Punitive damages

A client's guide to navigating punitive damages

Significant punitive damage awards against large corporations have become commonplace amid an increasingly hard insurance market. Perceptions about growing wealth disparities, a changing jury pool and desensitized jurors are contributing factors to the prevalence and severity of these awards. Moreover, clients of different industry classes, sizes and operations are at risk of a substantial punitive damage award being levied against them, even if they think they are not. However, there are several options to address risk transfer for punitive damages, and thus, secure coverage for these exposures on umbrella and excess casualty placements.

What are punitive damages?

In the United States, punitive damages are payments awarded by a judge or jury to punish bad actors engaging in reckless, willful, malicious or wanton conduct, and to deter similar wrongful conduct in the future. Punitive damages differ from compensatory damages, which are intended to compensate a victim or claimant for injuries or harm sustained. Generally, punitive damage awards require a compensatory damage award.

There are two types of punitive damages: direct and vicarious. Direct punitive damages are assessed for an insured's wrongful acts. Vicarious punitive damages are imposed against an insured if it is liable for acts of another. For example, an employer is said to be vicariously liable for the acts or omissions of an employee when the employee engages in wrongful conduct while within the scope of employment.

When are punitive damages awarded?

Punitive damage standards are determined by each state's legislature and are subject to change. States have established standards for the bad actor's conduct to determine whether a punitive damage award is warranted. For example, Illinois law allows for punitive damages in cases where the defendant engages in conduct with evil motive or with a reckless and outrageous indifference to a highly unreasonable risk of harm and with a conscious indifference to the rights and safety of others.[1] Conversely, Florida law states that a defendant may be held liable for punitive damages if the defendant was guilty of intentional misconduct or gross negligence.[2] In many states, claimants must meet a higher burden of proof to succeed on a punitive damage claim, offering clear and convincing evidence that a defendant's conduct justifies such an award.

[1] 735 ILCS 5/2-1115.05(b)

[2] Fla. Stat. § 768.72(2)

Punitive damages are not available in every state. Michigan,[3] Nebraska[4] and Washington[5] do not allow punitive damage awards. Several states that allow punitive damages often place caps on the amount that can be awarded. These constraints typically include a fixed dollar amount (Virginia[6]caps punitive damages at $350,000), a multiple of compensatory damages awarded (Wisconsin's[7] cap is the greater of $200,000 or twice the amount of the compensatory damages) or a limit tied to a percentage of the defendant's net worth (Montana[8] caps punitive damages at 3% of the defendant's net worth, up to $10,000,000). Some statutory caps on punitive damages contain carveouts for `specific types of claims, such as product liability or medical malpractice. For example, Georgia[9] has a punitive damages cap of $250,000, but this cap does not apply to cases involving product liability.

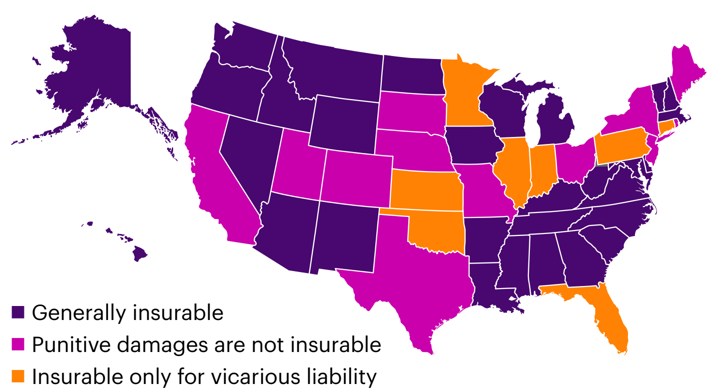
Courts may consider the "**ratio**" of punitive damages to compensatory damages when estimating the fairness of a punitive damage award. The U.S. Supreme Court considers punitive damage awards by state courts that exceed a single-digit multiple of compensatory damages to be "**grossly excessive**" and violative of constitutional due process[10]. By contrast, courts will generally uphold single-digit ratios between punitive damages and compensatory damages. For example, in 2016, an Arizona federal jury[11] awarded plaintiffs $1.8 million in compensatory damages and $5 million in punitive damages in a civil case involving asbestos. An appellate court upheld the award, stating that the 2.8-to-1 ratio was not excessive and constitutionally permissible. More recently, in 2021, a federal appeals court in Florida[12] upheld awards of $20.7 million in punitive damages and $6.25 million in compensatory damages against a tobacco products manufacturer, finding that a 3.3-to-1 ratio was neither excessive nor violative of constitutional due process.

Are punitive damages insurable?

Insurance is a creature of state law; as such, the question of the insurability of punitive damages varies by state. Most states allow punitive damages to be insured, with at least 26 states permitting directly assessed punitive damages to be insured. Other states, such as Florida[13], California[14], New York[15] and Illinois[16], do not condone insurance recovery for directly assessed punitive damages. However, many states, such as Pennsylvania[17] and Oklahoma[18], countenance the insurability of punitive damages arising from an insured's vicarious liability (e.g., an employee's wrongful conduct).

Other states have ruled against the insurability of punitive damages as a matter of public policy, arguing that insurability thwarts the rationale of punishing the defendant. When a defendant transfers punitive damages to its insurer, it does not suffer punishment, and therefore will not be discouraged from future action. Typically, courts barring risk transfer for punitive damages reason that to do so would pass the burden of the award from the wrongdoer to uninvolved, premium paying insureds.

Survey of Insurability of Punitive Damages by State



Source: Mark F. Rosenberg, Survey of U.S. State Laws on Insurability of Punitive Damages, N.Y. St. Bar Assoc. (2018)

https://nysba.org/NYSBA/Sections/International/Seasonal%20Meetings/Montreal%202018/Coursebook/Panel%209/Rosenberg%20paper%20Combined_50_State_Survey_on_Insurance_Coverage_for_Punitives_Damages.pdf

[3] McAuley v. Gen. Motors Corp., 578 N.W.2d 282 (Mich. 1998)
[4] NEB. CONST. ART. VII § 5
[5] Dailey v. N. Coast Life Ins. Co., 919 P.2d 589, 590 (Wash. 1996)
[6] VA. CODE ANN. § 8.01-38.1. (2010)
[7] WI Stat § 895.043(6)
[8] 27-1-220(3) MCA
[9] O.C.G.A. § 51-12-5.1(g)
[10] State Farm Mut. Automobile Ins. Co. v. Campbell, 538 U.S. 408
[11] Coulbourn v. Crane Co., No. 16-16925 (9th Cir. Mar. 29, 2018)
[12] Cote v. Philip Morris U.S., Inc., 985 F.3d 840 (11th Cir. 2021)

[13] U.S. Concrete Pipe Co. v. Bould, 437 So. 2d 1061 (Fla. 1983);
[14] PPG Industries, Inc. v. Transamerica Ins. Co., 975 P.2d 652 (Cal. 1999)
[15] Zurich Ins. Co. v. Shearson Lehman Hutton, Inc., 84 N.Y.2d 309 (N.Y. 1994)
[16] Beaver v. Country Mut. Ins. Co., 420 N.E.2d 1058, 1060 (Ill. App. Ct. 1981)
[17] Butterfield v. Giuntoli, 670 A.2d 646, 655 (Pa. Super. 1995)
[18] Sides v. John Cordes, Inc., 981 P.2d 301, 306 n.16 (Okla. 1999)

Obtaining punitive damage coverage on umbrella/excess policies

There are three ways to secure punitive damage coverage on umbrella and excess casualty programs:

Integrated occurrence form

An integrated occurrence (IO) policy bundles related losses into an "**integrated occurrence,**" which grants insureds access to higher excess limits for claims involving latent, repetitive or continuing injury or damage over the course of many years. One of the biggest advantages an IO policy offers versus its occurrence or claims-made counterparts is explicit coverage for punitive damages. The IO form recognizes punitive damages within the definitions of damages and ultimate net loss, whereas occurrence or claims-made policies do not.

Punitive damage wrap policy

A wrap policy, issued by an alien Bermudian insurer affiliated with a domestic carrier, provides punitive damage coverage when the onshore policy is prohibited by law, statute or public policy from insuring punitive damages.

In order to obtain a punitive damage wrap quote, a domestically issued quote is sent by a Bermudian broker to the insurer's offshore affiliate, which will issue a punitive wrap policy for the limits listed in the domestic quote, in exchange for a premium. The premium charged for a punitive wrap quote is usually between 10% and 15% of the domestic policy's premium. The wrap policy generally follows the terms and conditions of the domestic policy. As such, if a domestically issued policy excludes a particular risk, then the punitive damage policy will not provide punitive damage coverage for the excluded risk.

Wrap policies are triggered when three conditions are met. First, a compensatory and punitive damages award is issued against an insured. Second, the domestic policy, which pays for compensatory damages arising from a covered loss, is unable to pay for the punitive damages because the jurisdiction issuing the award prohibits the insurability of punitive damages. Third, a final award for punitive damages is paid by the insured. Once these three conditions are met, the offshore wrap policy will indemnify an insured for the punitive damage portion of a jury or arbitration award. Payments for punitive damage awards are often made by the offshore carrier to the insured's Bermudian-based broker, and the insured exercises its own discretion regarding repatriation of the punitive wrap claim payments.

Notably, a punitive damage wrap policy neither offers a separate insurance limit, nor increases the total limits available in a domestically issued policy. Instead, the limits of a punitive damage wrap policy follow that of the wrapped policy and are reduced by compensatory damage payments made under the domestic policy. Additionally, because wrap policies are issued outside of the United States, any disputes related to the insurability of punitive damages will be arbitrated in Bermuda or London. Lastly, wrap policies require that the insured provide notice of a claim for punitive damages to the issuing, offshore insurance carrier, in accordance with the notice requirements listed in the wrap policy.

Most favorable venue (MFV) or most favorable jurisdiction (MFJ) endorsements

An MFV/MFJ endorsement provides coverage for punitive damages under the law of any jurisdiction most favorable to honoring the contractual intent of the insurer and insured, where the insurability is otherwise prohibited by law, statute or public policy. An MFV/MFJ endorsement allows parties to an insurance contract to to apply the law of a jurisdiction that permits the insurability of punitive damages.

MFV/MFJ endorsement wordings vary by carrier and are not consistent across the insurance industry. Most wordings look to a substantial relationship between the insured, the insurer and the underlying facts of a claim. MFV/MFJ endorsements contain a choice of law provision through which the insured may select the law of the jurisdiction where (1) punitive damages were awarded, (2) the occurrence took place, (3) the insured is incorporated or has its principal place of business or (4) the policy was issued. If there is no substantial relationship between the proposed venue and the insurer, insured or the underlying facts of a claim, there may be no coverage for punitive damages. Similarly, MFV/MFJ endorsements may be drafted to select the law of a jurisdiction completely unrelated to the insurer, insured, occurrence or claimants, but courts may invalidate the provision.

It is worth noting that, while insurers offering these endorsements have obtained state regulatory approval, there are few state or federal court decisions interpreting the enforceability of MFV/MFJ endorsements. As such, an these endorsements should serve as a fallback for more preferable affirmative punitive damage coverage on the policy form, or a wrap policy.

In Practice

When it comes to ensuring punitive damages coverage on an umbrella and excess casualty program, one should not assume that silence is golden when it comes to punitive damages. Instead, it is better to ensure that a casualty placement explicitly provides punitive damage coverage. Some jurisdictions require affirmative coverage for punitive damages, rather than ambiguity or silence. Several courts have ruled against broad interpretations of the term "**damages**" in liability policies. These courts find that the inclusion of punitive damages, which is meant to punish wrongdoers and deter misconduct, exceeds the scope of liability policies, which are meant to compensate for bodily injury or property damage. As such, it is fundamentally important to secure explicit, coverage for punitive damages, whether it be through an integrated occurrence (IO) form, a punitive damage wrap policy or an MFV/MFJ endorsement.

Takeaways

- The treatment of punitive damages should be addressed on casualty placements.
- The insurability of punitive damages varies widely by state, as does the way each state allows or limits punitive damages.
- There are three ways in which punitive damages can be covered under an umbrella and excess casualty program: using an integrated occurrence form, purchasing a punitive damage wrap, or requesting a most favorable venue or most favorable jurisdiction (MFV/MFJ) endorsement.
- The enforceability of MFV/MFJ endorsements remains untested in the U.S. court system; as such, these endorsements should serve as a fallback for preferable affirmative punitive damage coverage on a policy form, or an offshore wrap policy.

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