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Coverage of Punitive Damages by a Liability Insurance Policy

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COVERAGE OF PUNITIVE DAMAGES BY A LIABILITY INSURANCE POLICY

I. INTRODUCTION

Punitive damages have become an accepted mechanism of modern jurisprudence. Insurance is a necessity of modern life. When the two become interwoven the result is anything but predictable. In attempting to unravel the confusion many legal concepts are encountered: those relating to insurance, punitive damages, public policy and their inter-dependence. A look at these diverse considerations should clearly show the problems that arise. It is hoped this note can suggest what solutions will be the fairest to all concerned.

II. THE PRESENT STATUS OF INSURANCE COVERAGE

The argument against insurance coverage of punitive damages has been based on a concept of public policy.[1] One such case where coverage was denied found the court confronted with double and treble damages which, although similar to, are not synonymous with the punitive or exemplary award; the former being vitally linked to a criminal violation.[2]

The most recent case to deny the recovery of punitive damages was *Northwestern National Casualty Company v. McNulty*.[3] This decision was based largely on public policy as well as the state law of Florida which construes punitive damages as being a punishment and a deterrent.[4] This interpretation the court integrated into their public policy argument:

> Where a person is able to insure himself against punishment he gains a freedom of misconduct in-

1. Universal Indem. Ins. Co. v. Tenery, 96 Colo. 10, 39 P.2d 776 (1934).

2. Tedesco v. Maryland Cas. Co., 127 Conn. 533, 18 A.2d 357 (1941). It should be noted that Connecticut considers punitive damages as compensatory in effect; see note 19, **infra.**

3. 307 F.2d 432 (5th Cir. 1962).

4. Dr. P. Phillips & Sons, Inc. v. Kilgore, 152 Fla. 578, 12 So. 2d 465 (1943) Florida East Coast Ry. Co. v. McRoberts, 111 Fla. 278, 149 So. 631 (1933).

> consistent with the establishment of sanctions against such misconduct. It is not disputed that insurance against criminal fines or penalties would be void as violative of public policy. The same public policy should invalidate any contract of insurance against the civil punishment that punitive damages represent.[5]

There are decisions constituting the majority of case law which support the contrary view. Liability policies often recite their coverage limits as the liability imposed by law[6] or arising out of an accident.[7] The policy seldom says more than this in respect to its limits. In one recent case, where compensatory and punitive damages were awarded in one undivided sum, the decision supported the coverage of all damages assessed.[8] Part of their convincing argument was as follows:

> Negligent conduct may be so gross as to merit characterization as willful and wanton in the sense of the rule for punitive damages, yet fall far short of an assault and battery which would distinguish it from an accidental event and withdraw it from the coverage of the policy. . . . To allow the appellant's argument would lead to the illogical and indefensible result, contrary to the purpose and spirit of liability insurance policies, which are designed to protect members of the public, that the more extreme the recklessness the more likely the insurer would be able to escape liability.[9]

Several cases hold that since punitive damages are imposed by law and the policy covers liability imposed by law the only fair result is that punitive damages be held within the scope of the policy.[10] A few of these cases have had qualifying circumstances; such as a master-servant relationship[11] or the insured's obligations being statutory.[12] In *Ohio State Casualty Insurance Company v. Welfare Finance Co.* the

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5. **Supra** note 3 at 440.
6. General Cas. Co. v. Woodby, 238 F.2d 452 (6th Cir. 1956); Am. Fid. & Cas. Co. v. Werfel, 231 Ala. 285, 164 So. 383 (1935); Morrell v. Lalonde, 45 R.I. 112, 120 Atl. 435 (1923).
7. Penn. R & F. Mut. Cas. Ins. Co. v. Thornton, 244 F.2d 823 (4th Cir. 1957); Ohio Cas. Ins. Co. v. Welfare Fin. Co. 75 F.2d 58 (8th Cir. 1934).
8. Penn. T. & F. Mut. Cas. Ins. Co. v. Thornton, **supra** note 7.
9. **Id.** at 827.
10. **Supra** note 6.
11. Ohio Cas. Ins. Co. v. Welfare Fin. Co., **supra** note 7.
12. American Fid. & Cas. Co. v. Werfel, **supra** note 6.

court said the insurance coverage was not contrary to public policy.[13] Elaborating on the point, the court declared:

> Since this policy clearly covers bodily damage through negligence and since these punitive damages are imposed because of the aggravated circumstances or form of this negligence, such punitive damages must be regarded as coming within the meaning of the policy.[14]

With limited authority on the precise question involved, an analysis of the numerous problems entailed is necessary.

III. AN ANALYSIS OF PUNITIVE DAMAGES

First one must closely examine the concept, meaning, and acceptance of punitive damages.[15] Here arises the first of many ambiguities. The great majority of states view punitive damages as penal or a form of punishment.[16] The theory is that their infliction will serve as an example and deter future wrongdoers from similar types of action.[17]

Not all states view punitive damages solely as punishment. Oregon has construed punitive damages as serving the dual role of both compensation and punishment.[18] Most pronounced is the stand of Connecticut where the courts hold that what are called punitive damages in effect are compensatory.[19] They limit the amount of a "punitive" award to the plaintiff's expenses of litigation in the suit, less his taxable costs.[20] Michigan[21] and New Hampshire[22] also seem to hold punitive damages to be compensatory in effect.

A few states have curtailed litigation on the point by not

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13. 75 F.2d 58 (8th Cir. 1938).

14. **Id.** at 59.

15. A summary of jurisdictional acceptance and theory of punitive damages can be found in OLECK, DAMAGES TO PERSONS AND PROPERTY, § 269 (1961).

16. Bucher v. Krause, 200 F.2d 576 (7th Cir. 1952); Dixon v. Bertrum, 258 S.W.2d 24 (Mo. 1953); For an analysis of statutory interpretations see notes 27 and 28, **infra.**

17. Polk v. Missouri—Kansas—Texas R. Co., 351 Mo. 865, 174 S.W.2d 176 (1943); Sanders v. Rolnick, 188 Misc. 627, 67 N.Y.S.2d 652 (1947).

18. Kinzua Lumber Co. v. Daggett, 203 Ore. 585, 281 P.2d 221 (1955).

19. Chykirda v. Yanush, 131 Conn. 565, 41 A.2d 449 (1945); Armstrong v. Dolge, 130 Conn. 516, 36 A.2d 24 (1944); Hanna v. Sweeney, 78 Conn. 492, 62 Atl. 785 (1906).

20. **Supra** note 19.

21. Wise v. Daniel, 221 Mich. 229, 190 N.W. 746 (1922).

22. Bruton v. Leavitt Stores Corp., 87 N.H. 304, 179 Atl. 185 (1935).

allowing punitive damages. A Federal decision based on Illinois law refused to allow an equity court to assess punitive damages without express statutory provision.[23] Massachusetts by statute does not allow the awarding of punitive, vindictive, or exemplary damages in designated areas.[24] Washington does not allow the awarding of punitive damages except by express statutory provision.[25] Nebraska absolutely forbids the awarding of any damages not compensatory and has declared that awarding any damage in the form of a fine or penalty would be unconstitutional.[26] Even where punitive damages are unavailable it can be fairly presumed that the jury will vary its "compensatory" award in proportion to the gravity and carelessness exhibited in relation to the act giving rise to the litigation.

The question then arises as to what type of conduct will result in an award of punitive damages. North Dakota has a clear and liberal statute on exemplary damages, setting out when such an award can be made and its purpose. It reads as follows:

> When jury may give exemplary damages. — In any action for the breach of an obligation not arising from contract, when the defendant has been guilty of oppression, fraud, or malice, actual or presumed, the jury in addition to the actual damages, may give damages for the sake of example and by way of punishing the defendant.[27]

Other state statutes pertaining to punitive or exemplary damages are also revealing.[28] Based on these statutes and on case law there are many situations involving much less than an intentional act where punitive damages are allowed. A jury may infer malice and award exemplary damages.

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23. Taylor v. Ford Motor Co., 2 F.2d 473 (N.D. Ill. 1924).

24. Not allowed under Massachusetts law in action of libel or slander, M.G.L.A. c. 231 § 93 (1958); O'Reilly v. Curtis Pub. Co., 31 F. Supp. 364 (D.C. Mass. 1940); Also not allowed in Massachusetts in any action of tort against an executor or administrator, M.G.L.A. c. 230 § 2 (1958).

25. Wilson v. Sun Pub. Co., 85 Wash. 503, 148 Pac. 774 (1915).

26. Abel v. Conover, 170 Neb. 926, 104 N.W.2d 684 (1960); Wilfong v. Omaha & Council Bluffs St. Ry. Co., 129 Neb. 600, 262 N.W. 537 (1935); Riewe v. McCormick, 11 Neb. 261, 9 N.W. 88 (1881).

27. N.D. Cent. Code § 32-03-07 (1961).

28. Cal. Civ. Code § 3294 (1954); Colo. Rev. Stat. § 41-2-2 (1953); S.D. Code § 37.1902 (1960 Supp.).

29. Mahanna v. Westland Oil Co., 107 N.W.2d 353 (N.D. 1960); McCurdy v. Hughes, 63 N.D. 435, 248 N.W. 512 (1933).

Other cases have held that punitive damages will be awarded for mere wanton or reckless disregard of the rights of others,[30] and that malice is not a necessary element of the act in question.[31]

IV. THE RELATIONSHIP OF THE PUNITIVE DAMAGE CONCEPT TO INSURANCE COVERAGE

In relating punitive damages to the typical insurance contract the difficulties are apparent. Liability insurance will not allow coverage for injuries caused wilfully and intentionally. This is an express clause in many policies; if not, then statutes, courts, and public policy demand that such be the law.[32]

With many punitive awards involving accident liability policies, another question that comes to mind is whether the term "accident" encompasses an action for which punitive damages may be granted. There is both a liberal and a strict view as to what constitutes an accident. The cases representing the majority state, in essence, that the term accident is a more comprehensive term than negligence.[33] The word accident does not negate the existence of negligence on the part of the person who brought about the event.[34] This was aptly stated by the court in *Beaumont, S.L. & W. Ry. Co. v. Schmidt*:

> While the word "accident" is often used in the law of negligence as meaning the happening of an event without fault or neglect on the part of anyone, in its ordinary meaning it does not negative the idea of negligence on the part of the person whose act brought about the event.[35]

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30. Coryell v. Lawson, 25 Colo. App. 432, 139 Pac. 25 (1914); Lindquist v. Friedman's Inc., 366 Ill. 232, 8 N.E.2d 625 (1937).

31. Carlson v. McNeill, 144 Colo. 78, 162 P.2d 226 (1945).

32. Cal. Ins. Code § 533 (1955); N.D. Cent. Code § 26-06-04 (1961) provides: "An insurer is not liable for a loss caused by the wilfull act of the insured, but he is not exonerated by the negligence of the insured or of his agents or others."; Weis v. State Farm Mut. Auto. Ins. Co., 242 Minn. 141, 64 N.W.2d 366 (1954).

33. Sheehan v. Goriansky, 321 Mass. 200, 72 N.E.2d 538 (1947); Rothman v. Metropolitan Cas. Ins. Co. 134 Ohio 241, 16 N.E.2d 417 (1938); See Peterson v. Western Cas. & Sur. Co., 5 Wis. 2d 535, 93 N.W.2d 433 (1958).

34. Bundy Tubing Co. v. Royal Indem. Co., 298 F.2d 151 (6th Cir. 1962); Globe Indem. Co. of New York v. Banner Grain Co., 90 F.2d 774 (8th Cir. 1937).

35. 123 Tex. Rep. 580, 72 S.W.2d 899, 903 (1934).

It has been held that a harm constructively intentional falls within the category of an injury "caused by accident."[36] The strict minority view as to what constitutes an accident is simply that that the term excludes any act in which negligence is found.[37]

If the insurance policy covers accidents, and punitive damages can be awarded for what in law is deemed an accident, can the insurer then deny coverage? As already discussed, many policies cover the liability imposed by law. Here again, the average insured would reasonably assume that the total sum of the liability imposed by the court and jury would be fully covered by his policy.

V. THE ROLE OF PUBLIC POLICY

Textual material on this point would seem to conclude that there should not be coverage of punitive damages under a liability insurance policy.[38] Professor Oleck, in his treatise on damages, takes a similar position.[39] Public policy is the frame within which these conclusions are reached.[40]

What is public policy? It is an obvious supposition that the concept is variable. A precise definition is difficult, if not impossible. Generally, it means that nothing can be done that is injurious to the public or against the public good.[41] An act against public policy is one that a good citizen would deem an imposition on his personal rights and interests, whether concerned with personal liberty or private property.[42] Courts may declare rules of public policy; when they do their decisions will become part of the law. These declarations should not be based on mere whim, fancy, or personal prejudice; they should view history, the constitution of the jurisdiction, existing legislative declarations and judicial

36. Sheehan v. Goriansky, **supra** note 33 at 542.

37. Morrow v. Southeastern Stages, 68 Ga. App. 142, 22 S.E.2d 336 (1942); Richter v. Atlantic Co., 65 Ga. App. 605, 16 S.E.2d 259 (1941).

38. Comment, **Insurance: Liability Insurance: Recovery of Punitive Damages,** 14 Okla, L. Rev. 220 (1961); Note, **Insurance Coverage and the Punitive Award in the Automobile Accident Suit,** 19 U. Pitt. L. Rev. 144 (1957); Note **Punitive Damages and Their Possible Application in Automobile Accident Litigation,** 46 Va. L. Rev. 1036 (1960).

39. OLECK, DAMAGES TO PERSONS AND PROPERTY, § 275c (1961).

40. **Supra** notes 38 and 39.

41. Schulte v. Missionaries of La Salette Corp of Mo., 352 S.W.2d 636 (Mo. 1961).

42. Safeway Stores v. Retail Clerks Int'l Ass'n., 41 Cal. 2d 567, 261 P.2d 721 (1953).

precedent.[43] In the field of contracts, which includes insurance policies, public detriment will not be inferred where nothing sinister or improper is done or contemplated.[44] The violation of public policy must be apparent from the face of the contract itself.[45] Courts will not restrict a contract on the ground of public policy where any reasonable construction will uphold it.[46]

VI. AMBIGUITY OF POLICY TERMS

Conceding that a proper construction of a liability policy might indicate public detriment by including punitive damages within its coverage, there is still another argument in favor of the insured. Insurance law has long recognized that any ambiguity in the policy will be strictly construed against the insurer.[47] If the policy will support an interpretation imposing liability, such construction will be adopted.[48]

Liberal rather than narrow and unreasonable interpretations of clauses in an insurance policy are favored.[49] *Rothman v. Metropolitan Casualty Ins. Co.* stated that where insurance is against loss resulting from an accident any limitations or exceptions to policy coverage should be contained in the policy.[50] Another settled rule of law is that where the language is plain and clear no construction or interpretation is permissible.[51]

VII. CONCLUDING REMARKS

It is true that in most states punitive damages are expressly intended as punishment. A sound argument can

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43. Landgraver v. Emanuel Lutheran Charity Bd., 203 Ore. 489, 280 P.2d 301 (1955).

44. Steele v. Drummond, 275 U.S. 199 (1927); Allman v. Winkelman, 106 F.2d 663 (9th Cir. 1939).

45. Twin City Pipe Line Co. v. Harding Glass Co., 283 U.S. 353 (1931).

46. Vick v. Patterson, 158 Cal. App. 2d 414, 332 P.2d 548 (1958); Maryland Cas. Co. v. Fid. & Cas. Co., 71 Cal. App. 492, 236 Pac. 210 (1925).

47. McNally v. American States Ins. Co., 308 F.2d 438 (6th Cir. 1962); Jones v. Standard Life & Acc. Ins. Co., 115 So. 2d 630 (La. 1959); Universal Underwriters Ins. Co. v. Johnson, 110 N.W.2d 224 (N.D. 1961); Conklin v. North American Life & Cas. Co., 88 N.W.2d 825 (N.D. 1958).

48. McMaster v. New York Life Ins. Co., 183 U.S. 25 (1901); Schmitt v. Paramount Fire Ins. Co., 92 N.W.2d 177 (N.D. 1958).

49. Stipich v. Ins. Co., 277 U.S. 311 (1928).

50. 134 Ohio St. 241, 16 N.E.2d 417 (1938).

51. Bergholm v. Peoria Life Ins. Co., 284 U.S. 489 (1932); Roth v. Western Assur. Co., 308 F.2d 771 (8th Cir. 1962).

be made that all insured citizens should not be forced to pay higher premiums on their policies to allow insurance coverage of the statutory punishments imposed upon their fellowmen. However, it has been shown how ambiguous the concept of punitive damages is in relation to its definitions, purposes, and applications. When insurance covers an accident or simply the liability imposed by law and no more detail is set out, is the insured expected to become a legal scholar and know precisely what is meant?

The purpose of indemnity insurance is to protect the insured. Public policy accepts the liability insurance theory. To restrict coverage whenever serious fault is shown would shatter the concept on which indemnity insurance is founded.[52] To withhold coverage wherever there is negligence would result in coverage only where there is no possible liability.

The basic question presented as to the coverage of punitive damages is a difficult one to answer. Public policy actually can claim arguments, both pro and con, which of themselves reach a standoff. The two propositions are: 1) punitive damages are intended as punishment and should be personal to the party at fault; and 2) wherever there are questions as to coverage the policy will be strictly construed in favor of the insured. Ambiguities always present themselves in respect to the coverage at issue. With that much granted, why not hold the insurer to some responsibility by requiring him to expressly exclude damages not deemed compensatory or damages and liability imposed as punishment! Appleman, the acknowledged expert in the insurance field, supports coverage of punitive damages.[53] He also believes insurers would lose policies if they purposely excluded such coverage.[54] Actually, it seems hard to believe that the average citizen would prefer no insurance to having insurance for compensatory damages. Insurers can educate the public to reasons for withholding coverage of punitive or exemplary awards. It would seem to be their duty to so act

52. Messersmith v. American Fid. Co., 232 N.Y. 161, 133 N.E. 432 (1921). This case presents a stimulating analysis of indemnity and liability insurance by Justice Cardozo.

53. 7 APPLEMAN, INSURANCE LAW AND PRACTICE § 4312 (1962).

54. **Id.**, at p. 137.

if they believe the coverage should be limited to compensatory awards. Without such an express limitation by insurers, the doubt arising as to the policy coverage must be resolved against them!

To say there should be coverage is slighting bona fide interests and to say there should not be coverage is likewise being blind to a variety of considerations. It is submitted that it would truly be fair to hold the responsibility to the insurers and, if they fail to meet it, let them pay the full liability imposed upon their policy holders as a type of exemplary damage for their own lack of diligence.

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