

Punitive Damages

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The Civil Rights Act of 1991 has had a dramatic impact on the employment-related claims of discrimination and sexual harassment. This amendment to Title VII of the Civil Rights Act of 1964 allows plaintiffs to collect punitive damages and it entitles them to a trial by jury. As a result, in the past decade, the number and size of punitive damages awarded in employment-related claims has increased significantly.

Punitive damages have their origin in 13th century England and were first recorded in this country in the early 1800's; but, the awarding of punitive damages was extremely rare prior to 1970. In the past three decades, the number of cases in which punitive damages are awarded and the size of those awards has gradually escalated. Punitive damages have become an important exposure in both Employment Practices Liability and Directors and Officers coverage. Today, every agent needs to know the fundamentals of punitive damages.

COMPENSATORY VERSUS PUNITIVE DAMAGES

Before a judge or jury awards punitive damages, they award compensatory damages to the plaintiff. Compensatory damages are designed to compensate the claimant for the loss they have sustained. Black's Law Dictionary presents the following definition:

“The combined total of monetary losses actually sustained and additional monetary losses that can be inferred from facts and circumstances of the case.”

Compensatory damages are divided into two categories:

1. Special Damages are those that result from measurable dollar amounts of actual loss. Special Damages would include medical expenses, damage to property, loss of use and loss of earnings, and the present value of potential future earnings.
2. General Damages are for intangible losses that can be inferred from special damages and other facts and circumstances of the case. General damages include such things as pain & suffering, mental anguish, and loss of consortium and bereavement from the death of a loved one.

Compensatory damages are everything that is paid to compensate the claimant for the loss sustained.

By contrast, punitive damages are intended to punish an individual or entity. Black's Law Dictionary defines punitive damages as:

“Damages imposed to punish the defendant, to teach the defendant a lesson, or to deter others from engaging in the same kind of conduct. They are awarded as an additional amount, over and above what is awarded for compensatory damages.”

Punitive damages are often referred to as exemplary damages. This hints at the fact that the purpose of punitive damages is not only to punish but also to deter others from doing the same. The goal is to set an example of the defendant so that others will not engage in the same type of conduct.

Punitive damages can be significant. Often they are a multiple of the compensatory damages awarded. If the compensatory damages in a given case are \$500,000, punitive damages might be awarded at ten times that amount, \$5,000,000. Usually the plaintiff's attorney presents evidence on the size of the assets of the defendant when asking for punitive damages, encouraging the judge or jury to “set an amount that will hurt.”

How bad does behavior have to be in order to justify the awarding of punitive damages? It varies from one state to another. In many states the conduct must be “wanton and willful,” “malicious” or “outrageous.” In other states, “gross negligence” is enough to justify punitive damages.

DIRECT VERSUS VICARIOUS PUNITIVE DAMAGES

Particularly in dealing with employment-related claims, one should appreciate the distinction between direct punitive damages and those that are imposed because of vicarious liability.

Black's Law Dictionary presents the following definition of vicarious liability:

“The imposition of liability on one person for the actionable conduct of another, based solely on a relationship between the two persons.”

A prime example of vicarious liability would be the responsibility of the principal for contracts entered into by an agent. An even more common example, would be the employers responsibility for the employee using his or her own car to run an errand for the company.

In the landmark Employment Practices Liability case of Burlington Industries, Inc. v. Ellerth (1998), the Supreme Court of the United States held the employer

responsible for the actionable discrimination engaged in by a supervisor who had authority over an employee. The court says that when a supervisor discriminates, his actions draw upon his superior position over the subordinate. As a result, the employer can be held responsible for the actions of the supervisory employee, even if the employer had no knowledge of the supervisor's actions.

Assume the supervisory employee in the scenario just presented was found guilty of such egregious actions that punitive damages were awarded. If they are awarded against the employee, the punitive damages awarded would be direct damages. If punitive damages are also awarded against the employer, those damages would be vicariously-imposed punitive damages.

THE QUESTIONS TO ADDRESS

Once one understands the definition of punitive damages, their purpose, and how they differ from compensatory damages, a professional should attempt to analyze the exposure they have to punitive damages. Is it possible that punitive damages could be awarded? What impact would they have? If punitive damages are covered under the professional liability contract, it is an important consideration in setting limits; it is an equally important matter for planning retention if they are not covered.

These are the three questions that need to be addressed in determining the impact and applicability of punitive damages.

1. Are punitive damages allowed in this state?

Currently, 47 of 50 states permit recovery of punitive damages in civil cases. The conduct that must be established in order to recover punitive damages varies from state to state. Even if the insured is doing business in a state that does not allow the awarding of punitive damages in state court, any action brought in a federal court would expose the professional to punitive damages. As a result, all insureds have an exposure to these multiplied damage awards.

2. Are punitive damages insurable?

Should an insurance company be allowed to pay the punitive damages imposed upon an insured? How much punishment can it be if someone else pays the damages? Some people feel that it is against public policy to have an insurance company pay the punitive damages awarded by the court.

As a result, punitive damages are not insurable in all states. And, many states make the distinction between directly-assessed punitive damages and those that are vicariously-

assessed. Some states allow both to be paid by an insurance company; some states allow an insurer to pay one, but not the other; some states do not allow either to be paid by the carrier. The question to ask is “Can punitive damages be paid by an insurance company in this state?”

3. Are punitive damages covered by the insurance policy in force?

The insured may be doing business in a state that allows the awarding of punitive damages and a state that allows an insurance company to pay punitive damages. However, if the policy covering the exposure does not provide coverage for punitive damages, the insured will still have to write out the check.

Some liability policies specifically address punitive damages, either providing coverage or excluding coverage. Other policies do not address the issue at all. Many American courts follow the view that, unless expressly excluded from coverage, punitive damages are covered. However, a significant minority view is that public policy considerations preclude the insurability of punitive damages and find no coverage when the policy is silent on the issue.

It should also be mentioned that some insurance policies will provide coverage for vicariously-assessed punitive damages but will not cover those that are directly assessed.

THE BOTTOM LINE

The legality and insurability of punitive damages is a significant issue today because of the rising frequency with which punitive damages are sought and the increasing size of punitive damage awards. The issues surrounding punitive damages should be taken into consideration when the professional is analyzing the exposures and when setting policy limits.

This article is excerpted from the book *Professional Liability: An Emerging Line*, written by Phyllis Van Wyhe, CPCU, CIC.