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Roy Ryden Anderson
Southern Methodist University, Dedman School of Law

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INDEMNITY AGAINST PUNITIVE DAMAGES: AN
EXAMINATION OF PUNITIVE DAMAGES, THEIR
PURPOSE, PUBLIC POLICY, AND THE COVERAGE
PROVISIONS OF THE TEXAS STANDARD
AUTOMOBILE LIABILITY INSURANCE POLICY

by

Roy R. Anderson, Jr.*

IN considering the question of whether exemplary damages assessed against an insured are covered by his liability insurance policy, it should be kept in mind that the concept of exemplary damages is as utilitarian a doctrine as exists in law. Depending upon the particular jurisdiction, court, and jury, exemplary damages serve to punish roguish defendants, to make examples of such defendants before society, to protect society's interest in right conduct and fair play, to compensate aggrieved plaintiffs for actual injuries too speculative to be proved with sufficient certainty, to vent the outrage of juries, to help insure payment of attorney fees of plaintiff counsel, and on and on.¹ Parading under aliases such as "vindictive damages," "punitive damages," and "smart money," the doctrine is truly chameleon-like, changing color with the jurisdiction, and hue with the circumstances of the particular case.

Although the social origins of exemplary damages have been traced to biblical times² and its legal origins in common law can be traced back some two hundred years,³ the concept has not developed in an orderly manner and we are left today with few fundamentals upon which to develop a thread of reasoning when analyzing the application of the doctrine to a particular legal problem. Lord Camden in *Huckle v. Money* is said to have been first to use the term "exemplary damages."⁴ In that case defendant falsely imprisoned plaintiff under an illegal warrant for a period of only six hours. A verdict of 300 pounds was upheld because the liberty of the plaintiff was at issue, even though the period of detention was short and he was quite well treated and plied "with beef steaks and beer."

The concept of exemplary damages is an outgrowth of the old common law practice of allowing juries unlimited discretion in setting the amount of

* B.A., Texas Christian University; J.D., Southern Methodist University. Associate Dean and Assistant Professor of Law, Southern Methodist University.

¹ See generally Morris, *Punitive Damages in Tort Cases*, 44 HARV. L. REV. 1173 (1931).

² "When a man steals an ox or a sheep, and slaughters or sells it, he shall restore five oxen for the one ox and four sheep for the one sheep." *Exodus* 21:37.

³ *Huckle v. Money*, 2 Wils. 205, 95 Eng. Rep. 768 (K.B. 1763); accord, *Chambers v. Robinson*, 2 Str. 691, 93 Eng. Rep. 787 (K.B. 1726).

⁴ 2 Wils. 205, 95 Eng. Rep. 768 (K.B. 1763); see 1 T. SEDGWICK, DAMAGES § 348 (9th ed. 1920), and Justice Stone's opinion in *Louis Pizitz Dry Goods Co. v. Yeldell*, 274 U.S. 112, 116 (1927).

damages.⁵ It was not until the early eighteenth century that courts began setting aside excessive verdicts in tort actions.⁶ With *Huckle v. Money* in the 1760's, courts began to talk in terms of "exemplary damages" and to affirm excessive verdicts on the basis of their compensating injured plaintiffs for intangible injuries such as mental suffering, wounded pride, and the like. The courts began saying that, in appropriate cases, large verdicts functioned to punish defendants as well as to compensate plaintiffs.⁷ This confusing blend of purposes, punishment on the one hand and compensation on the other, was picked up by American courts and was rampant in this country well into the nineteenth century.⁸ As compensation for intangible injuries came to be regarded as actual damages, the emphasis on exemplary damages began to shift from compensation to punishment. Unfortunately, remnants of this confusion of purpose of exemplary damages still exist in this country today, and as will be discussed later, necessarily complicate inquiries into whether liability insurance policies should cover exemplary damages assessed against the insured wrongdoer.

From the outset, the concept of punitive damages has been controversial and the butt of heated criticism.⁹ The concept has been chided for failing to fulfill its function of a deterrent and condemned for providing windfalls to lucky defendants. Indiscriminate windfalls, it has been suggested, violate the most basic of principles of damage law, the principle of compensation, that a plaintiff should be made whole but no more.¹⁰ A strong case has been made that, because the primary purpose of punitive damage awards is punishment, these awards are by nature criminal, and defendants subjected to them should be accorded the procedural due process safeguards of criminal proceedings—for example, the privilege against self-incrimination.¹¹ It has also been argued that exemplary damages should fall under the doctrine of double jeopardy, and a defendant should not be subjected to both criminal prosecution and civil penalty.¹²

To the critics of exemplary damages, Professor Dobbs in his treatise on remedies points to a fundamental function of exemplary damages in the modern legal scheme. Under what he labels the "bounty" or "private at-

⁵ See Note, *Exemplary Damages in the Law of Torts*, 70 HARV. L. REV. 517, 518-19 (1957).

⁶ Early cases include: *Chambers v. Robinson*, 2 Str. 691, 93 Eng. Rep. 787 (K.B. 1726); *Ash v. Lady Ash*, Comb. 357, 90 Eng. Rep. 526 (K.B. 1696); *Wood v. Gunston*, Style 466, 82 Eng. Rep. 867 (K.B. 1655).

⁷ *Huckle v. Money*, 2 Wils. 205, 95 Eng. Rep. 768 (K.B. 1763); *Wilkes v. Wood*, Lofft 1, 18-19, 98 Eng. Rep. 489, 498-99 (C.P. 1763).

⁸ See generally Note, *supra* note 5, at 520.

⁹ See *Fay v. Parker*, 53 N.H. 342, 382, 16 Am. R. 270, 320 (1873) labeling exemplary damages "a monstrous heresy . . . an unhealthy excrescence, deforming the symmetry of the body of the law." See also *Murphy v. Hobbs*, 7 Colo. 541, 5 P. 119 (1884); *Pegram v. Stortz*, 31 W. Va. 220, 6 S.E. 485 (1888); Willis, *Measure of Damages When Property Is Wrongfully Taken by a Private Individual*, 22 HARV. L. REV. 419, 420-23 (1909).

¹⁰ See Morris, *Rough Justice and Some Utopian Ideas*, 24 ILL. L. REV. 730 (1930); 70 YALE L.J. 1296 (1961).

¹¹ D. DOBBS, HANDBOOK ON THE LAW OF REMEDIES § 3.9, at 220 (1973) [hereinafter cited as DOBBS], citing Ford, *The Constitutionality of Punitive Damages*, in DEFENSE RESEARCH INSTITUTE, THE CASE AGAINST PUNITIVE DAMAGES 15 (1969).

¹² Aldridge, *The Indiana Doctrine of Exemplary Damages and Double Jeopardy*, 20 IND. L.J. 123 (1945); Willis, *supra* note 9, at 420-21.

torney general" theory,¹³ Professor Dobbs submits that punitive damages may often provide the needed incentive for a plaintiff to bring action against a defendant for outrageous behavior.¹⁴ His theory is that punitive damages are thereby beneficial to society, especially in cases involving wrongs against society generally, in situations where civil action would be otherwise economically unattractive or in situations where the plaintiff is reluctant to initiate criminal proceedings and the state is diverted by the burden of more important criminal matters.

The Court of Appeals of New York in *Walker v. Sheldon*¹⁵ recognized the importance of this function of exemplary damages. In *Walker* the court disregarded the longstanding rule in New York of not allowing punitive damages in actions for fraud and deceit because the public interest was at stake. The court said:

Punitive or exemplary damages have been allowed in cases where the wrong complained of is morally culpable, or is actuated by evil and reprehensible motives, not only to punish the defendant but to deter him, as well as others who might otherwise be so prompted, from indulging in similar conduct in the future. . . . Moreover, the possibility of an award of such damages may not infrequently induce the victim, otherwise unwilling to proceed because of the attendant trouble and expense, to take action against the wrongdoer.¹⁶

Even though controversy has always surrounded the doctrine, exemplary damages continue to be recognized, and generally awarded in appropriate cases, in the vast majority of jurisdictions in this country. Only three states, Massachusetts,¹⁷ Nebraska,¹⁸ and Washington¹⁹ refuse to recognize the doctrine in any case not authorized by statute.²⁰ Three other states, Con-

¹³ DOBBS § 3.9, at 205, 221.

¹⁴ See also C. MCCORMICK, HANDBOOK ON THE LAW OF DAMAGES § 77, at 276-77 (1935) [hereinafter cited as MCCORMICK]:

Perhaps the principal advantage is that it [the doctrine of exemplary damages] does tend to bring to punishment a type of cases of oppressive conduct, such as slanders, assaults, minor oppressions, and cruelties, which are theoretically criminally punishable, but which in actual practice go unnoticed by prosecutors occupied with more serious crimes. . . . The self-interest of the plaintiff leads to the actual prosecution of the claim for punitive damages, where the same motive would often lead him to refrain from the trouble incident to appearing against the wrongdoer in criminal proceedings.

¹⁵ 10 N.Y.2d 401, 179 N.E.2d 497, 223 N.Y.S.2d 488 (Ct. App. 1961).

¹⁶ 179 N.E.2d at 498, 223 N.Y.S.2d at 490.

¹⁷ See *City of Lowell v. Massachusetts Bonding & Ins. Co.*, 313 Mass. 257, 47 N.E.2d 265 (1943); *Boott Mills v. Boston & M.R.R.*, 218 Mass. 582, 106 N.E. 680 (1914).

¹⁸ See *Wilfong v. Omaha & Council Bluffs St. Ry.*, 129 Neb. 600, 262 N.W. 537 (1935); *Riewe v. McCormick*, 11 Neb. 261, 9 N.W. 88 (1881).

¹⁹ See *Conrad v. Lakewood Gen. Hosp.*, 67 Wash. 2d 934, 410 P.2d 785 (1966); *Anderson v. Dalton*, 40 Wash. 2d 894, 246 P.2d 853 (1952); *Wilson v. Sun Publishing Co.*, 85 Wash. 503, 148 P. 774 (1915).

²⁰ Most authorities list Louisiana among those jurisdictions refusing to allow exemplary damages. See MCCORMICK § 78, at 279. And indeed Louisiana decisions often repudiate the doctrine of exemplary damages absent statutory authorization. *Vincent v. Morgan's Louisiana & Tex. R.R. & Steamship Co.*, 140 La. 1027, 74 So. 541 (1917); *Post v. Rodrigue*, 205 So. 2d 67 (La. App. 1967). But in actions involving wrongs fraught with malice and wanton conduct, Louisiana courts allow a reasonable facsimile of exemplary damages under the theory of compensation. *Loeblich v.*

necticut,²¹ Michigan,²² and New Hampshire²³ recognize exemplary damages but regard their function as primarily compensatory. Notwithstanding the nagging hangover of the peculiar early common-law functional dichotomy of punishment and compensation,²⁴ all other states recognizing the doctrine regard exemplary damages as primarily punitive and as a windfall to the plaintiff.²⁵

The *Restatement of Torts* defines punitive damages in terms which would be acceptable in most states in this country.²⁶ The *Restatement* distinguishes punitive damages from nominal and compensatory damages on the basis of purpose and on the basis of method of computation.²⁷ Generally speaking, punitive damages are amounts awarded as damages for the purposes of punishing a defendant for outrageous conduct and deterring a defendant and others from similar future transgressions.²⁸ The conduct of the defendant which will give rise to exemplary damages must be either: (1) intentional and capable of being regarded as "wilful and malicious and wanton,"²⁹ or (2) grossly negligent coupled with a culpable state of mind exhibiting a "wanton disregard of the rights and safety of others."³⁰ Exemplary damages are assessed, not because of the degree of harm caused, but because of the nature of the defendant's wrong. Accordingly, a culpable state of mind on the part of the tortfeasor is necessary in order for exemplary damages to be appropriate in a given case.³¹ On occasion, cases speak in terms of gross negligence in itself being sufficient to give rise to punitive damages, thereby raising the inference that a culpable state of mind is not essential.³² But a close reading of such cases makes clear that

Garnier, 113 So. 2d 95 (La. App. 1959). As Professor Dobbs notes: "Presumably a thorn by any other name will hurt as much." DOBBS § 3.9, at 204 n.3.

²¹ In Connecticut exemplary damages are limited in amount to the expenses of litigation. MCCORMICK § 78, at 279. See *Tedesco v. Maryland Cas. Co.*, 127 Conn. 533, 18 A.2d 357 (1941), noted in 132 A.L.R. 1259 (1941); *Doroszka v. Lavine*, 111 Conn. 575, 150 A. 692 (1930), noted in 69 A.L.R. 1279 (1930); *Craney v. Donovan*, 92 Conn. 236, 102 A. 640 (1917).

²² *McFadden v. Tate*, 350 Mich. 84, 85 N.W.2d 181 (1957); *Hasted v. Van Wagnen*, 243 Mich. 350, 220 N.W. 762 (1928); *Wise v. Daniel*, 221 Mich. 229, 190 N.W. 746 (1922).

²³ *Bixby v. Dunlap*, 56 N.H. 456, 22 Am. R. 457 (1876); *Fay v. Parker*, 53 N.H. 342, 16 Am. R. 270 (1873).

²⁴ See text accompanying note 8 *supra*.

²⁵ See Gonsoulin, *Is an Award of Punitive Damages Covered Under An Automobile or Comprehensive Liability Policy?*, 22 Sw. L.J. 433 (1968).

²⁶ RESTATEMENT OF TORTS § 908 (1939).

²⁷ *Id.* § 903, comment (a).

²⁸ *Id.* § 908, comment (a); cf. *Northwestern Nat'l Cas. Co. v. McNulty*, 307 F.2d 432, 445 (5th Cir. 1962), stating that the rationale of compensatory damages is not so much a policy that the responsible party *should* pay, but more a policy that the wholly innocent party *should not* pay. With respect to punitive damages, however, the rationale is very much that the responsible party *should* pay.

²⁹ *Gostkowski v. Roman Catholic Church of the Sacred Hearts of Jesus & Mary*, 262 N.Y. 320, 186 N.E. 798, 799 (Ct. App. 1933).

³⁰ *Miller v. Blanton*, 213 Ark. 246, 210 S.W.2d 293, 294 (1948).

³¹ This concept should not be confused with the converse proposition of a minority of jurisdictions that exemplary damages will not lie unless substantial actual damages have been proven. See, e.g., *B & B Refrigeration & Air Conditioning Service Co. v. Stander*, 263 Md. 577, 284 A.2d 244 (Ct. App. 1971); *Mabry v. Abbott*, 471 S.W.2d 442 (Tex. Civ. App.—Waco 1971), error ref. n.r.e.; Annot., 17 A.L.R.2d 527 (1951).

³² See, e.g., *Smith v. Clemmons*, 216 Ala. 52, 112 So. 442 (1927); *Bailey v. Smith*, 132 S.C. 212, 128 S.E. 423 (1925).

the negligence involved must be so gross as to indicate a conscious disregard for the rights and safety of others or extreme anti-social behavior.³³ There are only two narrow areas of exception to this rule which are unimportant to the present discussion.³⁴

The issue of liability insurance coverage of exemplary damages assessed against an insured tortfeasor is necessarily confined to those cases involving gross negligence coupled with a culpable state of mind. Cases involving intentional misconduct do not present the problem because today liability insurance policies universally exclude intentional wrongdoing from coverage. In any event, the specific exclusion of intentional wrongdoing is relatively unimportant, because the courts in this country have long held insurance against willful misconduct to be violative of public policy.³⁵ Illustrative of this fact is the following statement by Justice Cardozo in *Messersmith v. American Fidelity Co.*: "Undoubtedly the policy is to be confined to liability for injuries that may be described as accidental. Even if its terms did not so limit it, the fundamental principle that no one shall be permitted to take advantage of his own wrong would import the limitation."³⁶ As fundamental as Justice Cardozo's observation may appear to be, there is authority to the contrary. An interesting case in point is the Sixth Circuit decision in *New Amsterdam Casualty Co. v. Jones*,³⁷ arising in Michigan. Jones, a gas station owner intentionally shot Martin under the erroneous belief that Martin was a gangster bent upon causing him harm. Jones served a criminal sentence for willful and felonious assault for his trouble. Jones' insurance policy covered accidental injury but did not specifically exclude intentional injuries. In the civil action by Jones against his insurance company, the court held that the distinction between intentional and accidental injuries is to be made from the viewpoint of the injured party. Accordingly, the injury in question was considered by the court to be accidental.³⁸ The court went on to reject the contention of the insurance company that insurance against intentional wrongdoing would violate public policy:

The public policy governing such contracts is that one should not profit from his own wrongful act, and that contracts to commit illegal acts or agreements which have a tendency to encourage unlawful conduct, are not to be sustained.

³³ Cf. *Rutland v. Dean*, 60 Ga. App. 896, 5 S.E.2d 601 (Ct. App. 1939); *Goff v. Lubbock Bldg. Prods.*, 267 S.W.2d 201 (Tex. Civ. App.—Amarillo 1953), *error ref. n.r.e.*

³⁴ The exceptions are cases involving abuse of power or privilege, such as wrongful firing of employees or wrongful stopping of services by utility companies, and cases in which the tortfeasor's conduct is so reckless that courts impute a culpable intent *per se*, even though the tortfeasor actually believed his conduct to be correct at the time. See generally DOBBS § 3.9, at 206-07.

³⁵ But see *Hill v. Standard Mut. Cas. Co.*, 110 F.2d 1001 (7th Cir. 1940), upholding policy exclusion from coverage of the wanton acts of the insured in action involving the Indiana guest statute requiring plaintiff to prove wanton negligence for recovery.

³⁶ 232 N.Y. 161, 133 N.E. 432, 433 (1921). See also *Richardson v. The Fair, Inc.*, 124 S.W.2d 885 (Tex. Civ. App.—Beaumont 1939), *error dismissed, judgment correct.*

³⁷ 135 F.2d 191 (6th Cir. 1943).

³⁸ Under this reasoning, it is unlikely that the court would have reached a different result even if the policy had specifically excluded intentional injuries.

In this regard, it is to be remembered that the insured is not seeking indemnity for the consequences of his own wrongful conduct; and that the provisions of the contract did not specifically insure against liability for unlawful acts. If the insured were bringing the action, a complete defense could be predicted and sustained on grounds of public policy that he could not profit by securing indemnity for his intentional wrongdoing; and if the policy had specifically insured against liability for intentionally injuring another, the contract would doubtlessly be void for its tendency to encourage illegal conduct.

Public policy is a changing concept and, in the case of a particular state, must be viewed in the light of the legislative acts and judicial pronouncements of that state; and courts are careful not to set aside contracts on grounds of public policy except in a clear case.³⁹

The court also reasoned that, since there was evidently no premeditation on the part of Jones, the insurance policy could not be said to have encouraged illegal conduct.

The court's hindsight on the premeditation point is indeed questionable. Further, one can only speculate as to why the court chose to disregard the obvious proposition that, regardless of who was party to the instant action, if the insurance company was obliged to pay for Jones' transgressions, Jones would no longer be legally obligated to do so. Fortunately, decisions along this line are few, and the strong rule of law in this country is that one may not insure himself against the consequences of his own intentional acts.

But this is not always to say that one cannot insure against the consequences of one's *illegal* acts. As Justice Cardozo noted in *Messersmith*,⁴⁰ the automobile safety and state highway laws have so covered the field that it is virtually impossible for liability to be incurred in an automobile accident without fault that is also a crime. State legislatures universally authorize indemnity by insurance companies for damages arising through the ownership, operation, and maintenance of automobiles, and "[t]o restrict insurance to cases where liability is incurred without fault of the insured would reduce indemnity to a shadow."⁴¹

As generally as the courts in this country have repudiated indemnity against intentional misconduct, they have allowed indemnity against simple negligence.⁴² And the courts have consistently held that indemnity against gross negligence is consistent with public policy as long as such negligence falls short of intentional wrongdoing.⁴³ As the Fourth Circuit noted in *Pennsylvania Threshermen & Farmers' Mutual Casualty Insurance Co. v. Thornton*: "Negligent conduct may be so gross as to merit characterization as willful and wanton in the sense of the rule for punitive damages, yet

³⁹ 135 F.2d at 193-94.

⁴⁰ 232 N.Y. 161, 133 N.E. 432 (1921).

⁴¹ 133 N.E. at 432; cf. *Jones v. Ross*, 141 Tex. 415, 173 S.W.2d 1022 (1943).

⁴² See generally Brin, *Punitive Damages and Liability Insurance*, 31 INS. COUNSEL J. 265 (1964); Morris, *Punitive Damages in Personal Injury Cases*, 21 OHIO ST. L.J. 216 (1960).

⁴³ See, e.g., *Pennsylvania Threshermen & Farmers' Mut. Cas. Ins. Co. v. Thornton*, 244 F.2d 823 (4th Cir. 1957); *General Cas. Co. of America v. Woodby*, 238 F.2d 452 (6th Cir. 1956).

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."⁴⁴ With respect to automobile guest statutes requiring gross negligence or wanton and malicious conduct in order for liability to attach, the courts have held with regularity that such coverage is not violative of public policy.⁴⁵ In *Travelers Insurance Co. v. Reed Co.* a Texas court reasoned as follows:

We have the same action both for ordinary negligence—the failure to exercise ordinary care—and gross negligence; and to the extent of compensation, both actions are governed by the same rules of law. A count on gross negligence includes all lesser degrees of negligence. . . . The only difference between the two actions is that in the action for gross negligence the injured party may recover punitive damages. Since on the issue of compensation the same rules of law govern both actions, and both actions are for 'negligence,' we think a policy of insurance, indemnifying the insured against loss resulting from negligence, should be construed to cover both ordinary and gross negligence.⁴⁶

Considering the one-time controversies over indemnity for simple negligence, gross negligence, and intentional misconduct, it is indeed surprising, if not ironic, that the very basic question of indemnity for exemplary damages escaped consideration for so long.⁴⁷ Even today less than one-third of the jurisdictions in this country have considered the question and there is a definite split in authority as to its answer. Simply stated, resolution of the issue requires a twofold analysis: (1) Is indemnity for exemplary damages provided for by the express wording of the coverage provisions of the insurance policy at issue? (2) If such coverage is provided for, does indemnity against exemplary damages violate public policy? For even though freedom of contract is as sacred a doctrine as is known to law, the parties thereto may not organize their individual relationships in contravention of basic tenets of public policy. Before detailed inquiry into each prong of the overall question, it will be helpful to turn to the brief and sketchy history of judicial decisions on the question in this country. Because the treatment

⁴⁴ 244 F.2d 823, 827 (4th Cir. 1957).

⁴⁵ See, e.g., *Barringer v. Employer's Mut. Liab. Ins. Co.*, 62 So. 2d 173 (La. 1952); *Rothman v. Metropolitan Cas. Ins. Co.*, 134 Ohio St. 241, 16 N.E.2d 417 (1938); *Travelers Ins. Co. v. Reed Co.*, 135 S.W.2d 611 (Tex. Civ. App.—Beaumont 1939), error dismissed, judgment correct; *United Serv. Auto. Ass'n v. Zeller*, 135 S.W.2d 161 (Tex. Civ. App.—San Antonio 1939), error dismissed, judgment correct. See also *General Cas. Co. of America v. Woodby*, 238 F.2d 452 (6th Cir. 1956); *Crull v. Gleb*, 382 S.W.2d 17 (Mo. Ct. App. 1964).

⁴⁶ 135 S.W.2d 611, 617 (Tex. Civ. App.—Beaumont 1939).

⁴⁷ Some writers suggest that insurance companies have assumed that they were liable for punitive damages assessed against their insured and have anticipated this expense in establishing premium rates. E.g., 63 COLUM. L. REV. 944, 950 (1963). As an explanation of the reason the issue has so successfully avoided litigation, however, the converse proposition is equally plausible. Probably the greatest factor which might explain this dilemma is the fact that the typical insurance company liberally engages in out-of-court settlements where actual damage is the result of gross misconduct on the part of its insured. Other factors to be considered are the sometimes relative monetary insignificance of punitive awards, the fact that punitive damages coupled with compensatory damages often amount to a sum well within policy limits, the failure of courts and juries to break down awards ascribing specific sums as compensatory and punitive damages, and the increased readiness of courts to reduce and remit large verdicts where the jury's concept of compensation is to the court's mind excessive.

of exemplary damages varies significantly among jurisdictions, the case law will be considered by jurisdiction with as much attention to chronology as feasible.

I. CASE HISTORY

Although as late as 1966 two distinguished writers were stating that a majority of the courts in this country held to the view that exemplary damages were recoverable under an automobile liability insurance policy,⁴⁸ presently the strong majority rule is to the contrary. Nine states⁴⁹ have ruled that exemplary damages are not covered by liability insurance, while six states⁵⁰ have ruled in favor of such coverage.⁵¹

A. Cases Not Allowing Coverage

Colorado. The first case to rule on the point was the Colorado Supreme Court decision in *Universal Indemnity Insurance Co. v. Tenery*.⁵² In *Tenery* Callahan rented an automobile from the Hertz Drive-Ur-Self System, Inc., and signed a rental agreement for the automobile. Later in the evening he carelessly and negligently operated the automobile so as to cause a collision with an automobile driven by Tenery. The collision resulted in property damage and personal injury to Tenery. In an action against Callahan, Tenery recovered compensatory and exemplary damages. Subsequently, Tenery brought a garnishment action against Universal Indemnity Insurance Company, which had issued the liability policy for Hertz. Universal Indemnity contended that it was not liable for exemplary damages, but did not assign this point as error on appeal. Stating that consideration of this point was necessary to do justice in the case, the Colorado Supreme Court nevertheless considered the question, and modified the judgment to exclude the exemplary damage claim. The court based its holding on the construction of the policy language, and, although the court did not discuss the question of public policy, the following language would indicate that public policy was also at the basis of the court's decision:

Included in the total amount of the judgment entered against the garnishee herein was the award of exemplary damages against defendant Callahan in the sum of \$1,000. This award was primarily for the punishment of Callahan for his wrongful acts and as a warning to others. It was in no wise compensation to the injured party for bodily injuries or actual loss occasioned by the negligence by Callahan. The insurance company did not participate in this wrong, and was under no contract to indemnify against such. In this particular matter the

⁴⁸ See 7 J. APPLEMAN, *INSURANCE LAW AND PRACTICE* § 4312 (1962); 15 G. COUCH, *CYCLOPEDIA OF INSURANCE LAW* § 56:27 (2d ed. 1966). See also 7 AM. JUR. 2D *Automobile Insurance* § 196 (1963).

⁴⁹ Arizona, Colorado, Connecticut, Florida, Kansas, Missouri, New Jersey, New York, Pennsylvania.

⁵⁰ Alabama, Arkansas, Kentucky, South Carolina, Tennessee, Texas.

⁵¹ Arguably New Jersey, for reasons noted herein, and Alabama and Kentucky, because of peculiar state statutes, should be dropped from the tally. The score would thereby be adjusted to eight for the majority and four for the minority.

⁵² 96 Colo. 10, 39 P.2d 776 (1934).

policy indemnifies against damage for bodily injuries, and nothing in addition is contracted for, and there is no further liability. The injured will not be allowed to collect from a non-participating party for a wrong against the public.⁵³

In 1971 two intermediate Colorado courts again considered the question and reaffirmed the decision in *Tenery*. In *Brown v. Western Casualty & Surety Co.*⁵⁴ the sole question before the court was whether the insurance company was liable for exemplary damages assessed against an insured under its liability policy.⁵⁵ Quoting the language from the decision in *Tenery*, the court ruled that exemplary damages are clearly not assessed "because of bodily injury," and accordingly, exemplary damages were not covered by the provision of the policy.

In *Gleason v. Fryer*⁵⁶ the Colorado Court of Appeals held that the trial court erred in permitting the plaintiff to recover exemplary damages from the garnishee insurance company and modified the judgment in this regard. Citing *Tenery*, the court stated that exemplary damages are intended primarily as punishment for wrongful acts and as an example to others. Accordingly, exemplary damages were not compensation for injuries suffered and were, therefore, not covered by the language of the liability policy.

Missouri. Following *Tenery*, the next case on point is *Ohio Casualty Insurance Co. v. Welfare Finance Co.*,⁵⁷ arising in Missouri and decided by the Eighth Circuit. The exact question before the court was whether a policy of liability insurance covered punitive damages assessed against the insured corporation for the negligent conduct of its employee. The insurance company argued that since the policy insured only against "accidentally sustained" injuries, the policy included only compensatory damages, but that, if the policy should be held to cover punitive damages, such coverage would be void as against public policy. The policy in question insured the corporation "against loss by reason of liability imposed by law upon the assured for damages on account of bodily injuries . . . accidentally sustained . . . by any person or persons, other than employees of the assured."⁵⁸ The court held that the policy language covered exemplary damages saying: "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."⁵⁹ With respect to the public policy argument, the court said:

⁵³ 39 P.2d at 779.

⁵⁴ 484 P.2d 1252 (Colo. Ct. App. 1971).

⁵⁵ Pertinent language of the policy was as follows: "To pay on behalf of the insured all sums which the insured shall become legally obligated to pay as damages because of bodily injury, sickness or disease, including death at any time resulting therefrom, sustained by any person and caused by accident." *Id.* at 1253.

⁵⁶ 30 Colo. 106, 491 P.2d 85 (Ct. App. 1971).

⁵⁷ 75 F.2d 58 (8th Cir. 1934), *cert. denied*, 295 U.S. 734 (1935).

⁵⁸ *Id.* at 58.

⁵⁹ *Id.* at 59. Citing several authorities, the court further said: "Under the Missouri law, where injuries are negligently caused and the negligence is of such an aggravated

'To allow one to insure oneself against the punishment intended in a verdict for punitive damages would be to defeat the purpose of the law in such case made and provided. To enforce the contract sued on in this case and to protect the appellee against punishment would be the same as to permit a defendant in a criminal case, after having been tried and convicted and sentenced to confinement either in a jail or a penitentiary, to substitute another in his stead.'⁶⁰

The court, however, went on to rule against the insurance company and to hold for coverage because in this case there was no direct or indirect participation by the master in the commission of the servant's act. The court reasoned that no public policy would be violated by protecting the master from the unauthorized action of his servant.

The first Missouri state court decision on point is *Crull v. Gleb*.⁶¹ As distinguished from the situation in *Ohio Casualty Insurance*, in *Crull* the insured was also the wrongdoer. The insurance company argued that, under the terms of the policy, it was not liable for exemplary damages assessed against its insured. The court decided in favor of the insurance company on the basis of construction of the policy language and on public policy. Noting that the chief purposes of punitive damages are punishment and deterrence, the court said:

This being true, it seems only just that the burden of paying punitive damages should rest ultimately, as well as nominally, on the party who actually committed the wrong. If the defendant Gleb was permitted to shift to garnishee the burden of the punitive damage award, then the award would have served no purpose. Plaintiff would have already been made whole through his compensatory damages, and the insurance company, which had done no wrong, would be punished. There is no language in the policy that provides for the payment of judgments for punitive damages.

Our highway safety problems have greatly increased. Death and destruction stalk our roads. The peaceful Sunday afternoon family drive through the hills has been abandoned by many as the result of brushes with near death at the hands of half-baked morons drunkenly weaving in and out of traffic at 80 or 90 miles per hour.

Criminal charges, convictions, and fines, are not a complete answer. These may be some atonement to society by the offender, but they have little deterring effect on others. In order for the theory of punitive damages . . . to work, the delinquent driver must not be able to transfer his responsibility for punitive damages to others.⁶²

Connecticut. Following the federal court decision in *Ohio Casualty Insurance Co.*, the next case of importance is *Tedesco v. Maryland Casualty Co.*,⁶³ arising in Connecticut. As noted above, under Connecticut law the

form or attended by such circumstances as to be wanton and reckless in character, punitive damages are authorized." *Id.* However, punitive damages are not generally awarded, even in Missouri, solely because the negligence is of an aggravated form. See notes 61-62 *infra*, and accompanying text.

⁶⁰ 75 F.2d at 60.

⁶¹ 382 S.W.2d 17 (Mo. Ct. App. 1964).

⁶² *Id.* at 23.

⁶³ 127 Conn. 533, 18 A.2d 357 (1941).

purpose of exemplary damages is not to punish the wrongdoer but rather to compensate the plaintiff for his injuries. The issue in *Tedesco* did not concern punitive damages per se, but rather dealt with an award under a Connecticut statute allowing multiple damages for injuries resulting from willful violation of traffic regulations. Presumably, however, there is no practical difference between penalties established by legislatures and those established by the courts with respect to pertinent coverage provisions of insurance policies and applicable public policy. The court based its decision against coverage on both construction of the policy language and public policy. The court stated: "A policy which permitted an insured to recover from the insurer fines imposed for a violation of a criminal law would certainly be against public policy. The same would be true of a policy which expressly covered an obligation of the insured to pay a sum of money in no way representing injuries or losses suffered by the plaintiff but imposed as a penalty because of a public wrong."⁶⁴ The court went on to say that the policy language imposing liability upon the insurance company for damages "because of bodily injury" clearly did not cover the penalty sum, but that if the language of the policy were susceptible to two constructions, that construction consistent with public policy should be adopted.

Florida. The best reasoned statement on the public policy point is Judge Wisdom's scholarly opinion for the Fifth Circuit in *Northwestern National Casualty Co. v. McNulty*.⁶⁵ The facts in *McNulty* are those upon which a strong statement of public policy would be readily generated. The insurance company issued a family combination automobile policy to Smith, a resident of Virginia. Smith was involved in an accident in Florida while in a drunken condition, traveling in excess of eighty miles an hour, and weaving from side to side on the highway. He attempted to pass an automobile driven by plaintiff McNulty where it was impossible to pass. He lost control of his car, smashed into the rear of McNulty's car, and fled the scene without stopping to render aid. Smith was arrested some twelve miles down the highway after his car had run out of gas. McNulty suffered severe personal injuries, including permanent brain damage. McNulty sued Smith in Florida state court and recovered both compensatory and punitive damages, and then brought an ancillary garnishment action against Smith's insurer, Northwestern National Casualty Company, in federal district court. Following the district court decision in favor of McNulty, the insurance company appealed to the Fifth Circuit from the portion of the judgment of the garnishment proceeding allowing recovery of exemplary damages under the insurance policy. The insurance company argued both that the language of the policy did not cover exemplary damages, and that, even if the policy construction would permit coverage, such coverage would violate public policy. The court based its holding against coverage entirely upon

⁶⁴ 18 A.2d at 359.

⁶⁵ 307 F.2d 432 (5th Cir. 1962).

the public policy argument.⁶⁶ The court stated that the fundamental purposes of exemplary damages are punishment and deterrence, and, accordingly, the burden of paying such damages should rest upon the wrongdoer. The court said that to rule otherwise would frustrate the basic purposes of exemplary damages, and noted that an attempt to shift the burden to the insurance company would, in reality, shift that burden to the public through increased insurance premiums. Society would then be punishing itself. Judge Wisdom expressed the opinion of the court as follows:

Where a person is able to insure himself against punishment he gains a freedom of misconduct inconsistent 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.⁶⁷

And further:

Considering the theory of punitive damages as punitory and as a deterrent and accepting as common knowledge the fact that death and injury by automobile is a problem far from solved by traffic regulations and criminal prosecutions, it appears to us that there are especially strong public policy reasons for not allowing socially irresponsible automobile drivers to escape the element of personal punishment in punitive damages when they are guilty of reckless slaughter or maiming on the highway. It is no answer to say, society imposes criminal sanctions to deter wrongdoers; that it is enough when a civil offender, through insurance, pays what he is adjudged to owe. A criminal conviction and payment of a fine to the state may be atonement to society for the offender. But it may not have a sufficient effect on the conduct of others to make the public policy in favor of punitive damages useful and effective To make that policy useful and effective the delinquent driver must not be allowed to receive a windfall at the expense of the purchasers of insurance, transferring his responsibility for punitive damages to the very people—the driving public—to whom he is a menace. We are sympathetic with the innocent victim here; perhaps there is no such thing as money damages making him whole. But his interest in receiving non-compensatory damages is small compared with the public interest in lessening the toll of injury and death on the highways; and there is such a thing as a state policy to punish and deter by making the wrongdoer pay.⁶⁸

⁶⁶ Through a process of negative reasoning, it might be asserted that by not considering the policy language issue the court indicated that it was of the opinion that construction of the insurance policy would permit coverage of exemplary damages. However, it is more plausible that the court felt its public policy position to be so strong that the language of the policy was irrelevant.

⁶⁷ 307 F.2d 432, 440 (5th Cir. 1962).

⁶⁸ *Id.* at 441-42. It would seem that the court is standing on a very weak leg of its public policy argument when it asserts that denying coverage of exemplary damages under liability policies will have a deterrent effect on reckless driving. See Judge Gewin's specially concurring opinion in *McNulty*:

All of us are concerned with the high death toll and personal injuries occurring on the highways, but I am somewhat skeptical that the prohibition of insurance against liability for punitive damages will accomplish the results expected by the majority. There is no certain measuring stick to determine the effectiveness with which the law operates in a given field, but all the states have rather strict criminal laws relating to the operation of motor vehicles. If the criminal penalties provided by such statutes

The question of coverage of exemplary damages by an automobile liability insurance policy presented itself for the first time in the Florida state courts in *Nicholson v. American Fire & Casualty Insurance Co.*⁶⁹ The Florida court cited *McNulty* with approval and based its decision in favor of the insurance company entirely upon public policy, saying that by so doing the question of interpretation of the policy need not be reached.

The Fifth Circuit later placed a limitation on its holding in *McNulty*. In *Ging v. American Liberty Insurance Co.*,⁷⁰ arising in Florida, the court held that where the insurance company did actually undertake the complete defense of its insured in an action for both compensatory and punitive damages, the insurance company must either act in good faith toward its insured in the entire undertaking, including the claim for exemplary damages, or be liable for such exemplary damages assessed against its insured. The court said that the *McNulty* decision should not be read as giving the insurance company a license to act in bad faith toward its insured with respect to punitive damages. In *Ging*, after undertaking to defend the entire suit and with the knowledge that assessment of punitive damages would be probable if the case were taken to trial, the insurance company refused an offer to settle within policy limits. The court implied that the insurance company did not act in good faith in refusing the settlement offer and also that it did not make full and fair disclosure to its insured of the settlement negotiations and of their status. *Ging* would indicate that the public policy in favor of fairness and diligence on the part of the insurance company in defending a claim against its insured overrides the public policy considerations against allowing the insured to pass his exemplary damage assessment to the insurance company. It should serve as a warning to insurance companies, in those jurisdictions holding against liability coverage of exemplary damages, that any undertaking to defend against claims involving exemplary damages should be undertaken with caution and full and fair disclosure to insureds.⁷¹

Two recent Florida cases illustrate that Florida is consistent with the strong majority rule in this country on the question of whether a liability insurance policy covers exemplary damages when assessed against an insured who is only vicariously liable for such damages. In *Sterling Insurance Co. v. Hughes*⁷² a Florida court held in favor of coverage in a situation where the insured was only vicariously liable. But in *Commercial Union Insurance Co. v. Reichard*⁷³ the federal district court, applying Florida law,

fail to deter the wrongdoers, I seriously doubt that closing the market to insurance coverage will do so. As a matter of fact, it is my judgment that the opposite result will follow.

Id. at 444.

⁶⁹ 177 So. 2d 52 (Fla. Ct. App. 1965).

⁷⁰ 423 F.2d 115 (5th Cir. 1970).

⁷¹ The Court based its holding on the conduct of the insurance company after the company had undertaken defense of the entire claim. The court specifically said that it did not intimate any holding as to whether an insurer has a duty initially to undertake defense of the exemplary damages aspect of a claim involving both exemplary and compensatory damages.

⁷² 187 So. 2d 898 (Fla. Ct. App. 1966).

⁷³ 262 F. Supp. 275 (S.D. Fla. 1966). Although the court granted a partial summary judgment in this case, it was reversed at 273 F. Supp. 952 (S.D. Fla. 1967). While the principle of law upon which the original judgment was granted was affirmed,

held that where the insured was more than vicariously liable, the liability policy did not cover exemplary damages assessed against the insured. The court said that, under circumstances where the insured authorizes or participates in the wrong, or knows in advance or should so know that his servant will or is likely to commit the wrong, the law will not permit such an employer to insure himself against exemplary damages for the wrongful conduct of his servant.

New Jersey. Although presumably not exactly on point, the 1964 New Jersey decision in *LoRocco v. New Jersey Manufacturers Indemnity Insurance Co.*⁷⁴ does bear on this discussion. The pertinence of the case is questionable because it is unclear from the facts whether exemplary damages were assessed against the insured because of wanton conduct or because of intentional acts. In holding against coverage of the exemplary damages under the insurance policy, the court would appear to have based its decision on public policy against allowing an insured to insure against his intentional wrongs. If this is true, much of the question of liability coverage for exemplary damages under New Jersey law remains open.

The noteworthy point of *LoRocco* is that the court placed a reasonable limitation on the rule in *Ging*. *LoRocco* was a declaratory judgment action against New Jersey Manufacturers Indemnity Insurance Company brought subsequent to a successful personal injury action by plaintiff LoRocco against the company's insured. In the prior action, plaintiff did not demand exemplary damages in its petition, but during the trial requested and received a trial amendment pleading for exemplary damages. In the subsequent declaratory judgment action LoRocco alleged that, because the insurance company controlled defense of the entire case, including the claim for exemplary damages, the insurance company was estopped to deny liability for such damages. The court held:

When the ambiguous pretrial order was amended *after* plaintiffs had completed presentation of their evidence, to clarify the issues and to manifest expressly for the first time that plaintiffs were also seeking punitive damages, the insurance company immediately objected to the amendment, pleaded surprise, disclaimed any responsibility for punitive damages, notified the insured and its driver that it would not defend them against such a claim and was withdrawing from that phase of the case, so that they might engage separate counsel to represent them, and then continued the defense upon the express understanding . . . that it would be answerable only for compensatory damages. Continuing to represent defendants under those circumstances did not make the insurance company liable to pay punitive damages. . . . The insured having by acquiescence accepted defense by the insurance company, with full knowledge of its disclaimer, the carrier may defend an action by a third party upon the policy, and if it appears that there is no coverage, there can be no recovery.⁷⁵

the court reversed the summary judgment because of the existence of an issue of material fact.

⁷⁴ 82 N.J. Super. 323, 197 A.2d 591 (1964).

⁷⁵ 197 A.2d at 595. Initially, the defendants in this action were the employee driver

Pennsylvania. In 1966 the question of exemplary damages and liability insurance coverage was presented for the first time in Pennsylvania by *Esmond v. Liscio*.⁷⁶ Although the court noted the policy language regarding coverage,⁷⁷ it based its entire decision against coverage on the public policy against permitting a tortfeasor to shift exemplary damages to his insurer. The court concluded that under Pennsylvania law the purposes of exemplary damages are punishment and deterrence, and that Pennsylvania follows the orthodox view that exemplary damages are in no sense compensatory. After quoting extensively from Judge Wisdom's opinion in *McNulty*, the court said:

When socially irresponsible drivers are guilty of reckless and grossly offensive conduct on the highways, there are sound and compelling policy reasons for not allowing them to escape the element of personal punishment in punitive damages. To permit insurance against the sanction of punitive damages would be to permit such offenders to purchase a freedom of misconduct altogether inconsistent with the theory of civil punishment which such damages represent.⁷⁸

Kansas. The next case of importance is Chief Judge Murrah's decision for the Tenth Circuit in *American Surety Co. v. Gold*,⁷⁹ arising under Kansas law. In *Gold* the insurance company argued against liability for punitive damages on the grounds that such damages were not covered by the language of the policy, and in the alternative, that such coverage would be against public policy. Noting that the courts of Kansas had not spoken on either of these points, the court expressly avoided the "troublesome question of coverage,"⁸⁰ and based its entire decision against coverage on public policy, citing with approval the *McNulty* decision. The insured argued that the insurance company was estopped to deny coverage because it had undertaken to defend the entire claim, including both compensatory and exemplary damages. The court summarily rejected this argument, saying that the insurance company had timely placed the insured upon notice that the company did not consider itself liable for the punitive damages, and the insured had signed an authorization for "claim service and non-waiver of rights" of the insurance company. The court said that the short answer to the insured's contention was covered by the following language from the *McNulty* decision: "The doctrines of estoppel and waiver do not in general apply in transactions that are forbidden by statute or that are contrary to public policy . . ."⁸¹ and, "since public policy forbids an insured to enter

of the vehicle and his dairy company employer. The question of exemplary damage coverage under the employer's liability policy did not arise, however, because, after plaintiffs presented their evidence, the action against the employer was dismissed on the grounds that the employee driver was not acting as an agent of the employer at the time of the accident.

⁷⁶ 209 Pa. Super. 200, 224 A.2d 793 (1966).

⁷⁷ "The policy further provides: 'The company will pay on behalf of the insured all sums which the insured shall become legally obligated to pay as damages because of: A. Bodily injury . . . caused by accident . . .'" 224 A.2d at 795.

⁷⁸ *Id.* at 799.

⁷⁹ 375 F.2d 523 (10th Cir. 1966).

⁸⁰ *Id.* at 525.

⁸¹ *Northwestern Nat'l Cas. Co. v. McNulty*, 307 F.2d 432, 442-43 (5th Cir. 1962),

into an insurance contract covering punitive damages, public policy forbids the accomplishment of the result by an estoppel."⁸²

The court in *Gold* also rejected the insured's contention that the Kansas Motor Vehicle Safety Responsibility Act⁸³ superseded any state public policy forbidding insurance against punitive damages. The court simply said that the purpose of the Act was to provide *compensation* for innocent victims of motor vehicle accidents, and under Kansas law, exemplary damages are punitive and have nothing to do with compensation.

*New York. Teska v. Atlantic National Insurance Co.*⁸⁴ was a case of first impression in New York, in which the only question before the court was whether the insurer under a standard automobile accident insurance policy was required to pay punitive damages awarded against its insured. Citing with approval Judge Murrah's opinion in *Gold*, the court held that coverage of punitive damages was against the public policy of the State of New York. The court met the insured's contention that this public policy was superseded by the Motor Vehicle Financial Security Act of New York⁸⁵ with the following language:

It is clear therefore, that the holdings in the various jurisdictions is [*sic*] that where there is compulsory insurance, it is not against public policy to require the insurance company to be liable for damages as a result of reckless, wanton or wilful acts of the insured, provided those damages are to compensate the injured party for his injuries. Where, however, as in the State of New York punitive damages are awarded for wilful or reckless negligence over and above compensatory damages, then such a holding would be against public policy. Under those circumstances the punitive damages awarded are to punish the defendant and not to compensate the plaintiff.⁸⁶

Arizona. The most recent case holding against coverage of exemplary damages by a liability insurance policy is the Arizona Court of Appeals decision in *Price v. Hartford Accident & Indemnity Co.*⁸⁷ Citing extensively from the *McNulty* decision, the court held that the public policy of Arizona prevents an insurance company from paying an exemplary damage award assessed against its insured when the insured has participated in the misconduct.

The court recognized that some jurisdictions have found no public policy prohibition against allowing such coverage of exemplary damages, their argument against Judge Wisdom's reasoning in *McNulty* being: (1) that because criminal laws have failed to decrease reckless driving significantly, it is very speculative whether closing the insurance market will so do; (2)

quoting *Montsdoca v. Highlands Bank & Trust Co.*, 85 Fla. 158, 95 So. 666, 668 (1923).

⁸² 307 F.2d at 442.

⁸³ KAN. STAT. ANN. §§ 8-722 to -762 (1972).

⁸⁴ 59 Misc. 2d 615, 300 N.Y.S.2d 375 (Dist. Ct. 1969).

⁸⁵ N.Y. VEH. & TRAF. LAW §§ 310-21 (McKinney 1970).

⁸⁶ 300 N.Y.S.2d at 378-79.

⁸⁷ 16 Ariz. App. 511, 494 P.2d 711 (1972).

that the language of insurance policies covering "all damages arising out of the negligent operation of automobiles" should be liberally construed in favor of the insured; and (3) that in most cases the whim of the jury will govern the extent of coverage and the jury cannot accurately make the distinction between ordinary and gross negligence.⁸⁸ In response to these contentions the court stated:

[1] The first argument assumes, without supporting evidence, that absent criminal sanction, the rate and severity of highway accidents would be unchanged. We see no basis for such an assumption. In Arizona, the purpose of punitive damages is not to compensate the injured plaintiff but rather to punish the defendant for his misconduct. . . . Permitting a wrongdoer to shift the burden of payment to an insurance company would negate the very purpose of punitive damages, i.e., punishment.

[2] Strongly entrenched in our law is the proposition that ambiguous language in insurance contracts must be liberally interpreted in favor of the insured and against the insurer. . . . This proposition has no applicability to the case at bar inasmuch as the trial court determined that the policy language covered punitive damage awards. We are asked herein only to determine whether public policy voids such coverage.

[3] The third argument is in essence an attack on our jury system. We must assume that a jury will follow the instructions and correctly decide the issues presented, in the absence of a clear showing to the contrary. Such possible discrepancies are best handled on a case-by-case basis and do not detract from the conclusion reached herein.⁸⁹

The court further held that the financial responsibility laws of the State of Arizona were not in conflict with the court's conclusions in the case. The court said that the purpose of such laws is to insure compensation of innocent victims of automobile accidents and "not to insulate reckless drivers from possible punitive damage awards."⁹⁰

B. Cases Allowing Coverage

Alabama. Other than the Eighth Circuit decision in *Ohio Casualty Insurance Co. v. Welfare Finance Co.*,⁹¹ the earliest decision in favor of liability insurance coverage of punitive damages is that of the Supreme Court of Alabama in *American Fidelity & Casualty Co. v. Werfel*.⁹² Alabama decisions such as *Werfel* and *Capital Motor Lines v. Loring*⁹³ are of little value as precedent to other jurisdictions on the question of indemnity against punitive damages. These cases are wrongful death actions, and, under the unique Alabama wrongful death statutory scheme,⁹⁴ all damages arising in

⁸⁸ 494 P.2d at 713-14.

⁸⁹ *Id.*

⁹⁰ *Id.* at 714.

⁹¹ 75 F.2d 58 (8th Cir. 1934), *cert. denied*, 295 U.S. 734 (1935); *see notes 57-60 supra*, and accompanying text.

⁹² 230 Ala. 552, 162 So. 103, *aff'd*, 231 Ala. 285, 164 So. 383 (1935).

⁹³ 238 Ala. 260, 189 So. 897 (1939).

⁹⁴ ALA. CODE tit. 7, § 123 (1960).

wrongful death actions are regarded as purely punitive, even though they perform a compensatory function.

However, an interesting decision of the Supreme Court of Alabama, *Employers Insurance Co. v. Brock*,⁹⁵ may place Alabama generally among those jurisdictions holding in favor of coverage of punitive damages under a liability insurance policy. In *Brock* the action arose under the Alabama automobile guest statute rather than under the wrongful death statute. The guest statute of Alabama does not incorporate the unique treatment of punitive damages of the wrongful death statute. Accordingly, by holding in favor of coverage of punitive damages, the court extended the holdings in *Werfel* and *Loring* to actions arising under the guest statute, and possibly, to general situations involving punitive damages. The actual meaning of the court's decision in *Brock* is unclear. The court gave no reasons for its decision, and, although it obliquely cited *Werfel*, it made no distinction between the situation in *Brock* and that in *Werfel*.

Kentucky. The next case in time holding in favor of coverage of exemplary damages by a liability insurance policy is the Kentucky intermediate appellate court decision in *Maryland Casualty Co. v. Baker*.⁹⁶ As with the Alabama cases, the *Baker* case is of little value as precedent to other jurisdictions because of a particular state statute. In a prior action, the plaintiff Baker had recovered a judgment for personal injuries against the insured, a taxicab owner and operator, for an assault by an employee taxi driver. The action resulted in a judgment for both compensatory and punitive damages. The judgment was not satisfied and plaintiff brought a subsequent action against the insured's insurance companies. The court held that the punitive damages were covered by two automobile liability insurance policies issued to the taxicab owner under a Kentucky statute requiring financial responsibility of the holders of permits to operate taxicabs. The court did not rest its decision on public policy, but rather on the language of the statute which protected passengers against damages resulting from "any act or omission connected with the operation of motor vehicles," and which insured the payment of "any final judgment" rendered against the operator of the taxi on account of such damage.⁹⁷

Tennessee. The first case directly on point holding in favor of coverage of exemplary damages by a liability insurance policy is the Sixth Circuit opinion in *General Casualty Co. of America v. Woodby*.⁹⁸ The pertinent portion of the policy in *Woodby* obligated the insurance company "to pay on behalf of the insured all sums which the insured shall become obligated to pay by reason of the liability . . . imposed upon him by law, (a) for damages . . . sustained . . . by any person"⁹⁹ The insurance company contended that this language did not obligate it to pay the exemplary dam-

⁹⁵ 233 Ala. 551, 172 So. 671 (1937).

⁹⁶ 304 Ky. 296, 200 S.W.2d 757 (Ct. App. 1947).

⁹⁷ 200 S.W.2d at 761.

⁹⁸ 238 F.2d 452 (6th Cir. 1956).

⁹⁹ *Id.* at 457.

ages assessed against its insured because they are penalties rather than true "damages." The company supported its position with authorities holding that intentionally inflicted injuries are not accidental injuries under liability insurance policies. The court held that injuries from gross or wanton negligence are not the same as injuries caused intentionally; therefore, punitive damages are liabilities imposed by law for damages within the meaning of the policy. The court based its entire decision on construction of the policy language and made no mention of public policy.

In *Lazenby v. Universal Underwriters Insurance Co.*¹⁰⁰ the Supreme Court of Tennessee upheld the reasoning of the Sixth Circuit in *Woodby*. The pertinent policy provision in *Lazenby* reads as follows: "Coverage A—Bodily Injury Liability. To pay on behalf of the insured all sums which the insured shall become legally obligated to pay as damages because of bodily injury, sickness or disease, including death at anytime resulting therefrom sustained by any person caused by accident and arising out of ownership, maintenance or use of the automobile."¹⁰¹ The court admitted that the primary purposes of punitive damages in Tennessee are punishment and deterrence, and noted and cited extensively from the Fifth Circuit decision in *McNulty*. However, it declined to follow *McNulty* for three reasons. First, the court said that, although it accepted as common knowledge the fact that highway accidents and resulting deaths and injuries are a very serious problem, it was "not able to agree [that] the closing of the insurance market, on the payment on punitive damages, to such drivers would necessarily accomplish the result of deterring them in their wrongful conduct."¹⁰² Second, the court said that the language in the insurance policy had been construed by most courts to cover punitive damages and it was its opinion that the average policy holder, after reading the language, would believe he was protected against all claims not intentionally inflicted. Third, the court said that to deny coverage of punitive damages would be to void in part the contract between the insurance company and its insured. Considering all factors, it found no persuasive public policy reasons for such action, because partial voiding of private contracts should not be done except in the clearest of cases.

South Carolina. The 1957 Fourth Circuit decision in *Pennsylvania Threshermen & Farmers' Mutual Casualty Insurance Co. v. Thornton*,¹⁰³ arising in South Carolina, is one of the more frequently cited decisions holding in favor of coverage. During trial, and again on appeal, the insurance company contended against liability on the questionable basis that punitive damages are assessed for willful acts, rather than negligence, and the insurance policy covered negligent but not intentional acts. The court summarily rejected this contention, noting that negligent conduct may be of such a gross nature as to be characterized as wanton and willful for purposes of assessing punit-

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

¹⁰¹ 383 S.W.2d at 2.

¹⁰² *Id.* at 5.

¹⁰³ 244 F.2d 823 (4th Cir. 1957).

tive damages and yet fall far short of intentional wrongdoing. The court went on to say:

Punitive damages are not limited to assaults and batteries, and the award of such damages does not convert the case into an assault and battery. 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 to escape liability.¹⁰⁴

This decision has received much attention, primarily because it was rendered after the persuasive Fifth Circuit decision in *McNulty* and, indeed, expresses a contrary policy. It should be noted, however, that the court's policy statement is in response to a highly questionable contention by the insurance company. One can only wonder how the court would have responded to more persuasive public policy arguments, had they been presented.

Of greater interest is the 1965 Supreme Court of South Carolina decision in *Carroway v. Johnson*.¹⁰⁵ In *Carroway* the court based its holding entirely upon construction of the policy language: "To pay on behalf of the insured all sums which the insured shall become legally obligated to pay as damages because of: A. bodily injury . . . sustained by any person . . . arising out of the . . . use of the owned automobile or any non-owned automobile . . ." ¹⁰⁶ Although the court noted that, under the well settled rule of policy construction, all ambiguities must be construed most liberally in favor of the insured, it did not specifically find any ambiguity in the quoted language. The court observed that the policy language obligated the insurance company to pay "all sums" which the insured was legally obligated to pay as damages, and punitive damages are sums required to be paid as damages, but said that the question of whether or not punitive damages are "damages because of bodily injury" was a more difficult question. After quoting *Appleman*¹⁰⁷ with approval to the effect that the average insured contemplates coverage of all claims arising out of his use of his automobile, including punitive damages, the court decided that the language of the insurance policy, granting coverage for all damages arising because of bodily injury, was sufficiently broad to cover liability for punitive damages.

Arkansas. The Arkansas Supreme Court in *Southern Farm Bureau Casualty Insurance Co. v. Daniel*¹⁰⁸ held in favor of coverage of punitive damages under a standard automobile liability policy both on the basis of policy construction and on public policy. In the comprehensive automobile policy in question the company agreed:

¹⁰⁴ *Id.* at 827.

¹⁰⁵ 245 S.C. 200, 139 S.E.2d 908 (1965).

¹⁰⁶ 139 S.E.2d at 909.

¹⁰⁷ 7 J. APPLEMAN, *supra* note 48, § 4312, at 132-33.

¹⁰⁸ 246 Ark. 849, 440 S.W.2d 582 (1969).

To pay on behalf of the insured all sums which the insured shall become legally obligated to pay as damages:

Coverage A. Because of bodily injuries sustained by any person, and

Coverage B. Because of injury to or destruction of property, caused by accident and arising out of the ownership, maintenance, or use of any automobile, including loading and unloading thereof.¹⁰⁹

The court noted that under Arkansas law no recovery for punitive damages is allowed unless substantial actual damages are suffered.¹¹⁰ Accordingly, with somewhat curious reasoning, the court held that, because a defendant cannot become legally obligated to pay punitive damages unless actual damages have also been assessed, punitive damages do constitute sums, under the provisions of the policy in question, which the insured shall become legally obligated to pay as damages because of bodily injuries sustained. The court went further, holding that it could find nothing under Arkansas public policy which would prohibit coverage of punitive damages by the insurance policy in question:

Since we have permitted punitive damages to be assessed against an employer under the doctrine of respondeat superior even in the absence of the employer's knowledge or authorization of the employee's acts, we can perceive of no good reason why an employer should be prohibited from insuring himself against such losses, since the losses are in effect a business loss—*i.e.* a calculated risk of doing business.¹¹¹

Texas. The most recent decision in favor of coverage of punitive damages by an automobile liability insurance policy is that of the Texas Court of Civil Appeals in *Dairyland County Mutual Insurance Co. v. Wallgren*.¹¹² In reaching its decision the court rejected the insurance company's contention that such coverage would violate public policy of the state and held that the policy language clearly covered punitive damages. In rejecting the public policy argument, the court stated that public policy is reflected by expressions of state constitutions, state statutes, and judicial decisions, which are often enlarged to include the administrative practices of state officers. Accordingly, since a state administrative agency, the Texas Insurance Commission, had prescribed and approved the policy language in question, the court summarily held that such policy language reflected public policy and, therefore, was incapable of violating it. In considering whether the policy language covered punitive damages, the court quoted the following portion of the policy: "[The company is obligated to] pay on behalf of the insured all sums which the insured shall become legally obligated to pay as damages because of: . . . bodily injury, sickness or disease, including death

¹⁰⁹ 440 S.W.2d at 583.

¹¹⁰ See *Holmes v. Hollingsworth*, 234 Ark. 347, 352 S.W.2d 96 (1961); *Miller v. Blanton*, 213 Ark. 246, 210 S.W.2d 293 (1948); *Kroger Grocery & Baking Co. v. Reeves*, 210 Ark. 178, 194 S.W.2d 876 (1946).

¹¹¹ 440 S.W.2d at 584.

¹¹² 477 S.W.2d 341 (Tex. Civ. App.—Fort Worth 1972), *error ref. n.r.e., noted in* 10 Hous. L. Rev. 192 (1972).

resulting therefrom, hereinafter called 'bodily injury,' sustained by any person . . . arising out of the ownership, maintenance or use of the owned automobile or any non-owned automobile"¹¹³ Citing a local secondary source¹¹⁴ and the Sixth Circuit decision in *General Casualty Co. of America v. Woodby*,¹¹⁵ the court held that the above language clearly covered punitive damages.

II. THE TEXAS VIEW: A TWOFOLD ANALYSIS

The foregoing decisions would indicate that there is no judicial trend in this country with respect to the issue of coverage of punitive damages under liability insurance policies. Judicial decisions over the past decade which represent cases of first impression in their respective jurisdictions have divided about equally on the matter. The scope and purposes of punitive damages vary significantly among jurisdictions, and accordingly, close analysis of the problem should be confined to a particular jurisdiction, with guidance taken where appropriate from decisions in other jurisdictions. This Article will concern itself illustratively from this point with Texas law. Nevertheless, most of the comments can be applied with equal force to other jurisdictions. To begin, two nutshell generalizations should be made. First, under the clear wording of pertinent coverage provision of automobile liability insurance policies, punitive damage coverage is not contracted for. However, serious argument can be made in favor of construing such policies so as to provide coverage of punitive damages. Second, whether or not the policy is interpreted in favor of such coverage, either interpretation is consistent with public policy. This second proposition is especially true in those jurisdictions, such as Texas, which attribute a compensatory as well as a punitive function to exemplary damages.¹¹⁶

A. *Punitive Damages and Construction of the Insurance Policy*

The pertinent language of the Texas standard automobile liability insurance policy reads as follows:

[The company is obligated to] pay on behalf of the insured all sums which the insured shall become legally obligated to pay as damages because of: . . . bodily injury, sickness or disease, including death resulting therefrom, hereinafter called 'bodily injury', sustained by any person; . . . arising out of the ownership, maintenance or use of the owned automobile or any non-owned automobile¹¹⁷

In *Dairyland County Mutual Insurance Co. v. Wallgren*¹¹⁸ a Texas court concluded that this policy language clearly covered punitive damages as-

¹¹³ 477 S.W.2d at 343.

¹¹⁴ Brin, *supra* note 42, at 265.

¹¹⁵ 238 F.2d 452 (6th Cir. 1956).

¹¹⁶ For a general survey of the position of each state in this regard, see H. OLECK, DAMAGES TO PERSONS AND PROPERTY § 269, at 540.1 (1957).

¹¹⁷ *Dairyland County Mut. Ins. Co. v. Wallgren*, 477 S.W.2d 341, 343 (Tex. Civ. App.—Fort Worth 1972), *error ref. n.r.e.*

¹¹⁸ 477 S.W.2d 341 (Tex. Civ. App.—Fort Worth 1972), *error ref. n.r.e.*

essed against the insured. The court reasoned that punitive damages are liabilities imposed upon an insured as damages within the policy provision binding the insurer to pay "all sums which the insured shall become legally obligated to pay as damages." In support of its conclusion, the court cited *General Casualty Co. of America v. Woodby*¹¹⁹ and quoted as follows from an article by Mr. Royal Brin: "Certainly it is difficult to quarrel with this conclusion as an interpretation of the language of the policy, and those courts and commentators which espouse non-coverage usually do so on the basis of public policy rather than of construction of the policy language."¹²⁰ The exact opposite would seem to be true. From the four corners of the instrument, it is virtually impossible to construe the language in favor of coverage of punitive damages. It is certainly true that punitive damages are sums levied against the insured as damages and the insurance company has contracted to pay all sums which the insured becomes legally obligated to pay as damages. But the coverage provision goes on to qualify coverage in terms of damages assessed because of "bodily injury." Under no reasonable interpretation can punitive damages be said to be assessed because of bodily injury.

Further, a perusal of the cases prior to *Dairyland County* which have considered the question of punitive damages and liability insurance will show that ten of the decisions have been based, at least in part, on construction of the policy language. Of these decisions, five were in favor of coverage¹²¹ and five against.¹²²

The courts which have held that punitive damages are beyond the coverage provisions of liability insurance policies have unanimously based their decisions on the reasoning that punitive damages are not assessed *because of bodily injury*. The courts interpreting the pertinent provisions of the respective policies in favor of coverage of punitive damages have varied considerably in their reasoning.

The Eighth Circuit, in *Ohio Casualty Insurance Co. v. Welfare Finance Co.*, stated: "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."¹²³ The court's reasoning is simply not responsive to the question of whether punitive damages are imposed because of bodily injury. Nor is the court's position otherwise sound. Punitive damages are not generally assessed because of aggravated negligence, which of course is covered by the insurance policy,

¹¹⁹ 238 F.2d 452 (6th Cir. 1956).

¹²⁰ Brin, *supra* note 42, at 265.

¹²¹ *General Cas. Co. of America v. Woodby*, 238 F.2d 452 (6th Cir. 1956); *Ohio Cas. Ins. Co. v. Welfare Fin. Co.*, 75 F.2d 58 (8th Cir. 1934); *Southern Farm Bureau Cas. Ins. Co. v. Daniel*, 246 Ark. 849, 440 S.W.2d 582 (1969); *Carroway v. Johnson*, 245 S.C. 200, 139 S.E.2d 908 (1965); *Lazenby v. Universal Underwriters Ins. Co.*, 214 Tenn. 639, 383 S.W.2d 1 (1964).

¹²² *Universal Indem. Ins. Co. v. Tenery*, 96 Colo. 10, 39 P.2d 776 (1934); *Gleason v. Fryer*, 30 Colo. App. 224, 491 P.2d 85 (1971); *Brown v. Western Cas. & Sur. Co.*, 484 P.2d 1252 (Colo. Ct. App. 1971); *Tedesco v. Maryland Cas. Co.*, 127 Conn. 533, 18 A.2d 357 (1941); *Crull v. Gleb*, 382 S.W.2d 17 (Mo. Ct. App. 1964).

¹²³ 75 F.2d 58, 59 (8th Cir. 1934).

but rather because of the culpable state of mind evidenced by the tortfeasor's actions.¹²⁴

Nor was the Sixth Circuit's answer responsive in *General Casualty Co. of America v. Woodby*,¹²⁵ cited and referred to by the Texas court in *Dairyland County*.¹²⁶ In *Woodby* the court said: "The policy in the present cases obligated the appellants 'to pay on behalf of the insured all sums which the insured shall become obligated to pay by reason of the liability imposed upon him by law, (a) for damages * * * sustained * * * by any person. * * *' . . . We are of the opinion that the punitive damages awarded in these cases are liabilities imposed by law for damages within the meaning of the policy."¹²⁷ The quotation from the policy provision by the *Woodby* court simply ignored the additional language in the standard Texas policy—"because of bodily injury, sickness or disease."¹²⁸

Another case arising, as did *Woodby*, in Tennessee, *Lazenby v. Universal Underwriters Insurance Co.*,¹²⁹ quoted all of the pertinent policy language in its decision, but, nevertheless, held against punitive damage coverage under the terms of the policy on the basis that most courts had so interpreted the policy provisions. The court further reasoned that the average policy holder, upon reading the policy, would interpret the language to provide coverage in all instances except those of intentional wrongdoing. With respect to the first argument, prior to 1964 only three courts had considered the question of construction of the policy language with respect to punitive damages, two courts¹³⁰ holding against and one in favor of coverage.¹³¹ The court's second basis, although again not responsive to the question of whether punitive damages are assessed because of bodily injury, is a sound argument in favor of interpreting the policy language to include punitive damage coverage. This argument will be discussed more fully below.

The Supreme Court of South Carolina, in *Carroway v. Johnson*,¹³² at least candidly recognized the problem before artfully dodging it in reaching its decision. The court noted that punitive damages are "sums which the insured shall become legally obligated to pay as damages," but said that the question of whether such damages are "damages because of bodily injury" was more difficult.¹³³ After throwing up a smokescreen with the observation that ambiguities in insurance policies are to be interpreted in favor of the insured, but without noting any ambiguity in the policy language, the court said that the average insured would contemplate coverage of all claims arising out of use of his automobile and held the language of the policy sufficiently broad to include coverage of punitive damages. At least one writer has explained the court's loose construction as simply being responsive

¹²⁴ See text accompanying notes 31-34 *supra*.

¹²⁵ 238 F.2d 452 (6th Cir. 1956).

¹²⁶ 477 S.W.2d 341 (Tex. Civ. App.—Fort Worth 1972), *error ref. n.r.e.*

¹²⁷ 238 F.2d 452, 457-58 (6th Cir. 1956).

¹²⁸ See text accompanying note 117 *supra*.

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

¹³⁰ *General Cas. Co. of America v. Woodby*, 238 F.2d 452 (6th Cir. 1956); *Lazenby v. Universal Underwriters Ins. Co.*, 214 Tenn. 639, 383 S.W.2d 1 (1964).

¹³¹ *Universal Indem. Ins. Co. v. Tenery*, 96 Colo. 10, 39 P.2d 776 (1934).

¹³² 245 S.C. 200, 139 S.E.2d 908 (1965).

¹³³ 139 S.E.2d at 910.

to, and in conformity with, a state statute requiring that South Carolina liability insurance policies insure against loss from *any liability* imposed by law for damages arising out of the ownership, maintenance or use of a motor vehicle.¹³⁴ If this explanation is valid, then the South Carolina decisions are of little value as precedent to other jurisdictions on the question of proper construction of pertinent policy provisions with respect to punitive damage coverage.

The only case directly responsive to the question of whether punitive damages are imposed because of bodily injury is the Arkansas Supreme Court decision in *Southern Farm Bureau Casualty Insurance Co. v. Daniel*.¹³⁵ The court reasoned that, because actual damages are a prerequisite to recovery of punitive damages under Arkansas law, punitive damages are assessed because of bodily injury. This conclusion suffers for several reasons. First, the actual damage predicate to a recovery of punitive damages is a minority rule in this country imposed for the purpose of limiting the circumstances under which punitive damages may be recovered.¹³⁶ In this instance, the court is using the rule to expand rather than contract the availability of punitive damages. Further, the court erroneously equates "actual damages" to "bodily injury" under the terms of the policy. "Actual damages" is a much broader concept including bodily injury, sickness, disease, and death, covered by the policy provisions, as well as damages not covered under the policy, such as those arising from injuries intentionally inflicted. Finally, granting for the sake of argument that bodily injury is a prerequisite to recovery of punitive damages under Arkansas law, it does not follow that, in all cases in which bodily injury results, punitive damages are recoverable. Accordingly, punitive damages would not be appropriate in a given case "because of" bodily injury, but rather "because of" willful, wanton, or malicious conduct.

Clearly, as long as construction of the policy language remains within the four corners of the instrument, the conclusion is inescapable that punitive damages are beyond the coverage provisions of the policy. However, by going beyond the language of the policy itself, strong argument can be made in favor of interpreting the policy to allow coverage of punitive damages.

An established rule in this country regarding construction of insurance contracts, as well as contracts of adhesion generally, is the proposition that ambiguities in the contract documents are to be resolved against the party responsible for the drafting.¹³⁷ In the case of insurance contracts the draft-

¹³⁴ S.C. CODE ANN. §§ 46-750.31, .32 (Supp. 1971); see Justice Fogleman's dissent in *Southern Farm Bureau Cas. Ins. Co. v. Daniel*, 246 Ark. 849, 440 S.W.2d 582, 584 (1969).

¹³⁵ *Southern Farm Bureau Cas. Ins. Co. v. Daniel*, 246 Ark. 849, 440 S.W.2d 582 (1969).

¹³⁶ See generally DOBBS § 3.9, at 208-10; McCORMICK § 83, at 293-95. The rule also obtains in Texas. *Fort Worth Elevators Co. v. Russell*, 123 Tex. 128, 70 S.W.2d 397 (1934); *Giraud v. Moore*, 86 Tex. 675, 26 S.W. 945 (1894); *McDonald v. International & G.N. Ry.*, 86 Tex. 1, 22 S.W. 939 (1893); *Traweek v. Martin-Brown Co.*, 79 Tex. 460, 14 S.W. 564 (1890).

¹³⁷ E.g., *State Mut. Life Assur. Co. v. Heine*, 141 F.2d 741 (6th Cir. 1944); *Bonnie v. Maryland Cas. Co.*, 280 Ky. 568, 133 S.W.2d 904 (1939); *Inter-Southern Life Ins.*

ing party is the insurer. The principle holds true even in those jurisdictions, such as Texas, where the autonomy of insurance companies in drafting insurance policies has been largely usurped by legislative or administrative bodies.¹³⁸ The reason is that even under such systems insurers continue to exert a profound influence on policy drafting, the regulation by government bodies being relatively weak and their approval of policy provisions being largely influenced by proposals made by draftsmen representing insurance companies.¹³⁹ Any argument, however, that the coverage provisions of the standard automobile liability insurance policy are ambiguous with respect to punitive damages is doomed to failure. In interpreting these provisions in this context, only one court¹⁴⁰ has raised the question and it wisely moved on without attempting to point specifically to ambiguity. Nor will it suffice to say that the policy provisions are ambiguous because the provisions have been subject to contrary interpretations by different courts. Such a statement clearly begs the question.

Simply stated, there is nothing inconsistent or patently ambiguous in the words "all sums . . . as damages . . . because of: . . . bodily injury." To contend that first saying "all sums" and then limiting such sums to those arising because of bodily injury gives rise to ambiguity is to render the entire exclusion section of a liability insurance policy a nullity. It has also been argued that, if it had been the intention of the insurance company to exclude liability for punitive damages from coverage, then logically such exclusion would have been specifically stated, particularly in view of the numerous conditions enumerated in the exclusion section of insurance policies. Such an argument is not forceful. The purpose of the exclusion section is to limit specific coverage granted under coverage provisions—for example, damages arising from intentional wrongdoing. Since liability for punitive damages is not contracted for by the coverage provisions, specific exclusion of punitive damages would be inappropriate and superfluous.

But the broader principle which upholds the doctrine of resolving ambiguities in favor of the insured can be used to make a strong argument in favor of interpreting the language of insurance policies in favor of coverage of punitive damages. Professor Keeton labels this broader principle "honoring reasonable expectations" and defines it as follows: "The objectively reasonable expectations of applicants and intended beneficiaries regarding the terms of insurance contracts will be honored even though painstaking study of the policy provisions would have negated those expectations."¹⁴¹ Professor Keeton applauds the principle of honoring reasonable expectations of the insured for fairly requiring an interpretation of technical language in lay terms and for realistically taking into account the fact that most insureds do not read their policies. He persuasively documents judicial

Co. v. Duff, 184 Ky. 227, 211 S.W. 738 (1919); Continental Beneficial Ass'n v. Holt, 167 Ky. 806, 181 S.W. 648 (1916); Francis v. International Travelers' Ass'n, 260 S.W. 938 (Tex. Civ. App.—Dallas 1924), *aff'd*, 119 Tex. 1, 23 S.W.2d 282 (1930).

¹³⁸ See R. KEETON, BASIC TEXT ON INSURANCE LAW § 2.10(b), at 69-73 (1971).

¹³⁹ *Id.* § 6.3, at 350.

¹⁴⁰ Carroway v. Johnson, 245 S.C. 200, 139 S.E.2d 908 (1965).

¹⁴¹ R. KEETON, *supra* note 138, § 6.3, at 351.

recognition of the principle as an unstated extension of the basic construction rule of resolving ambiguities in favor of the insured.¹⁴² Indeed, two of the five decisions interpreting coverage provisions to include punitive damages have done so, at least in part, on the theory of honoring the reasonable expectations of the insured.

In *Lazenby* the court said:

The language in the insurance policy in the case at bar, which is similar to many types of liability policies, has been construed by most courts, as a matter of interpretation of the language of a policy, to cover both compensatory and punitive damages. Since most courts have so construed this language in the policy, we think the average policy holder reading this language would expect to be protected against all claims, not intentionally inflicted.¹⁴³

In *Carroway* the court quoted with approval and adopted as a basis for its decision the following statement by Appleman:

However, it is clear that the average insured contemplates protection against claims of any character caused by his operation of an automobile, not intentionally inflicted. When so many states have guest statutes in which the test of liability is made to depend upon willful and wanton conduct, or when courts, in an effort to get away from contributory negligence of the plaintiff, permit a jury to find a defendant guilty of willful and wanton conduct where the acts would clearly not fall within the common law definitions of those terms, the insured expects and rightfully so, that his liability under those circumstances will be protected by his automobile liability policy. With this view the majority of courts have agreed, and have imposed liability upon the insurer even though the recovery was based upon willful or wanton conduct, or even though the verdict may have included punitive damages.¹⁴⁴

In summary, it is submitted that the coverage provisions of most, if not all, automobile liability insurance policies on their face clearly exclude punitive damages from coverage. Probably the only cogent argument in favor of punitive damage coverage is the concept of honoring reasonable expectations of the insured. The question then remains whether, especially considering the forceful analysis of Judge Wisdom in the *McNulty* decision, such coverage is violative of public policy.

¹⁴² See, e.g., the words of Judge Learned Hand in response to the argument of an insurance company that a binding receipt for a life insurance premium unambiguously postponed coverage until actual approval by the insurer of the application:

An underwriter might so understand the phrase, when read in its context, but the application was not to be submitted to underwriters; it was to go to persons utterly unacquainted with the niceties of life insurance, who would read it colloquially. It is the understanding of such persons that counts; and not one in a hundred would suppose that he would be covered, not 'as of the date of completion of Part B,' as the defendant promised, but only as of the date of approval.

Gaunt v. John Hancock Mut. Life Ins. Co., 160 F.2d 599, 601 (2d Cir. 1947), cert. denied, 331 U.S. 849 (1947). See generally *R. KEETON, supra* note 138, at 6.3, at 350-61.

¹⁴³ *Lazenby v. Universal Underwriters Ins. Co.*, 214 Tenn. 639, 383 S.W.2d 1, 5 (1964).

¹⁴⁴ 7 J. APPLEMAN, *supra* note 48, § 4312, at 132-33, quoted in part in *Carroway v. Johnson*, 245 S.C. 200, 139 S.E.2d 908, 910 (1965).

B. *Public Policy and Indemnification Against Punitive Damages*

Judicial inquiry into the compatibility of indemnity against punitive damages with concepts of public policy has remained limited to the question of the impact of such indemnity upon the fundamental purposes of punitive damages. As long as the question is so limited, indemnity against punitive damages is not violative of the public policy of the State of Texas and of at least those other jurisdictions which attribute a compensatory as well as punitive function to exemplary damages.¹⁴⁵ With respect to the remaining states, those holding to the orthodox view that the sole purposes of punitive damages are punishment and deterrence, and in no event compensation, the reasoning of Judge Wisdom in *McNulty* is inescapable.

It is certainly true that indemnification against liability for punitive damages can present serious inroads into the public interest. However, it is also submitted that denial of such coverage may also infringe upon the interests of the public. A fundamental purpose of punitive damages in modern society is the furtherance of what Professor Dobbs calls the "bounty theory" or the "private attorney general theory."¹⁴⁶ This proposition will be discussed more fully below. Simply stated, public policy and indemnity for punitive damages is a two-way street.

Texas adheres strongly to the fundamental rule of contract law that the terms of private contracts are to be accorded the utmost respect by courts of law and are not to be lightly set aside. For example, in one of its earliest pronouncements on the subject of public policy and insurance contracts, the Supreme Court of Texas spoke in the following terms:

It must not be forgotten that you are not to extend arbitrarily those rules which say that a given contract is void as being against public policy, because, if there is one thing which more than another public policy requires, it is that men of full age and competent understanding shall have the utmost liberty of contracting, and that their contracts, when entered into freely and voluntarily, shall be held sacred, and shall be enforced by courts of justice. Therefore you have this paramount public policy to consider: That you are not lightly to interfere with this freedom of contract.¹⁴⁷

But even when mirrored against this fundamental principle, the Texas court's reasoning in *Dairyland County* with respect to the issue of public policy is simply not persuasive. The Texas Court of Civil Appeals not only adhered to a highly questionable construction of the pertinent coverage provisions of the insurance policy, but its reasoning with respect to applicable public policy is circular and suffers under close scrutiny. After holding that,

¹⁴⁵ What is public policy? See 13 TEX. JUR. 2D *Contracts* § 171, at 364-65(1960): "Public policy" is a vague and extremely broad term. Basically, it comprehends the protection of the public or, in other words, the public good. "Public policy" is determined by the spirit of the law of the state, constitutional or statutory, and is derived not only from the express enactments of the legislature, but also from the decisions of the courts and the common law, insofar as it has not been altered by statute."

¹⁴⁶ See text accompanying notes 13-16 *supra*.

¹⁴⁷ *Missouri K. & T. Ry. v. Carter*, 95 Tex. 461, 476, 68 S.W. 159, 164 (1902), quoting from *Registering Co. v. Sampson*, L.R. 19 Eq. 462, 465 (1875).

under the terms of the policy, the insurance company had contracted for liability for punitive damages assessed against its insured, the court held that the contract did not violate public policy. The court reasoned that under articles 5.06¹⁴⁸ and 5.35¹⁴⁹ of the Texas Insurance Code, the Texas State Board of Insurance is empowered, by valid delegation of legislative authority, to prescribe terms, conditions, and language of liability insurance policies. The court further reasoned that, because the terms of the liability insurance policy at issue had been prescribed and approved by the insurance board, those terms reflected, and therefore were incapable of violating, the public policy of the State of Texas.

By attributing to the Texas Insurance Board a questionable construction of the coverage provisions of the insurance policy at issue the court has assumed the major premise of its argument. There would appear from the record to have been nothing before the court to indicate any position of the insurance board on the matter. Realistically, it is highly unlikely that the board ever considered the question of public policy and indemnity against punitive damages when it prescribed the terms of the insurance policy. Such a question is one of law, not one of insurance, and accordingly, is beyond the board's expertise.

Further it would appear fallacious for the court to abdicate judicial review of a fundamental question of law to an administrative body which must be presumed to have no expertise with respect to questions of law. The point can be made by analogy: if the court had determined, either on grounds of public policy or on the basis of interpretation of the insurance contract, that liability for punitive damages was beyond the coverage provisions of the contract, could the Texas Insurance Board overrule the court's decision? Surely not.

Under articles 5.06 and 5.35 of the Texas Insurance Code, the Texas Insurance Board clearly has the authority to prescribe and approve "uni-

¹⁴⁸ In addition to the duty of approving classifications and rates, the Board shall prescribe policy forms for each kind of insurance uniform in all respects except as necessitated by the different plans on which the various kinds of insurers operate, and no insurer shall thereafter use any other form in writing automobile insurance in this State; provided, however, that any insurer may use any form of endorsement appropriate to its plan of operation, provided such endorsement shall be first submitted to and approved by the Board; and any contract or agreement not written into the application and policy shall be void and of no effect and in violation of the provisions of this subchapter, and shall be sufficient cause for revocation of license of such insurer to write automobile insurance within this State. Acts 1951, 52nd Leg., ch. 491.

TEX. REV. CIV. STAT. ANN. art. 5.06 (Supp. 1972).

¹⁴⁹ The Board shall make, promulgate and establish uniform policies of insurance applicable to the various risks of this State, copies of which uniform policies shall be furnished each company now or hereafter doing business in this State. After such uniform policies shall have been established and promulgated and furnished the respective companies doing business in this State, such companies shall, within sixty (60) days after the receipt of such forms of policies, adopt and use said form or forms and no others; also all companies which may commence business in this State after the adoption and promulgation of such forms of policies, shall adopt and use the same and no other forms of policies. Acts. 1951, 52nd Leg., ch. 491.

TEX. REV. CIV. STAT. ANN. art. 5.35 (Supp. 1972).

form" or "standard" liability insurance policies. But it is a much different proposition to read into articles 5.06 and 5.35 authority in the board to decide core issues of public policy. By so interpreting these provisions, the court's decision in *Dairyland County* fails to comport with a long and clear line of Texas judicial authority delimiting the scope of valid legislative delegation. In *Commercial Standard Insurance Co. v. Board of Insurance Commissioners*, the court said: "The board can exercise only the authority conferred upon it by law 'in clear and unmistakable terms, and will not be deemed to be given by implication, nor can it be extended by inference, but must be strictly construed.'"¹⁵⁰ Nothing in articles 5.06 or 5.35 can be construed as giving, "in clear and unmistakable terms" or otherwise, the board authority over fundamental questions of law or controlling issues of public policy.

An even stricter statement limiting the scope of delegated legislative authority is that of the Texas Supreme Court in *Creager v. Hidalgo County Water Improvement District No. 4*: "Moreover, to authorize the supplying of a power by implication, inference, or presumption of intention, it is not sufficient that the act is advantageous or convenient to the major power conferred, or even effectual in the exercise of it. The power to be supplied by such process must be practically indispensable and essential in order to execute the power actually conferred."¹⁵¹

Thus, it would seem clear that, by reading into articles 5.06 and 5.35 an extension of the authority of the Texas State Board of Insurance to include matters of public policy, the *Dairyland County* decision is contrary to strongly entrenched principles delimiting legislative delegation of authority. The wisdom of the foregoing principles and the weakness of the court's position in *Dairyland County* is illustrated by the decision of the Supreme Court of Texas in *American Liberty Insurance Co. v. Ranzau*,¹⁵² reached subsequently to the decision in *Dairyland County*. In *Ranzau* the court held that the Texas State Board of Insurance "may not act contrary to but only consistent with, and in furtherance of, . . . expressed statutory purposes . . ." ¹⁵³ If the board may only act in a manner consistent with expressed statutory purpose, then certainly the board must also act in conformity with public policy.¹⁵⁴ And if the board is subject to this restriction, then surely

¹⁵⁰ 34 S.W.2d 343, 345 (Tex. Civ. App.—Austin 1930), *error ref.*; *cf.* Board of Ins. Comm'rs v. Guardian Life Ins. Co., 142 Tex. 630, 180 S.W.2d 906 (1944); Humble Oil and Ref. Co. v. Railroad Comm'n, 133 Tex. 330, 128 S.W.2d 9 (1939).

¹⁵¹ 283 S.W. 151, 152 (Tex. Comm'n App. 1926), *judgment adopted*.

¹⁵² 481 S.W.2d 793 (Tex. 1972).

¹⁵³ *Id.* at 796-97.

¹⁵⁴ Though there is authority to the contrary, assuming for the sake of argument that an express exclusion of exemplary damages were to be interpreted as inconsistent with the tenets of the Texas Motor Vehicle Safety Responsibility Act then, under *Ranzau*, the Board of Insurance would be powerless to amend the coverage provided by the Responsibility Act to exclude coverage of punitive damages. And, under *Dairyland County*, the courts of this state would be powerless to hold indemnity against exemplary damages to be violative of public policy, the courts having abdicated their authority to the Texas Insurance Board, a body the supreme court subsequently held without authority to act in the matter. The only recourse to resolving the dilemma would be by way of legislative amendment providing express exclusion of punitive damages from coverage provided under the Texas Motor Vehicle Responsibility Act. Hav-

the courts of this state may review actions of the board and measure such actions against public policy. The courts of Texas themselves also reflect, and often establish, public policy, but their actions in this regard are continually subject to judicial review.

Finally, there is an interesting, and apparently irreconcilable, inconsistency between the public policy decision in *Dairyland County* and the Texas rule regarding recovery of punitive damages against a decedent tortfeasor's estate. The Texas courts have consistently held that there can be no recovery of punitive damages against the estate of a decedent. The purpose of exemplary damages is punishment, and the tortfeasor's death prior to judgment will abate that part of an action for exemplary damages;¹⁵⁵ the tortfeasor can be punished no more. The analogy seems appropriate. The estate of the decedent, composed of his own personal wealth, stands in closer personal proximity, and, therefore, legal liability, to the decedent than do the funds of his insurance company, such funds being the product of the premium dollars of payers who are unrelated to the insured. And yet the law in Texas is that the insured can pass on his liability for exemplary damages to his insurance company, while his personal estate is immune from similar liability. As previously noted, punitive damages are like the chameleon, changing hue and color against the different backdrops of varying legal issues. Analogy is doomed to failure, inconsistency of judicial treatment being the hallmark of punitive damages.

In order to argue persuasively that indemnity against punitive damages is not violative of public policy, it is necessary to circumvent Judge Wisdom's thorough and well-reasoned opinion in *McNulty*, the strength of which lies in its simplicity. "It would seem that insurance against exemplary damages frustrates their purposes."¹⁵⁶ Those purposes are punishment and deterrence, and public policy

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.¹⁵⁷

ing delegated to the Insurance Board its authority over prescribing terms of insurance policies, it is unlikely that the state legislature would act in the matter. Such bizarre results were surely not intended by the court in *Dairyland County*.

¹⁵⁵ *Sears Roebuck & Co. v. Jones*, 303 S.W.2d 432 (Tex. Civ. App.—Waco 1957), error ref. n.r.e.; *Wright v. E-Z Fin. Co.*, 267 S.W.2d 602 (Texas Civ. App.—Dallas 1954), error ref. n.r.e.

¹⁵⁶ H. OLECK, *supra* note 116, § 275C, at 560.

¹⁵⁷ 307 F.2d 432, 440-41 (5th Cir. 1962).

And:

Where a person is able to insure himself against punishment he gains a freedom of misconduct inconsistent 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.¹⁵⁸

Beginning with Judge Gewin's specially concurring opinion in *McNulty* and the decision of the Supreme Court of Tennessee in *Lazenby v. Universal Underwriters Insurance Company*,¹⁵⁹ the tenets of *McNulty* have come under a threefold attack from judges and writers.¹⁶⁰ First, there has been substantial doubt expressed as to whether closing the insurance market on the payment of punitive damages would actually deter reckless and wanton conduct on our highways. Second, some writers have noted that, because of the difficulty in discerning between ordinary negligence and gross negligence, which would give rise to punitive damages, if coverage of punitive damages were disallowed the extent of actual coverage in a given case could vary considerably dependent on the caprice of the jury. Third, it has been argued that denial of coverage of punitive damages violates the letter as well as the spirit of state automobile financial responsibility laws.

Judge Murrah, for the Tenth Circuit, in *American Surety Co. v. Gold*,¹⁶¹ persuasively met all three of these arguments. As to the first argument, Judge Murrah said:

We do not believe the Kansas courts would be persuaded by the arguments pressed in *Lazenby* that closing the insurance market on the payment of punitive damages would not tend to deter the reckless and wanton driver. This argument seems to miss the mark, for we may as well say criminal sanctions serve no useful purpose just because they are constantly violated. The question is not so much the efficacy of the policy underlying punitive damages; rather it is a question of the implementation of that policy. Permitting the penalty for the misdeed to be levied on one other than he who committed it cannot possibly implement the policy.¹⁶²

And as to the second:

Nor do we think the Kansas court would be persuaded by the argument that if public policy precludes contracts insuring against punitive damage awards, the extent of coverage will vary with the whim of the jury as it undertakes to discern whether a given set of facts constitutes ordinary or gross negligence. This argument has much to commend it, for the fallibility of man makes some jury error inevitable. We must assume, however, any given jury will accurately follow the law and correctly distinguish liability for ordinary from liability for

¹⁵⁸ *Id.* at 440.

¹⁵⁹ 214 Tenn. 639, 383 S.W.2d 1 (1964); see note 129 *supra*, and accompanying text.

¹⁶⁰ See Brin, *supra* note 42; Note, *supra* note 47; 12 BUFF. L. REV. 623 (1963).

¹⁶¹ 375 F.2d 523 (10th Cir. 1966).

¹⁶² *Id.* at 526-27.

gross and wanton negligence. To hold to the contrary would impugn the integrity of the jury system.¹⁶³

As to the third argument Judge Murrah simply said that the fundamental purpose of financial responsibility laws is to provide compensation for innocent victims of automobile accidents; once the victim has been made whole by compensatory damages, denial of insurance coverage of punitive damages would violate neither the spirit nor the letter of such laws.¹⁶⁴

Judge Wisdom in *McNulty* also pointed to several practical problems related to allowing insurance against punitive damages. First, conflict of interest problems could arise in conjunction with the insurer's defense of the case against its insured. Second, there would be a conflict between the rule allowing admission of evidence at trial of the financial worth of the defendant in assessing the punitive damage issue and the rule disallowing any reference to the jury of the defendant's insurance company. Third, bizarre results would result in those instances where actual damages were small but the defendant's conduct was particularly reprehensible and the corresponding assessment of punitive damages representing the jury's retribution was enormous.

On the other hand equally serious practical problems are engendered by the disallowance of insurance against punitive damages. It is submitted that probably more significant conflict of interest problems would thereby be created. In fact, in all cases in which punitive damages are likely to be at issue the insured would be well advised to obtain separate counsel on that portion of the action involving punitive damages. The same would be true in pre-trial settlement negotiations on the question of how much of the settlement should be attributed to compensatory damages and how much to punitive damages.¹⁶⁵ And serious questions are presented by denial of indemnity against punitive damages in those jurisdictions following the theory of Texas' Stowers Doctrine.¹⁶⁶ Under the Stowers Doctrine, the insurer must exercise in settlement negotiations the degree of care and diligence of an ordinary prudent person in the management of his own business or be liable for the full amount of a subsequent verdict, including that amount in excess of policy limits. Typically, settlement negotiations are made in terms of lump sums, no distinction being made between compensatory and punitive damages. But in Texas and other jurisdictions the distinction is made in the final judgment. Is the insurance company under the dictates of the Stowers Doctrine if the judgment for compensatory damages is less than the settlement offer but, coupled with the judgment for punitive damages, the total amount exceeds the settlement offer?

But in the final analysis the simple thrust of Judge Wisdom's reasoning still stands. If the basic purposes of punitive damages are punishment and deterrence, then insurance against punitive damages frustrates those pur-

¹⁶³ *Id.* at 527.

¹⁶⁴ *Id.* at 527-28.

¹⁶⁵ See Gonsoulin, *supra* note 25, at 443.

¹⁶⁶ See *G.A. Stowers Furniture Co. v. American Indem. Co.*, 15 S.W.2d 544 (Tex. Comm'n App. 1929), *holding approved*.

poses, and therefore, is violative of public policy. In many jurisdictions, including Texas, punitive damages work at cross-purposes, the other purposes being: (1) to compensate the plaintiff for intangible injuries which are otherwise too speculative to be proved with sufficient certainty; and (2) to provide the plaintiff with a monetary inducement or "bounty" so that he may exact society's pound of flesh from the defendant for outrageous behavior in those instances in which society is unable to do so. In those jurisdictions which utilize punitive damages for these additional purposes, indemnity against punitive damages is not inconsistent with public policy. By the same token, of course, public policy would not be violated by a refusal to grant insurance against punitive damages on the basis that the parties have not contracted therefor.

Judge Wisdom certainly recognized that many jurisdictions attribute a compensatory function, carried over from early common law, to punitive damages. He probably excepted such jurisdictions from much of the scope of his reasoning by first going to great lengths to substantiate that under Florida law punitive damages are purely for purposes of punishment and deterrence and are not in the least compensatory, and second by the following statement:

There is an argument for regarding the punitory theory of punitive damages as anachronistic in cases where, historically exemplary damages represent non-pecuniary losses such as injured feelings, damaged reputation, humiliation, shame, pain and suffering (in certain states). In these cases it can be said that liability insurance is for the injured party, and that the insurance carrier should be liable for such losses.¹⁶⁷

Under Texas law punitive damages do perform a recognized compensatory function of making whole the plaintiff, in those cases in which a punitive award is warranted, for actual non-pecuniary losses which are otherwise too speculative and uncertain to be recovered. Interestingly, there is an apparent anomaly in this state presented by the case law. There is ample authority to the effect that Texas follows the more orthodox viewpoint with respect to punitive damages.

In *Piper v. Duncan* the court said: "Exemplary damages are not allowed as a matter of right or as compensation, but as an incident to and an enhancement of the actual damages, as punishment for the wanton malicious or oppressive conduct, of which complaint is made."¹⁶⁸ And the Supreme Court of Texas affirmed this statement in *Bennett v. Howard* by specific reference and by saying: "Exemplary damages are not allowed as a matter of right, or as compensation. If such damages are allowed, they are considered excess compensation in addition to the actual damages sustained, as punishment for the gross negligence alleged as the basis of the suit."¹⁶⁹ In

¹⁶⁷ *Northwestern Nat'l Cas. Co. v. McNulty*, 307 F.2d 432, 441 (5th Cir. 1962).

¹⁶⁸ 131 S.W.2d 397, 398 (Tex. Civ. App.—Dallas 1939), *error ref.*

¹⁶⁹ 141 Tex. 101, 109, 170 S.W.2d 709, 713 (1943).

fact, those cases in support of the orthodox theory of punitive damages in Texas are almost endless.¹⁷⁰

On the other hand, all punitive damages are to some extent compensatory because they are universally awarded to the injured party himself.¹⁷¹ But Texas courts go much further. Notwithstanding a long line of judicial pronouncement, to the contrary, Texas courts continue to regard punitive damages as compensatory payment to an injured party for mental suffering and for other actual damages too remote to be otherwise recompensed. For example, in *Dallas Joint Stock Land Bank v. Britton* the court noted:

The award of exemplary damages sometimes serves a twofold purpose; first, as punishment to the defendant so as to compel respect by him for the law and to deter others from similar infractions; and second, it is sometimes said that they are allowed as compensation to the plaintiff for elements of damage that are otherwise too remote to be considered in estimating the actual damages, such as expenses incurred, mental anguish, and injury to the reputation or business and the like.¹⁷²

Justice Bonner's opinion for the Supreme Court of Texas in *Flanagan v. Womack*¹⁷³ is interesting and goes far to explain the origin of the anomaly of treatment of punitive damages in this state.

¹⁷⁰ "Exemplary damages are authorized in proper cases as punishment for a wrongdoer and they cannot properly be awarded as additional compensatory damages." *Sheffield Div. Armco Steel Corp. v. Jones*, 369 S.W.2d 71, 82 (Tex. Civ. App.—Houston 1963).

"Exemplary damages are awarded as a matter of sound public policy in punishment of the guilty one for malicious acts, and not as compensation. The amount awarded goes to the complaining party merely because assessed in his suit." *Evans v. McKay*, 212 S.W. 680, 685 (Tex. Civ. App.—Dallas 1919), *error dismissed without judgment*.

"Exemplary damages for gross negligence are awarded by way of civil punishment of—as distinguished from compensation by—a party who does harm with a callous state of mind." *Bernal v. Seitt*, 158 Tex. 521, 527, 313 S.W.2d 520, 523 (1958).

"Exemplary damages are not allowed as compensation, but as punishment, or 'smart money,' for an offense committed, and necessarily involves a blending of the general interest of society with those peculiar to the aggrieved party." *South Texas Coaches v. Eastland*, 101 S.W.2d 878, 883 (Tex. Civ. App.—Dallas 1937), *error dismissed*.

See also *Southern Cotton Press & Mfg. Co. v. Bradley*, 52 Tex. 587 (1880); *Hays v. Houston G.N.R.R.*, 46 Tex. 272 (1876); *Cotton v. Cooper*, 209 S.W. 135 (Tex. Comm'n App. 1919), *judgment adopted*; *Jamison v. Sockwell*, 405 S.W.2d 618 (Tex. Civ. App.—Dallas 1966), *error ref. n.r.e.*; *General Ins. Corp. v. Harris*, 327 S.W.2d 651 (Tex. Civ. App.—Dallas 1959); *Burlington-Rock Island R.R. v. Newsom*, 239 S.W.2d 734 (Tex. Civ. App.—Waco 1951); *Schutz v. Morris*, 201 S.W.2d 144 (Tex. Civ. App.—Austin 1947); *Southwestern Gas & Elec. Co. v. Stanley*, 45 S.W.2d 671 (Tex. Civ. App.—Texarkana 1931); *Anderson v. Alcus*, 42 S.W.2d 294 (Tex. Civ. App.—Beaumont 1931); *Morton Salt Co. v. Wells*, 35 S.W.2d 454 (Tex. Civ. App.—Dallas 1930); *Express Publishing Co. v. Hormuth*, 5 S.W.2d 1025 (Tex. Civ. App.—El Paso 1928), *error ref.*; *Steinberg v. Morgan*, 300 S.W. 253 (Tex. Civ. App.—Amarillo 1927); *Evans v. McKay*, 212 S.W. 680 (Tex. Civ. App.—Dallas 1919), *error dismissed without judgment*; *Holland v. Closs*, 146 S.W. 671 (Tex. Civ. App.—Galveston 1912); *Harmon v. Callahan*, 35 S.W. 705 (Tex. Civ. App. 1896).

¹⁷¹ See *Koehler v. Sircovich*, 269 S.W. 812, 819 (Tex. Civ. App.—Galveston 1925): "It has always seemed to the writer to be illogical and impolitic to permit a plaintiff in actions of this character to recover exemplary damages. When such damages are assessed, it should be for the benefit of a public charity or other public purposes, and not to give extra compensation for private injury."

¹⁷² 114 S.W.2d 907, 911 (Tex. Civ. App.—Waco 1938), *rev'd on other grounds*, 134 Tex. 529, 135 S.W.2d 981 (1940).

¹⁷³ 54 Tex. 45 (1880).

The doctrine of exemplary damages doubtless originated from those cases in which a sense of justice to the injured party demanded that more compensation should be given him than could be allowed by any defined strict legal rule for the measure of damages. Frequently the mere physical injury sustained, and which ordinarily is the test of actual damages, would of itself be comparatively insufficient, but the outrage upon the feelings—the ordinary test of what is now usually called exemplary, vindictive or punitive damages—would be of such gross character or under such indignant circumstances as should require ample reparation from the offender, but which could not be referred to any fixed primary standard. Hence this character of damage was, in a great degree, necessarily left to the discretion of the jury trying the particular case. Indulgence was extended by the courts to such verdicts, as they tended to prevent breaches of the peace, and to encourage, by a resort to the law of the land, the settlement of difficulties which otherwise might have ended in personal conflicts. To this extent the public also was interested.

This indirect result to the public good, led some courts into the error of assuming as one of the grounds why such damages should be allowed at the suit of a private party, that it was intended as a public punishment to the offender, thus making that an active cause which originally was but a passive result, and in this way converting private recompense into public punishment.

I do not doubt the propriety of allowing full compensation to the injured party for both that damage which can be reduced to a reasonably fixed money standard, usually called actual damages, and also for that damage which should be recovered, but which cannot, in the nature of things, be determined by any such standard, but which must be left to the sound discretion of the juries and courts of the country, and which are properly included under what is now called exemplary damages.¹⁷⁴

In short, notwithstanding clear judicial statements to the contrary, there is an equally long line of authority in Texas to the effect that punitive damages are compensatory as well as punitive.¹⁷⁵ Accordingly, Texas is exempted from much of the force of Judge Wisdom's public policy arguments in *McNulty*. Indemnity against punitive damages would not totally frustrate the purposes of such damages in Texas. The compensatory function would still stand.

Finally, argument can be made that denial of insurance against punitive damages would frustrate an additional fundamental purpose of such damages. Under the "bounty" or "private attorney general" theory punitive damages encourage private individuals to bring action against defendants, guilty of outrageous conduct offensive to society, in instances in which no criminal offense is committed or where the state is too preoccupied with more important matters to bring action. In view of the extremely crowded

¹⁷⁴ *Id.* at 47-48.

¹⁷⁵ *Traweck v. Martin-Brown Co.*, 79 Tex. 460, 14 S.W. 564 (1890); *Bisso v. Southworth*, 71 Tex. 765, 10 S.W. 523 (1888); *Stuart v. Western Union Tel. Co.*, 66 Tex. 580, 18 S.W. 351 (1885); *Cole v. Tucker*, 6 Tex. 266 (1851); *Briggs v. Rodriguez*, 236 S.W.2d 510 (Tex. Civ. App.—San Antonio 1951), *error ref. n.r.e.*; *Wright Titus, Inc. v. Swafford*, 133 S.W.2d 287 (Tex. Civ. App.—Austin 1939), *error dismissed, judgment correct*; *Foster v. Bourgeois*, 253 S.W. 880 (Tex. Civ. App.—Austin 1923); *Basham v. Evans*, 216 S.W. 446 (Tex. Civ. App.—Amarillo 1919).

dockets of today's criminal courts and the overburdened offices of public prosecutors, the "bounty" function is important. A tortfeasor covered for punitive as well as compensatory damages by a liability insurance policy is, generally speaking, a manifestly more attractive defendant to an aggrieved plaintiff than one not similarly covered.

III. CONCLUSION

There is little doubt that exemplary damages will continue to be utilized by many jurisdictions in this country for purposes of complementing the traditional punitive functions of such damages by providing additional compensation to plaintiffs as well as additional incentive for plaintiffs to bring legal action. To the extent that these damages are so used, public policy is not a viable issue with respect to the ultimate question of the legality of indemnity against liability for exemplary damages. Resolution of the matter, at least in Texas, must logically rest with a construction of the coverage provisions of the insurance contract. And, unless the Texas courts wish to adopt expressly a position of honoring the reasonable expectations of the insured, the conclusion is unavoidable that the coverage provisions of the Texas Standard Automobile Liability Insurance Policy do not provide for coverage of exemplary damages.