverage for punitive damage awards finds broad support from both Alaska insurance contract law and public policy. Moreover, the proposition in *Shane* that such coverage is relevant to the appropriate measure of punitive damages has the potential to significantly affect the fact finder's inquiry. Once bifurcation of the punitive and compensatory damage inquiries becomes more widely used, the conclusions of *Shane v. Rhines* should have greater impact in tort litigation in Alaska.

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author (Jan. 19, 1990). Those that had been requested to bifurcate trials, however, did not suggest that the bifurcation request added unnecessary length to the trial. *See, e.g.,* Letter from Judge James M. Fitzgerald to author (Feb. 15, 1990) (Judge Fitzgerald had not granted request for bifurcation, but did not cite delay as the reason for refusal. He did indicate that he would use the same jury to avoid duplication of evidence.); Letter from Judge Thomas M. Jahnke to author (Feb. 7, 1990) (discussing bifurcation procedure used in Shanks v. Upjohn, 1PE-86-101 CI (Aug. 30, 1989), modeled after Justice Compton's opinion, estimating a three- to four-hour increase in total trial time). (Copies of letters are available from the offices of the *Alaska Law Review.*)