

Don't Make Assumptions About Coverage for Punitive Damages

By [Leane Capps Medford](#)¹⁰

A common misconception exists that no insurance coverage is ever available for punitive damages, especially in aviation cases. In countless cases, insurers routinely issue reservation of rights letters when there is a claim for punitive damages without consulting the applicable state law, and insureds accept such reservations without question.

Many times this assumption is incorrect. Whether coverage for punitive damages exists in any particular case requires a complex legal and factual inquiry that should be conducted by all insurers and insureds. Indeed, in many states the law on the issue is in flux and opportunities exist to further develop the law on the insurability of punitive damages.

Whether coverage exists usually rests on (1) the terms of the policy, (2) what findings are obtained from the fact finder and what they mean under the applicable state law, and (3) whether the state has decided that allowing recovery of insurance for punitive damages is against the "public policy" of that state. Although some jurisdictions have firmly addressed the public policy issue, many have not. In the middle are jurisdictions, like Texas, that simply avoid the issue, although the Texas Supreme Court has suggested in dicta that it will decide in the right case.

The first inquiry is whether the insuring agreement provides coverage for punitive damages. In some jurisdictions, if a policy does not expressly exclude coverage for punitive damages, courts find that punitive damages are part of the "all sums" insuring clause that the insurer contractually agreed to pay on behalf of the insured where the insured is "legally obligated to pay" the punitive damages.¹¹ In other jurisdictions, similar language has been found to not provide coverage for punitive damages on the grounds that "damages" does

not include damages that are not compensatory, but rather are imposed solely for punishment.¹²

Another frequently litigated issue is whether the punitive damages are covered because they do not arise from bodily injury or property damage. Other cases address whether the insured's conduct was intentional or willful. Such conduct is often expressly excluded from coverage, while conduct that is merely grossly negligent most often is not.

A good example of why you should thoroughly analyze the availability of insurance for punitive damages prior to trial or settlement is the case of *Herrera v. C.A. Segurus Catatumbo*. In *Herrera*,¹³ the successful plaintiffs in a personal injury suit against a Venezuelan airline brought a declaratory judgment action against the airline's insurer seeking to recover upon a judgment awarding them compensatory and punitive damages. The plaintiffs alleged they were subjected to an improper cavity search and brought claims for intentional infliction of emotional distress, negligence, and false imprisonment.¹⁴ The jury returned a general verdict in favor of the plaintiffs on all three claims, but did not allocate a dollar amount to any particular claim.¹⁵ The trial court held that there was no coverage and the plaintiffs appealed.

The airline argued that no coverage was available because malice was a necessary element of all the plaintiffs' causes of action and the punitive damage award.¹⁶ The airline maintained that punitive damages were not covered because the policy excluded malicious acts. The court rejected these arguments, finding that the jury made no specific finding of malice and, moreover, malice was not a necessary element of all the plaintiffs' causes of action.¹⁷ Importantly, the court found there was coverage for punitive damages because the applicable state law allowed the jury to award

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¹¹ *South Carolina State Budget & Control Bd., Div. of General Services, Ins. Reserve Fund v. Prince*, 304 S.C. 241, 249, 403 S.E.2d 643, 648 (1991) (because the policy does not limit recovery to actual damages, rules of construction and interpretation dictate that it encompasses punitive damages); *Harrell v. Travelers Indem. Co.*, 279 Or. 199, 567 P.2d 1013, 1015-16 (1977) (rejecting argument that the insurer's intent was to provide coverage for compensatory damages and noting that insured would expect punitive damages to be included unless specifically excluded); *United Services Auto. Ass'n v. Webb*, 235 Va. 655, 658, 369 S.E.2d 196, 198 (1988); *State Farm Mut. Auto. Ins. Co. v. Lawrence*, 26 P.3d 1074, 1080 (Alaska 2001).

¹² *Calvin's Inc. v. Atlantic Mut. Ins. Co.*, 27 N.C. App. 698, 220 S.E.2d 403, 406 (1975); *Caspersen v. Webber*, 298 Minn. 93, 213 N.W.2d 327, 331 (1973); *Heartland Stores, Inc. v. Royal Ins. Co.*, 815 S.W.2d 39, 42 (Mo. App. 1991) ("all sums" did not include punitive damages because they were for punishment and not for bodily injury).

¹³ 844 So.2d 664 (Fla. 3d D.C.A. 2003).

¹⁴ *Id.* at 665.

¹⁵ *Id.*

¹⁶ *Id.* at 668.

¹⁷ *Id.*

punitive damages based on intentional actions or gross negligence. Because there was no finding whether the punitive damages were based on intentional acts, which were excluded, and gross negligence, which was not, the exclusion did not apply.¹⁸ Obviously, because state law differs on the standard for the imposition of punitive damages, choice-of-law battles may be critical to the ultimate issue of whether coverage is available.

If the policy language and applicable state law allow coverage of punitive damages, the next inquiry is whether coverage for punitive damage awards has been held to be against the state's public policy.

The debate surrounding the insurability of punitive damages began in the 1960s with two automobile insurance cases, *Northwestern National Casualty Co. v. McNulty*¹⁹ and *Lazenby v. Universal Underwriters Insurance Co.*²⁰ Each case addressed whether intoxicated drivers should be insured for damages caused by more than their mere negligence. Most courts that examine the public policy issues surrounding the insurability of punitive damages begin with an analysis of the arguments in these competing cases.²¹

In *McNulty*, an intoxicated driver hit the plaintiff and fled the scene, resulting in significant and permanent brain damage to the other driver.²² The jury awarded the plaintiff compensatory and punitive damages, and the plaintiff brought a successful separate action to recover all the damages from the driver's insurer.²³ The insurer appealed and asserted that punitive damages were not insurable because allowing coverage would be contrary to public policy.²⁴ The Fifth Circuit agreed, finding that the principle purpose of punitive damages is to punish and deter, neither of which is served by

allowing punitive damages to be shifted to the insurer.²⁵

Although this may be surprising to many insurers, few jurisdictions have adopted *McNulty*, and those that have temper its impact with multiple exceptions.²⁶ For example, they may allow coverage of punitive damages if they arise from vicarious liability.²⁷

On the opposite side of the debate is *Lazenby*, which held allowing insurance coverage for punitive damages does not violate public policy.²⁸ In rejecting the *McNulty* rationale, the court recognized that the purpose of punitive damages was to punish the wrongdoer and deter similar conduct by the wrongdoer or others. The court reasoned that allowing insurance for punitive damages would not undercut these policies because it would be speculative to assume that eliminating coverage for punitive damages would deter persons who were not already deterred by potential criminal actions, injury or death.²⁹ The *Lazenby* court also weighed the importance of the freedom to contract and the expectations of the insured, noting there is "often a fine line between simple negligence and negligence upon which an award of punitive damages can be made."³⁰ Some courts following *Lazenby* have reasoned that a deterrent effect still exists when punitive damages are insurable because the insured could later face higher insurance premiums or an inability to obtain insurance.³¹

In these jurisdictions, courts stress that insurers are able to charge additional premiums for punitive damages and are free to exclude punitive damages altogether.³² A significant factor in this line of cases is also the assumed expectations of the insureds, who assume they are covered for all damages claims that did not result from intentional acts.³³

¹⁸ *Id.* 667-68.

¹⁹ 307 F.2d 432 (5th Cir. 1962).

²⁰ 214 Tenn. 639, 383 S.W.2d 1 (1964).

²¹ See *Fairfield Ins. Co. v. Stephens Martin Paving, LP*, 246 S.W.3d 653, 661-64 (Tex. 2008).

²² *McNulty*, 307 F.2d at 433.

²³ *Id.*

²⁴ *Id.*

²⁵ *Id.* at 441.

²⁶ See *Fairfield Ins. Co.*, 246 S.W.3d at 661-62 n.13 (citing Ohio, Utah, California, Colorado, Illinois, New York, Rhode Island and South Dakota as states adopting a "broad prohibition against punitive damages," but recognizing that the Ohio statute is limited to certain automobile, casualty and liability policies).

²⁷ See *Beaver v. Country Mut. Ins. Co.*, 95 Ill. App.3d 1122, 1125, 420 N.E.2d 1058, 1061 (Ill. App. 5 Dist. 1981)(emphasizing that finding that one cannot insure for damages that arise out of one's own misconduct does not affect the rule that an employer may insure itself against vicarious liability for punitive damages); see *Town of Cumberland v. Rhode Island Interlocal Risk Mgt. Trust, Inc.*, 860 A.2d 1210, 1219 (R.I. 2004)(cited by the *Fairfield* opinion as having a broad public policy against the insurability of punitive damages but the opinion actually rejected the argument that Rhode Island's public policy bars an insured from indemnification for intentional torts when the insurance policy explicitly provides such coverage); Cf., *Allen v. Simmons*, 553 A.2d 541 (R.I. 1987).

²⁸ *Lazenby*, 214 Tenn. 639, 383 S.W.2d 1 (1964).

²⁹ *Id.*

³⁰ *Id.* at 648.

³¹ *Brown v. Maxey*, 124 Wis. 2d 426, 369 N.W.2d 677 (1985).

³² *Harrell*, 567 P.2d at 1020.

³³ See *Price v. Hartford Acc. & Indem. Co.*, 108 Ariz. 485, 502 P.2d 522, 524 (1972)(stating "it is clear that the average insured contemplates protection against claims of any character caused by his operation of an automobile, not intentionally inflicted").


In addition to emphasizing freedom to contract, courts also have been unwilling to find insurance contracts that include coverage for punitive damage as contrary to the public policy of the state when the policies were written under the state's insurance code or approved by the state's insurance board.³⁴ Today, the *Lazenby* philosophy has been codified as the public policy of a few states.³⁵

The generalization that the majority of jurisdictions follow *Lazenby* has its limits. Many of the courts that held that insuring against punitive damages is not against public policy based their rulings primarily on the underlying facts of the case or a particular type of insurance policy.³⁶ For example, many of the cases that have held it is not against public policy to provide insurance for punitive damages only considered the public policies underlying uninsured/underinsured motorist claims.³⁷ An insurer or insured should not assume the same public policy analysis applies to all cases or all policies.

Moreover, the principles underlying *Lazenby* may no longer apply in all cases. Does the assumption that the availability of insurance will not deter grossly negligent behavior apply to large corporations and to product liability cases? Are the expectations of consumers and sophisticated companies with risk departments as to the scope of their insurance the same? Like the principles underlying *McNulty*, the *Lazenby* philosophy is not necessarily invulnerable to attack even in jurisdic-

tions that have adopted its general holding. As a result, only in the rare case should an insurer or insured conclude without significant analysis that the public policy of the state allows coverage for punitive damages.

Additional issues are raised when the coverage available under underlying and excess policies is different. In a matter of first impression, the court in *Davis v. Allied Processors, Inc.* held that, when the primary coverage included coverage for punitive damages but the excess did not, it was improper to allocate the punitive damages to the primary policy to exhaust coverage and subject the excess insurer to the entire compensatory award.³⁸

With the exception of a few states that have clear statutes governing the issue, the continued debate over the insurability of punitive damages is far from over. In jurisdictions that follow the *McNulty* philosophy, new and additional arguments exist that providing coverage for punitive damages does not eliminate the punishment to the insured or their deterrent effect. The assumption that insurers in a highly regulated industry would pass on these costs to policy holders may also no longer hold true. In jurisdictions that follow the *Lazenby* philosophy, the arguments underlying the assumption that insurability does not affect deterrence or punishment may also be subject to attack depending on the insured. A creative advocate will still be able to craft arguments in favor of the positions of both insurers and insureds. 

³⁴ See *Dairyland County Mut. Ins. Co. v. Walgreen*, 477 S.W.2d 341 (Tex. Civ. App.—Fort Worth 1972, writ ref'd n.r.e); *Fairfield Ins. Co.*, 246 S.W.3d at 659-660 (Tex. 2008)(finding that the Texas Department of Insurance's regulatory scheme that approved standard policies and endorsements revealed the legislative intent to provide additional coverage for an employer's gross negligence because that authority was delegated to the Texas Department of Insurance by the Texas Legislature).

³⁵ Haw. Rev. Stat. §431:10-240 (2008); Mont. Code Ann. §33-15-317 (2008); Va. Code Ann. §38.2-227 (2007) ("It is not against the public policy of the Commonwealth for any person to purchase insurance providing coverage for punitive damages arising out of the death or injury of any person as the result of negligence, including willful and wanton negligence, but excluding intentional acts.")

³⁶ See *Fairfield Ins. Co.*, 246 S.W.3d at 660-61, n.12 (listing the 25 states that have "established generally that their public policy does not prohibit coverage" for punitive damages, but noting that these states also include or exclude cases based on uninsured motorist or vicarious liability).

³⁷ *Id.* (citing *State Farm Mut. Auto. Ins. Co. v. Lawrence*, 26 P.3d 1074, 1080 (Alaska 2001); *State Farm Mut. Auto. Ins. Co. v. Wilson*, 162 Ariz. 251, 782 P.2d 727, 729-36 (1989)).

³⁸ 214 Wis.2d 294, 571 N.W.2d 692, 693 (Ct. App. 1997).

Demystifying Medicare Extension Act Reporting Requirements

By [Elaine D. Solomon](#) and [Lev Kalman](#)³⁹

If you are an insurer or attorney involved in making payment to a Medicare beneficiary or potential Medicare beneficiary on an aviation personal injury claim, you should be aware of the new reporting requirements under the Medicare and Medicaid State Children's Health Insurance Program Extension Act (the "Act"), which are scheduled to go into effect April 1, 2011. A great deal of confusion and uncertainty exists as to the entire process, including what

must be reported, when the report must be made, and how counsel and insurers can protect themselves and their clients against potential penalties for reporting deficiencies. This article will "demystify" some of these issues.

Background

In 2007, Congress enacted the Act in order to further the goal that Medicare's payment of medical expenses

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