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Insurance - Insurance Coverage against Punitive Damages - Sinclair Oil Corp. v. Columbia Casualty Co.

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Insurance—Insurance Coverage Against Punitive Damages. *Sinclair Oil Corp. v. Columbia Casualty Co.*, 682 P.2d 975 (Wyo. 1984).

In 1976, Sinclair Oil Corporation purchased an excess liability insurance policy from Columbia Casualty Company.[1] While the Columbia policy was in effect, Robert Bohenna sustained serious injuries at the Sinclair refinery.[2] Mr. Bohenna and his wife sued Sinclair, seeking compensatory and punitive damages. After a trial on the merits, a jury returned a verdict against Sinclair, awarding $375,000 in compensatory damages. The jury also found Sinclair liable for punitive damages, based on willful and wanton misconduct.[3]

In accordance with Wyoming's bifurcated trial procedure,[4] the court scheduled the second phase of the trial to determine the measure of punitive damages. On the day before the second phase was to begin, Columbia informed Sinclair that it would not indemnify Sinclair against liability for punitive damages because insurance coverage against punitive damages was contrary to the public policy of the State of Wyoming.[5]

Having been informed that Columbia would not pay punitive damages, Sinclair settled the claim, incurring $280,000 in losses "within the coverage layer of the Columbia policy."[6] Sinclair then sued Columbia in the United States District Court for the District of Wyoming, seeking to recover on the insurance contract. Sinclair contended that the policy covered punitive damages, relying on the policy language, the absence of exclusions, and its own reasonable expectations of coverage.[7] Columbia moved for summary judgment, asserting that the insurance policy did not cover liability for punitive damages because such coverage would defeat the punishment and deterrent aspects of those damages and was therefore contrary to public policy. For purposes of its motion for summary judgment, in order to remove any questions of fact, Columbia admitted that the policy terms were broad enough to cover punitive damages.

In order to rule on Columbia's motion for summary judgment, the district court certified the following questions to the Wyoming Supreme Court:

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1. Sinclair Oil Corp. v. Columbia Casualty Co., 682 P.2d 975, 976 (Wyo. 1984). The insurance policy provided $300,000 in coverage for liability in excess of a $100,000 self-insured retention and a $300,000 first level excess liability policy issued by another insurance company. Under the self-insured retention, Sinclair undertook the obligations of investigation, defense of claims, reporting developments to excess carriers, and covering losses up to $100,000. Brief for Defendant at 6, Sinclair Oil Corp. v. Columbia Casualty Co., 682 P.2d 975 (Wyo. 1984).

2. *Id.* Mr. Bohenna received sulphuric acid burns while unloading a tanker. Sinclair's emergency shower allegedly did not work, and Mr. Bohenna's injuries were thereby aggravated. Brief for Plaintiff at 6-7, Sinclair Oil Corp. v. Columbia Casualty Co., 682 P.2d 975 (Wyo. 1984) [hereinafter Brief for Plaintiff].

3. *Sinclair*, 682 P.2d at 977.

4. *See* Campen v. Stone, 635 P.2d 1121 (Wyo. 1981).

5. *Sinclair*, 682 P.2d at 977.

6. *Id.*

7. In the alternative, Sinclair claimed that the equitable principles of estoppel and waiver should prevent Columbia from denying coverage. The court did not reach these issues. *Id.* at 978.

Where a general liability policy is broad enough to cover punitive damages and makes no distinction between compensatory or punitive damages, and there is no exclusion in the policy against coverage for punitive damages, does Wyoming public policy prohibit the enforcement of punitive damage coverage in the following circumstances:

a) For vicarious liability of the insured as to punitive damages under applicable Wyoming law and the instructions given in the Bohenna case on the basis of willful and wanton conduct?

b) For personal liability of the insured as to punitive damages under applicable Wyoming law and the instructions given in the Bohenna case on the basis of willful and wanton conduct?[8]

The court answered both questions in the negative, holding that insurance coverage against either personal or vicarious liability for punitive damages, based on willful or wanton misconduct, is not contrary to Wyoming public policy.[9] In reaching this decision, the court balanced two conflicting doctrines—the purpose of punitive damages and freedom of contract—and decided that freedom of contract should prevail.

THE RATIONALE BEHIND PUNITIVE DAMAGES

While some jurisdictions recognize punitive damages as a form of compensation for the plaintiff, the vast majority justify them in terms of punishing the wrongdoer and deterring his future misconduct.[10] Wyoming follows the majority view. In a long line of cases beginning with the 1902 case of *Cosgriff v. Miller,*[11] and continuing through the 1984 case of *Adel v. Parkhurst,*[12] the Wyoming Supreme Court has consistently held that the purposes of imposing punitive damages are to punish and deter, and not to compensate the plaintiff.

All jurisdictions generally agree that mere negligence will not support a punitive damages claim.[13] A higher degree of culpability is required. Some jurisdictions will impose punitive damages for gross negligence.[14] But in Wyoming, to be liable for punitive damages, a defendant must engage in "willful or wanton" misconduct.[15] In *Danculovich v. Brown,*[16] the Wyoming Supreme Court described willful and wanton misconduct as an act or omission committed "in reckless disregard of the consequences, and under such circumstances and conditions that a reasonable

8. *Id.* at 976.
9. *Id.* at 981.
10. J. GHIARDI & J. KIRCHER, PUNITIVE DAMAGES: LAW AND PRACTICE, §§ 4.01-.16 (1984).
11. 10 Wyo. 190, 68 P. 206 (1902).
12. 681 P.2d 886 (Wyo. 1984). In this case, decided one day before *Sinclair*, the court reiterated the "punishment and deterrence" theme. *Id.* at 890. Yet, one day later, in *Sinclair*, the court seriously questioned the deterrent value of punitive damages.
13. W. PROSSER, LAW OF TORTS, § 2, at 10 (1971).
14. J. GHIARDI & J. KIRCHER, *supra* note 10, at § 5.01.
15. Danculovich v. Brown, 593 P.2d 187 (Wyo. 1979).
16. *Id.*

man would know, or have reason to know, that such conduct would, in a high degree of probability, result in substantial harm to another."[17]

PUBLIC POLICY

Under Wyoming law, an insurance contract or any provision contained therein which is contrary to public policy is unenforceable.[18] In defining public policy, courts first look to the state's constitution, statutes, and judicial decisions. If these sources do not speak to the matter, public policy "refers to a principle of law that holds no one can lawfully do that which has a tendency to be injurious to the public" or is "against the public good."[19] On its surface, this broad definition of public policy seems to give courts great latitude in voiding private agreements. The courts are limited in this area, however, by the freedom of contract doctrine. Wyoming case law reflects a reluctance to void contracts on public policy grounds unless they *clearly* conflict with "public right or the public welfare."[20]

INSURANCE AGAINST PUNITIVE DAMAGES

Although the principal case was one of first impression in Wyoming, other jurisdictions have produced an abundance of case law dealing with insurance against punitive damages.[21] The question typically arises when an insurance company has issued a policy, containing vague terms, which may or may not cover punitive damages.[22] In many cases the court will first interpret the contract to determine whether or not punitive damages are indeed covered. Some courts, however, may refuse to interpret the contract, on the grounds that public policy would preclude coverage in any event.[23] If the contract is deemed to provide coverage, the public policy question must be addressed.

On the issue of public policy, two lines of authority have developed. One view is that insurance coverage thwarts the purposes behind punitive damages, and therefore coverage should not be permitted.[24] Some courts which accept this view make an exception where the defendant's liability is purely vicarious, reasoning that such a defendant is personally blameless and should not be punished.[25] The opposite view holds that punitive

17. *Id.* at 193.
18. Allstate Ins. Co. v. Wyoming Ins. Dep't, 672 P.2d 810, 816 (Wyo. 1983).
19. *In re* Adoption of MM, 652 P.2d 974, 978 (Wyo. 1982).
20. Chicago and N.W. Ry. v. Rissler, 184 F. Supp. 98, 101 (D. Wyo. 1960).
21. *See* Annot., 17 A.L.R. 4TH 11 (1982).
22. Considering the number of reported cases in this area, there is no longer any excuse for an insurance company to issue a policy containing ambiguous terms as to whether or not coverage includes punitive damages. In 1977, the Insurance Services office promulgated a uniform punitive damages exclusion, which was approved by thirty-three jurisdictions but was later withdrawn. Burrell and Young, *Insurability of Punitive Damages*, 62 MARQ. L. REV. 1, 10-11 (1978).
23. *See, e.g.*, Northwestern National Casualty Co. v. McNulty, 307 F.2d 432, 434 (5th Cir. 1962).
24. *Id.*
25. *See, e.g.*, Norfolk & W. Ry. v. Hartford Accident & Indem. Co., 420 F. Supp. 92 (N.D. Ind. 1976).

damages are often ineffectual, regardless of whether or not insurance coverage is involved, and therefore, the asserted public policy is not strong enough to justify the avoidance of a voluntary contractual obligation.[26]

The leading case supporting the anti-coverage position is *Northwestern National Casualty Co. v. McNulty*.[27] In that case, a drunk driver crashed into the plaintiff's car and left the scene of the accident. After a jury trial, the plaintiff was awarded both compensatory and punitive damages. The defendant's insurance company refused to pay the punitive damage claim, asserting that the insurance policy did not cover punitive damages, and even if it did, public policy precluded such coverage. The court found it unnecessary to interpret the contract, holding that insurance coverage against punitive damages frustrates the punitive and deterrent functions of those damages:

> 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.[28]

The pro-coverage argument was perhaps best expressed by the Supreme Court of Tennessee in *Lazenby v. Universal Underwriter's Insurance Co.*[29] *Lazenby* also involved the question of coverage against punitive damages imposed for drunk driving. The *Lazenby* court quoted the *McNulty* case at length, and then reached the opposite conslusion. First, the court rejected the idea that the unavailability of insurance coverage would deter irresponsible driving.[30] Second, the court reasoned that the average insured would expect to be covered for punitive damage liability where no intentional tort was committed.[31] Third, the court noted that a fine line existed between ordinary negligence and conduct for which punitive damages could be awarded.[32] Finally, the court decided that the public policy favoring non-coverage was not clear enough to void a private contract.[33]

THE PRINCIPAL CASE

In *Sinclair*, the Wyoming Supreme Court found itself faced with two "competing policies": the purposes of punitive damages on one hand, and

26. *See, e.g.*, Lazenby v. Universal Underwriters Ins. Co., 214 Tenn. 639, 383 S.W.2d 1 (1964).
27. 307 F.2d 432 (5th Cir. 1962).
28. *Id.* at 440.
29. 214 Tenn. 639, 383 S.W.2d 1 (1964).
30. *Id.* at 647, 383 S.W.2d at 5.
31. *Id.*
32. *Id.* The court did not expand on this point. Subsequent cases, however, including *Sinclair*, more fully explain the argument. *See infra* text accompanying note 41.
33. *Id.*

the freedom to contract for insurance coverage on the other.[34] After summarizing the facts and the parties' contentions, the court promptly defended the freedom of contract doctrine, while expressing disdain for the "vague and nebulous concept" of public policy:

> "Public policy is a very unruly horse and once you get astride it you never know where it will carry you. [citations omitted]"
>
> We will not invalidate a contract entered into freely by competent parties on the basis of public policy unless that policy is well settled, unambiguous and not in conflict with another public policy equally or more compelling.[35]

The court declared that its own past justifications for punitive damages—punishment and deterrence—did not constitute a public policy that was sufficiently "clear and unequivocal" to preclude punitive damage coverage.[36] After quoting at length from both *McNulty* and *Lazenby*, the court noted its agreement with all of the conclusions of the *Lazenby* court.[37]

One of the major arguments advanced in the *Lazenby* decision was that punitive damages do not deter misconduct, regardless of insurance coverage.[38] By adhering to the *Lazenby* analysis, the Wyoming Supreme Court forced itself to re-evaluate those purposes behind punitive damages which it had previously embraced. Noting a lack of empirical proof supporting the deterrence theory, the court admitted that "[p]unishment is perhaps the only actual goal realized in a punitive damage award."[39]

Apart from questioning the deterrence value of punitive damages, the court based its decision on two other grounds. First, the court observed that the border between conduct justifying punitive damages and conduct not justifying those damages was a "fine line." A refusal of insurance coverage based on this somewhat flexible standard would be "necessarily arbitary."[40] Second, the court explained that because the insurance agreement purported to indemnify against "all claims," the insured reasonably expected coverage for punitive damages.[41]

Finally, the court ruled that one could insure against vicarious, as well as personal, liability for punitive damages.[42] The considerations involv-

34. *Sinclair*, 682 P.2d at 978.
35. *Id.* at 979.
36. *Id.* at 980.
37. *Id.* at 980-81.
38. *Lazenby*, 214 Tenn. 639, 383 S.W.2d 1 (1964).
39. *Sinclair*, 682 P.2d at 981.
40. *Id.* at 980.
41. *Id.* at 981. *Sinclair* was the first case in which the Wyoming Supreme Court applied the "reasonable expectations" doctrine. In a 1980 case, the court declined to discuss the concept. Aetna Ins. Co. v. Lythgoe, 618 P.2d 1057, 1058 (Wyo. 1980).
42. *Id.*

ing vicarious liability, the court said, were the same as those for personal liability.[43] Curiously, the court identified deterrence as one of those considerations.[44]

ANALYSIS OF THE COURT'S OPINION

The policy considerations raised in *Sinclair* present a myriad of problems. The Montana Supreme Court recently described a similar case as a Gordian knot.[45] The attempt to untangle this knot invariably leads to an inquiry into the foundations of the punitive damages doctrine.

In undertaking such an inquiry, the Wyoming Supreme Court summarily discarded the deterrence theory, and suggested that punishment is the only purpose served by punitive damages.[46] Apparently, the court felt that insurability destroyed the deterrence function (which, it says, probably didn't exist anyway), but not the punishment function. Therefore, the argument presumably goes, insurance against punitive damages does not frustrate their single remaining purpose: punishment. This analysis falls short on both points. First, while punitive damages do not always deter misconduct, they do serve as a deterrent in some situations. Second, even if punishment were the only purpose achieved by punitive damages, that purpose is diluted, if not completely destroyed in some cases, when an insurance company picks up the tab.

The court said that it knew of no empirical proof which showed that punitive damages deter misconduct.[47] Commentators point out that the average person either does not understand or is completely unaware of the concept of punitive damages, and therefore he cannot be deterred by them.[48] This observation is probably accurate. Yet, in the commercial and corporate sector, where legal advice is close at hand and often solicited, potential defendants are probably not ignorant of the punitive damage doctrine. Here, the deterrent function does exist.[49]

Turning to the punishment aspect of punitive damages, the court suggested that this is the only purpose achieved through punitive damages.[50] But the court failed to explain how this purpose is served when an insurance company, and not the party at fault, pays the penalty. In some cases, the threat of increased premiums and the possibility of damages exceeding policy limits may preserve the punishment aspect, as well as the deterrent aspect, of punitive damages.[51] Yet in those cases where

43. *Id.*
44. *Id.*
45. First Bank (N.A.) - Billings v. Transamerica Ins. Co., ___ Mont. ___, 679 P.2d 1217, 1223 (Mont. 1984).
46. *Sinclair*, 682 P.2d at 981.
47. *Id.* The court, however, offered no proof to show that punitive damages do not deter misconduct.
48. *See, e.g.*, J. GHIARDI & J. KIRCHER, *supra* note 10, at § 2.09.
49. *Id.*
50. *Sinclair*, 682 P.2d at 981.
51. Price v. Hartford Accident and Indem. Co., 108 Ariz. 485, 487, 502 P.2d 522, 524 (1972).

damages do not exceed policy limits, the tortfeasor has indeed purchased, at a relatively small cost, the freedom to engage in willful and wanton misconduct. In *Sinclair*, the court answered this argument by saying that insurance coverage against punitive damages *is* against public policy *if* "the fact of insurance coverage can be related in some substantial way to the commission of such wrongful acts."[52] The idea is appealing, but proving the relationship will not always be easy.

On purely theoretical grounds, it is hard to agree with the court's public policy analysis. Instead of narrowing its justification for punitive damages so that the only remaining purpose is punishment, the court could have recognized two additional purposes behind punitive damages.[53] The availability of punitive damages encourages plaintiffs, and their counsel, to prosecute meritorious claims which would otherwise never be pursued. A plaintiff may have suffered an egregious civil wrong, while suffering little in the way of pecuniary loss. Limitation to recovery of actual damages may dissuade him from litigating his claim. Here, insurance coverage actually enhances a reason for the existence of punitive damages, by guaranteeing a solvent defendant and thereby providing the plaintiff with the incentive to remedy a civil wrong. Punitive damages also compensate plaintiffs for actual damages, such as litigation costs and attorney fees, which might not otherwise be recovered. If one accepts the majority view that punitive damages should not compensate the plaintiff, it becomes difficult to explain why the plaintiff, and not the state, receives the award.

As a practical matter, insurability against punitive damages raises another consideration. In Wyoming, as in many jurisdictions, the measure of punitive damages assessed against a defendant must be related to his wealth.[54] Yet, a jury cannot be told whether, or to what extent, a defendant is insured.[55] If a defendant is allowed to insure against punitive damages, and a jury is informed of his wealth but not his insurance status, the jury cannot possibly come up with a meaningful measure of punitive damages.

On the other hand, practical problems arise when insurability is denied. First, such an approach causes a conflict of interest between the defendant and his insurer. A small compensatory award coupled with large punitive damages will benefit the insurer. The insurer's trial tactics may be accordingly affected.[56] Second, settlement negotiations may be hampered if an insured is denied coverage for punitive damages.[57] Because it may be difficult or impossible to apportion between compensatory and

52. *Sinclair*, 682 P.2d at 981.

53. For an historical background of punitive damages and their purposes, see Belli, *Punitive Damages: Their History, Their Use and Their Worth in Present-Day Society*, 49 U.M.K.C. L. REV. 1 (1980).

54. Adel v. Parkhurst, 681 P.2d 886, 892 (Wyo. 1984).

55. Eagan v. O'Malley, 45 Wyo. 505, 509-10, 21 P.2d 821, 822 (1933).

56. Comment, *Punitive Damages and Liability Insurance: Theory, Reality, and Practicality*, 9 CUM. L. REV. 487, 517 (1978).

57. *Id.* at 518.

punitive damages in a settlement figure, an insurer might be less likely to settle, thinking that in settling he will be subjected to greater liability than if he goes to trial.

OTHER FACTORS SURROUNDING THE SINCLAIR CASE

While the court in *Sinclair* premised its decision on a perceived weakness in the insurer's public policy argument, one might surmise that the case was really decided on other grounds. From the time Sinclair's policy was written, the insurer's conduct was less than commendable. The insurer issued the policy knowing full well that it might be called upon to pay a punitive damage claim.[58] Yet, the company used broad, ambiguous language and omitted a punitive damage exclusion, while apparently reserving the self-granted option of denying payment for punitive damages.[59] Then, when Sinclair's claim arose, the company attempted to avoid payment, hiding behind amorphous concepts of public policy.

The insurance policy stated that Columbia would indemnify Sinclair against "all claims,"[60] and the premium presumably reflected coverage for punitive as well as compensatory damages. If the court voided the contract on public policy grounds, Columbia would have gained the benefit of the full premium while avoiding its voluntary obligation to indemnify Sinclair. In addition to this, Columbia waited until the day before the punitive damage trial to inform Sinclair that it would not cover punitive damages.[61]

It is hard to believe that the Wyoming Supreme Court did not take these factors into account. This is unfortunate, because the public policy question, the only question the court actually answered, was deserving of more serious analysis than the court ultimately devoted to it.

CONCLUSION

In *Sinclair*, the Wyoming Supreme Court clearly concluded that punitive damages are insurable. It is now up to insurance companies to decide whether or not they will agree to cover such damages. If a company does not wish to include punitive damage coverage in a liability policy, it may simply insert an exclusion in the policy. Such an exclusion would not be a novel development. Most liability policies presently exclude coverage for damages resulting from intentional misconduct.[62] If a company wishes to include coverage for punitive damages, it should do so in express language within the policy. Insurance rates can be adjusted accordingly.

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58. Columbia apparently followed an "undisclosed corporate plan" regarding punitive damages, in anticipation of possible controversy. Brief for Plaintiff, *supra* note 2, at 9-11.
59. *Id.*
60. *Sinclair*, 682 P.2d at 981.
61. *Id.* at 977.
62. J. GHIARDI & J. KIRCHER, *supra* note 14, at § 7.02.

Because a punitive damage award, not insured against, could financially destroy a defendant, the insured's counsel should demand a liability policy that expressly includes coverage for punitive damages. Counsel should insist on a provision that includes punitive damages in clear terms, to avoid the possibility of contract-interpretation litigation.

In *Sinclair*, the Wyoming Supreme Court explicity and implicity questioned the traditional rationales behind punitive damages. The case demonstrates that generalities in this area are dangerous. In some cases, the possibility of punitive damages may deter misconduct; in others, they may serve as punishment. Punitive damages do not always serve both purposes in a given case. In fact, they may serve neither purpose. But punitive damages will encourage plaintiffs to pursue claims which may benefit society as a whole. They will also reimburse plaintiffs for actual damages, such as litigation costs and attorney fees, which might not otherwise be recovered. To ignore these functions is, as one court has said, to ignore practical reality.[63] In order to resolve the inconsistency between the rationale behind punitive damages and the allowance of insurance against them, the Wyoming Supreme Court should openly recognize these additional functions served by punitive damages.

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63. Hensley v. Erie Ins. Co., 283 S.E.2d 227, 233 (W.Va. 1981).