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How Insurers Try To Limit Coverage For Punitive Damages

By **Kelby Van Patten** (April 16, 2018, 5:43 PM EDT)

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Insurers treat it as a given that their policies do not cover punitive damages, and insureds often mistakenly accept that premise. However, there are circumstances in which punitive damages may be covered, and some insurers even sell policies that specifically provide coverage for punitive damages. This article explores (a) the arguments insurers make to avoid paying for punitive damages; (b) some of the ways to defeat those arguments; and (c) some of the creative tactics insurers are employing as they try to sell insurance for punitive damages awards even when the law prohibits that kind of coverage.

Policies, Policies, Policies — How Insurers Try to Limit Coverage for Punitive Damages, and Why They Sometimes Fail

Insurers rely upon two arguments for denying coverage for punitive damages: (1) Policy language prohibits it; and (2) public policy prohibits it. These arguments are often well-founded, but not always.

Policy Language Limiting Coverage for Punitive Damages

Insurers typically argue that standard policy language precludes coverage for punitive damages. If the policy language specifically excludes coverage for punitive damages, then the insurer is probably right. But if there is not a specific punitive damage exclusion, then the other provisions insurers typically rely upon are not as airtight as insurers suggest.

For example, a standard commercial general liability policy provides coverage for an "occurrence," which the policy defines as an "accident." It also has an exclusion for harm that is "expected or intended" by the insured. Insurers rely on these provisions to argue that, since punitive damages are inherently based on intentional conduct, they cannot be covered. But this is not true, for two reasons.

First, most states allow a punitive damages award to be based upon either intentional or reckless behavior. Reckless behavior falls short of the intentional standard; so, it is not true that punitive damages are inherently based on intentional conduct.

Second, courts in many states have found that these policy provisions limit coverage for intentional acts only if both (a) the conduct was intentional, and (b) the resulting harm was intended. As the Oregon Supreme Court has explained, "It is not sufficient that the insured's intentional, albeit unlawful, acts

have resulted in unintended harm; the acts must have been committed for the purpose of inflicting the injury and harm before [a] policy provision excluding intentional harm applies ... ."[1] So, even if punitive damages are based on an insured's intentional conduct, the "occurrence" requirement may be satisfied and the "expected or intended" exclusion may not apply, provided the insured did not intend the resulting harm.

Public Policy Limiting Coverage for Punitive Damages

Insurers also rely on public policy to argue that, even if their policy language does not exclude coverage for punitive damages, the applicable law precludes an insurer from indemnifying the insured for punitive damages.

In some states, insurers are right. In California, for example, courts bend over backwards to avoid providing coverage for punitive damages based on public policy.[2] Some other states follow suit.[3]

But other states take different approaches. For example, Virginia public policy permits coverage for punitive damages if the punitive damages are based on willful and wanton negligence, but not if they are based on intentional conduct.[4] As another example, under Illinois public policy, punitive damages may be covered if they are based on vicarious liability for an employee's misconduct, but not if they are based on the insured's own misconduct.[5]

Because different states have different public policies regarding the insurability of punitive damages, getting coverage for punitive damages can depend on choice of law rules. Before filing suit, an insured seeking coverage for punitive damages should carefully evaluate the insurability of punitive damages under the laws of all the states whose law may apply, and the insured should consider filing suit in a venue that will apply choice of law rules most likely result in favorable law. Because different states apply different choice of law tests when it comes to insurance coverage, the insured should carefully look at those different tests before selecting a venue.

Getting Creative: Yes, You Can Buy Punitive Damages Coverage, and Insurers Have Found Creative Ways to Make It Enforceable (When They Want To)

Some insurance companies have realized that many companies want coverage for punitive damage and are willing to pay significant premiums for that coverage. They want this coverage not because they intend to engage in conduct likely to result in punitive damages, but because there are many areas of business (such as being an employer in certain parts of the country, especially in certain industries) that carry a significant risk of claims that could result in punitive damages awards. Some insurers have therefore decided to embrace coverage for punitive damages rather than run from it, and to collect the premiums that go with that coverage.

The challenge these insurers face is that so many states have public policies that preclude coverage for punitive damages. So, while it may be simple for an insurer to draft a policy that covers punitive damages, how can the insurer give the insured any confidence that the coverage will be enforced, such that the insured is willing to pay premiums for it?

Creative insurers have found an answer: Don't let the courts decide whether the coverage is enforceable.

Some insurers sell punitive damages insurance (a "Puni-Wrap" policy) that specifically covers punitive

damages, and these policies have venue and choice of law provisions designed to take the enforceability question away from the courts. First, the policies contain a Bermuda choice of law provision. Second, the policies contain an arbitration provision requiring any coverage dispute to be decided in a Bermuda arbitration. Combined, these provisions are designed to provide the insured with some comfort that the insurer will not be able to nullify the coverage it sold by asking a United States court to declare the coverage unenforceable as a matter of public policy.

There is no guarantee that an insurer won't try to avoid its obligations under these policies. If the insurer files a declaratory relief action in state court to declare the coverage unenforceable, the insured would have to ask the court to enforce the Bermuda arbitration provision. A court may look for reasons not to enforce that provision if Bermuda's only connection to the case is that it provided the safest path for circumventing the state's public policy. Certainly, states are not friendly to these punitive damages policies — in New York, for example, brokers are precluded from selling them.[6] It would not be surprising if state courts find ways to avoid enforcing arbitration and choice of law provisions in punitive damages policies.

Regardless of enforceability, a punitive damages policy may still provide a valuable benefit when it matters most: Settlement discussions in the underlying action. When an insured faces significant punitive damages exposure in an ugly case, it is helpful for the insurer to know that it is the insurer, not the insured, who will face that exposure if the case goes badly. The insurer has a strong incentive to avoid that exposure rather than demand that the insured contribute significant sums toward settlement.

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[1] Nielsen v. St. Paul Cos., 583 P.2d 545 (Or. 1978)

[2] PPG Industries, Inc. v. Transamerica Ins. Co., 20 Cal. 4th 310, 975 P.2d 652 (1999).

[3] See, eg., Norfolk & W. Ry. Co. v. Hartford Acc. & Indem. Co., 420 F. Supp. 92, 95 (N.D. Ind. 1976) (applying Indiana law); Public Service Mut. Ins. Co. v. Goldfarb, 53 N.Y.2d 392, 442 N.Y.S.2d 422 (1981) (New York law); Lira v. Shelter Ins. Co., 913 P.2d 514, 518 (Colo. 1996) (Colorado law).

[4] Va. Code Ann. §38.2-227; see also Price v. Hartford Acc. & Indem. Co., 502 P.2d 522 (Ariz. 1972).

[5] Beaver v. Country Mut. Ins. Co., 95 Ill. App. 3d 1122, 420 N.E.2d 1058 (1981).

[6] New York Office of the General Counsel, Opinion No. 08-08-09 (August 27, 2008)