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THE VALIDITY OF INSURANCE COVERAGE FOR PUNITIVE DAMAGES— AN UNRESOLVED QUESTION?

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With increasing frequency the trial attorney finds himself involved in litigation in which the prayer for relief includes punitive damages. Because availability of the remedy is determined by the defendant's conduct rather than the plaintiff's injury, punitive damages are recoverable in actions in breach of contract as well as tort.[1] So long as compensatory damages are recovered, punitive damages may be awarded in any case in which the defendant's willful and wanton misconduct was the cause of the plaintiff's injury.[2] The volume of punitive damages litigation can be attributed in part to a definition of willful and wanton misconduct which includes non-intentional wrongs. In New Mexico, as in many other jurisdictions, grossly negligent conduct will support a claim for punitive damages.[3]

A TWO ISSUE PROBLEM

Where the facts of a case suggest that a claim for punitive damages is more than just a filler in the complaint, the plaintiff's ability to collect them is an immediate concern of all parties. Not infrequently collection of punitive damages depends upon the availability of insurance coverage. Bringing punitive damages within the language of a liability policy is only one of two issues facing the attorney who seeks to establish "coverage." Irrespective of a policy's terms, the question arises whether insurance coverage for punitive damages is void as contrary to the public policy of the state where the contract was issued.[4]

A review of the case law in this field illustrates that the public policy issue is the more formidable obstacle to coverage. For the obvious purpose of marketing a desirable contract, liability insurers omit any language excluding punitive damages. The standard insuring agreement obligates the company to "pay on behalf of the insured all sums which the insured shall become legally obligated to pay because of injury. . . ."[5] Though in a few instances insurers have successfully

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1. *See* Stewart v. Potter, 44 N.M. 460, 466, 104 P.2d 736 (1940).
2. Uniform Jury Instruction 14.25 (1966).
3. *See, e.g.*, Los Alamos Medical Center v. Coe, 58 N.M. 686, 691, 275 P.2d 175 (1954).
4. *See* American Sur. Co. v. Gold, 375 F.2d 523, 524-525 (10th Cir. 1966).
5. Farbstein, *Insurance for the Commission of Intentional Torts*, 20 Hastings L. J. 1219, 1241 (1969).

argued that punitive damages are not payable because of injury,[6] in the absence of an exclusion alerting the insured to this gap in coverage most courts have rewarded the insured's expectation and rejected a defense based upon the language of the insuring agreement.[7]

ARRIVING AT PUBLIC POLICY BY ANALYSIS OF OBJECTIVES

A defense based upon the contention that insurance coverage for punitive damages is contrary to public policy has given the courts more difficulty and resulted in variances between jurisdictions. Where insurance coverage for punitive damages is held to contravene public policy, the holding is based upon an analysis of the purpose of the damages. With the exception of those few jurisdictions in which they are regarded as additional compensation,[8] punitive damages are awarded for the purpose of punishing the wrongdoer and deterring similar conduct by others. In states in which the announced objective is punishment, not compensation, many courts have concluded that this objective would be frustrated by permitting the wrongdoer to shift the burden of his penalty to an insurance carrier.[9] However, there are several jurisdictions in which insurance coverage for punitive damages has been declared valid even though the announced objectives of the damages are punishment and deterrence.[10] In these jurisdictions the courts have abandoned an analysis of the purpose of punitive damages for a case by case examination of the wrongdoer's conduct. They reason that if the wrongdoer acted intentionally and maliciously his conduct is reprehensible to a degree that he cannot be permitted to shift the burden of punitive damages. On the other hand, if he were only grossly negligent the public interest is not offended by permitting an insurer to bear the loss.[11]

By holding that insurance coverage for punitive damages is valid if the damages are predicated upon gross negligence, the courts which adhere to this view are questioning the efficacy of imposing punitive damages for such conduct. If a distinction is to be made between intentional and grossly negligent conduct, shouldn't that distinction be made by the public policy which establishes punitive damages

6. *See, e.g.*, Tedesco v. Maryland Cas. Co., 127 Conn. 533, 18 A.2d 357 (1941).

7. *See, e.g.*, Southern Farm Bureau Cas. Ins. Co. v. Daniel, 440 S.W.2d 582 (Sup. Ct. Ark. 1969).

8. *See* discussion in Northwestern Nat'l Cas. Co. v. McNulty, 307 F.2d 432, 434-442 (5th Cir. 1962).

9. *See, e.g.*, American Sur. Co. v. Gold, 375 F.2d 523, 526-527 (10th Cir. 1966).

10. Lazenby v. Universal Underwriters Ins. Co., 383 S.W.2d 1 (Sup. Ct. Tenn. 1964); Southern Farm Bureau Cas. Ins. Co. v. Daniel, 440 S.W.2d 582 (Sup. Ct. Ark. 1969).

11. Lazenby v. Universal Underwriters Ins. Co., 383 S.W.2d 1, 3-4 (Sup. Ct. Tenn. 1964).

rather than the public policy which seeks to implement them? It may well be that in a given case the conduct of the tort-feasor is such that it does not offend public sensibility to permit him to shift the damages to his insurance carrier; however, if this is true, is the desire to punish sufficiently strong to justify their award in the first instance? Once a jurisdiction has determined that punitive damages may be awarded for grossly negligent conduct, the objectives of the award—punishment and deterrence—should be implemented in every case. It is difficult to rationalize a public policy which enforces the punishment in some cases but not in others. The logical inconsistencies of such a policy have been noted by several courts which have refused to draw distinctions between intentional and grossly negligent conduct while deciding whether insurance coverage for punitive damages is valid.[12]

THE OBJECTIVES OF A PUNITIVE DAMAGES AWARD IN NEW MEXICO

Against this background, what ruling would the New Mexico attorney expect from his appellate courts on the question of the validity of liability insurance for punitive damages? Using the analysis which looks to the purpose underlying punitive damages, the New Mexico lawyer would expect a ruling that insurance coverage for exemplary damages imposed for an intentional wrong is void as contrary to public policy. By a long line of decisions the Supreme Court of New Mexico has declared that punishment of the wrongdoer and deterrence of similar conduct by others are the sole objectives of punitive damages. Though mentioned briefly in a prior decision,[13] punitive damages were first recognized in *Colbert v. Journal Publishing Co.*[14] Regarding punitive damages as part of the common law of England adopted in New Mexico, the Court declared that ". . . a jury may inflict what are called exemplary, punitive, or vindictive damages upon a defendant, rather than the measure of compensation to the plaintiff."[15] Since *Colbert*, the Supreme Court has frequently reiterated that punishment and deterrence of similar conduct by others are the sole objectives of punitive damages.[16]

The attorney seeking to establish the validity of coverage would hope to find an indication in the case law that compensation for the injured party is an additional objective of punitive damages. If com-

12. *See, e.g.*, American Sur. Co. v. Gold, 375 F.2d 523, 526-527 (10th Cir. 1966).
13. Hagerman Irrigation Co. v. McMurry, 16 N.M. 172, 113 P. 823 (1911).
14. 19 N.M. 156, 142 P. 146 (1914).
15. *Id.* at 167.
16. *See, e.g.*, Sanchez v. Dale Bellamah Homes, Inc., 76 N.M. 526, 531, 417 P.2d 25 (1966).

pensation is an objective no public policy is offended by permitting the plaintiff to collect the damages from the tort-feasor's insurer. Arguably, the decision in *Montoya v. Moore*[17] adds compensation as an objective. While remitting the punitive damages awarded in an action for fraud, the Supreme Court stated that ". . . punitive damages are inflicted for the limited purpose of punishment and only when compensatory damages seem inadequate to satisfy the wrong committed."[18] To understand the meaning of this phrase it is necessary to interpret "the wrong committed." If the "wrong" referred to is plaintiff's injury the Supreme Court is saying that punitive damages may serve a compensatory function. If, on the other hand, the "wrong" referred to is the conduct of the defendant, the reference to inadequacy of compensatory damages is to their inadequacy as a means of punishing the wrongdoer and satisfying society's desire to teach him a lesson.

By later decision, the Court of Appeals interpreted the language in *Montoya* to be a reference to the inadequacy of compensatory damages to satisfy the wrong because of the nature of the offense committed by the defendant.[19] Thus, the Court of Appeals read out of the phrase any implication that compensation is an additional objective of punitive damages. In view of the repeated statement in the cases that punishment and deterrence are the sole objectives of punitive damages, the Court of Appeals' interpretation of *Montoya* would probably prevail should the question ever be raised in the Supreme Court.

UNDERSTANDING WOLFF v. GENERAL CAS. CO. OF AMERICA[20]

Given New Mexico's long adherence to the principle that punitive damages are awarded for punishment and deterrence, the opinion in *Wolff v. General Cas. Co. of America*,[21] will come as a surprise to the attorney with no previous exposure to the decision. On its face, *Wolff* seems to hold that insurance coverage for punitive damages does not contravene any public policy in New Mexico. Before examining the language of this decision which arguably resolves the issue of punitive damages vis-a-vis public policy, it is helpful to consider the several facets of public policy which may be involved when coverage under an insurance policy is litigated. Considerations of public policy are by no means uniquely applicable to the insurance

17. 77 N.M. 326, 442 P.2d 363 (1967).
18. *Id.* at 330-331.
19. Sweitzer v. Sanchez, 80 N.M. 408, 411, 456 P.2d 882 (Ct. App. 1969).
20. 68 N.M. 292, 361 P.2d 330 (1961).
21. *Id.*

contract which purports to cover punitive damages. Many insurance relationships have been challenged on public policy grounds. On the basis of a public policy which will not allow one to benefit from his own wrong, American courts have consistently rejected insurance claims presented under property, life, health or accident policies by insureds whose intentional acts produced the loss.[22]

The principle of no recovery for intentional losses which developed in the law surrounding life and casualty policies was carried over to liability insurance and expressed in the judicial axiom that a tort-feasor cannot insure himself against the consequences of his willful acts. Where applied, this axiom voids coverage for all damages—compensatory as well as punitive—on the theory that to permit any coverage would create an inducement to purchase insurance in anticipation of intentional wrongs. To the lawyer it will come as no surprise that insurers have argued on occasion that a tort's intentional quality should be judged from the standpoint of the insured so that even negligent acts which produce unintended injury are, nonetheless, intentional. Though a few courts have been influenced by this argument, the public policy which prohibits liability coverage for willful injuries is generally invoked only where the insured acted with intent to inflict injury.[23]

What bearing, if any, does this background have upon an interpretation of *Wolff*? The writer of this article submits that the decision in *Wolff* was addressed to the public policy just discussed, that which prohibits insurance coverage for the consequences of a willful act, and did not reach the separate issue of insurance coverage for punitive damages. What were the facts of the case? Wolff, the insured under a blanket liability policy issued by General Casualty, became involved in an altercation with Chacon. Wolff, feeling himself in danger of bodily harm, discharged a tear gas pencil in the direction of Chacon. Chacon sued Wolff for assault and General Casualty refused to defend the action on Wolff's behalf. A jury returned a verdict in Chacon's favor for $1,000.00 compensatory and $5,000.00 punitive damages. Wolff subsequently filed suit on the policy seeking indemnification from General Casualty.

The district court granted summary judgment for General Casualty on the ground that the liability insurance policy did not insure Wolff against damages awarded in suits arising out of Wolff's willful acts.[24] From the statement of the grounds for summary judgment it is im-

22. *See, e.g.*, Taylor v. John Hancock Mut. Life Ins. Co., 11 Ill. 2d 227, 142 N.E.2d 5 (1957).

23. Travelers Ins. Co. v. Reed Co., 135 S.W.2d 611, 617 (Tex. Civ. App. 1939).

24. 68 N.M. at 294.

possible to tell whether the district court relied upon public policy or language in the contract of insurance to arrive at this conclusion. On appeal the company argued both public policy and contract language.[25]

Due to the broad language of the insuring agreement and the absence of the standard exclusions for assault and battery or intentional injuries committed by or at the direction of the insured, the summary judgment could be affirmed only on the basis of a public policy prohibiting insurance against willful acts. The district court had apparently concluded that Wolff's actions met the prerequisites to invoking this public policy. The Supreme Court correctly recognized that an award of punitive damages did not establish that Wolff acted with an intent to injure Chacon since the award could be based upon gross negligence. On the record presented to the court it appeared that Wolff had not intended to injure Chacon and acted only in self-defense believing himself in danger of bodily harm.[26]

The language of the opinion reflects the court's concern over extending the public policy prohibiting coverage for intentionally produced injuries to unintended consequences of intentional acts. As previously discussed, the logical extension of such a holding would eliminate coverage for even negligent acts on public policy grounds. Cognizant of this danger and faced with a record indicating that Wolff did not intend to injure Chacon, the Supreme Court reversed the summary judgment without discussion of the separate public policy argument against coverage for punitive damages.

Two reasons appear for the court's failure to discuss the independent facet of public policy dealing with coverage for punitive damages: (1) resolution of this public policy issue was unnecessary to disposition of the appeal and (2) General Casualty failed to raise the issue. Summary judgment had been granted on the basis of a public policy which voided coverage for all damages—compensatory as well as punitive. Having determined that the district court erred in denying Wolff reimbursement for the compensatory damages awarded against him, the judgment had to be reversed irrespective of the validity of coverage for the punitive damages.

General Casualty's failure to challenge the validity of coverage for punitive damages does not appear from the opinion of the court. This failure does appear from the briefs and motions filed with the court. An examination of the court file shows that the original opinion was entered in February, 1961. Upon receipt of the original

25. Brief for appellee at 3, 11, 68 N.M. 292.
26. 68 N.M. at 294.

opinion appellant and appellee joined in submitting a motion for rehearing. This motion recites that counsel for both parties did not discover until reading the opinion that the transcript submitted to the court contained a form of policy different from that introduced in the district court.[27] Though the original opinion was withdrawn and is no longer available, presumably it affirmed the summary judgment based upon exclusions which appeared in the policy included in the transcript but did not appear in the policy introduced in the district court.[28] After consideration of the correct policy the court handed down the opinion which now appears in the New Mexico Reports. Following entry of this opinion, General Casualty filed a second motion for rehearing. By this motion General Casualty sought to have the court clarify that the opinion did not sanction insurance coverage for punitive damages.[29] Wolff's brief in answer to the motion for rehearing objects that General Casualty ". . . is now asking for the first time in this case . . ." to argue the validity of coverage for punitive damages.[30] The motion for rehearing was not granted.

SOME CONTRARY INTERPRETATIONS

It goes without saying to a reading audience comprised of fellow attorneys that this interpretation of *Wolff* will not be unanimously endorsed by the bar or judiciary. Certainly the holding of the opinion is couched in language sufficiently ambiguous to admit of more than one interpretation: "We hold that under the terms of the insurance policy involved and on the basis of the facts alleged in the complaint and the motion for summary judgment, that there is no public policy in New Mexico which requires denial of coverage."[31] Denial of coverage for what? Compensatory damages or compensatory *and* punitive damages? The opinion does not say and thus opens the way for the fertile minds of those members of the profession who prefer to have the question of the validity of coverage for punitive damages unresolved.

27. Motion for Rehearing at 1, 68 N.M. 292.
28. *See*, motion for rehearing which states:
    In fact the policy in the transcript and the one upon which the Supreme Court based its opinion was a policy which contained certain exclusion clauses which were set forth in the Supreme Court opinion, and they were clauses which were not contained in the actual policy purchased by the Appellant from the Appellee and which was the subject of this action. Motion for Rehearing at 1, 68 N.M. 292.
29. Appellees' Motion for Rehearing at 1, 68 N.M. 292.
30. Appellant's Answer Brief to Appellees' Brief on Motion for Rehearing at 1, 68 N.M. 292.
31. 68 N.M. at 298.

In an unreported decision at least one court has interpreted *Wolff* as declaring that coverage for punitive damages is valid in New Mexico. In a brief Memorandum Opinion disposing of a preliminary motion for summary judgment, a United States District Judge has stated that ". . . a reading of the decision in *Wolff* seems to indicate that New Mexico public policy does not prohibit insurance coverage of a claim against the insured for punitive damages under all circumstances."[32] After a renewed motion, summary judgment was ultimately entered in the case upon plaintiff's prayer for a declaration that coverage for punitive damages is valid. An appeal from the judgment was dismissed before the issue was passed on by the Tenth Circuit Court of Appeals.

A similar view of the decision in *Wolff* is implied by the action of the district court reported in *Svejcara v. Whitman.*[33] Upon trial of a personal injury action involving a claim for punitive damages the district judge admitted the defendant's liability insurance policy. On appeal plaintiff justified the admission on the ground that the policy was a pertinent factor in the setting of exemplary damages. Plaintiff argued that the policy proceeds were an asset which must be considered in determining the size of the punitive award necessary to punish the defendant. The argument, which apparently persuaded the district judge, assumes that insurance coverage for punitive damages is not in contravention of public policy. The Court of Appeals found it unnecessary to pass on the propriety of the policy's admission.[34]

A BRIEF REBUTTAL

The interpretation of *Wolff* advanced in this article is supported by the nature of the authorities cited in the opinion. Though at the time of the decision cases dealing with the issue had been decided in several jurisdictions, not one of the cases cited by the court in *Wolff* deals with the question of public policy and liability insurance for punitive damages. The opinion discusses exclusively cases dealing with other facets of public policy. The cases and authorities which are cited and discuss liability insurance all deal with principles of contract interpretation or the public policy which renders contracts insuring willful or illegal acts unenforceable. It also seems significant that since the opinion in *Wolff* was handed down, no case or commentator discussing the issue has cited *Wolff* as authority for the proposition that public policy permits liability insurance covering

32. Maryland Cas. Co. v. Seidenberg, Civil No. 7980 (D. N.M. 1970).
33. 82 N.M. 739, 487 P.2d 167 (Ct. App. 1971).
34. 82 N.M. at 741-742.

punitive damages. This is true even though several comprehensive law review articles have been written purporting to discuss and classify all cases on the subject.[35]

The question asked by the title of this article will be finally answered only by the Supreme Court of New Mexico. Until that body speaks, *Wolff v. General Cas. Co. of America* will be responsible for more than a few hours of discussion in the trial courts of New Mexico.

35. Gonsoulin, *Is an Award of Punitive Damages Covered Under an Automobile or Comprehensive Liability Policy?*, 22 S.W.L.J. 433 (1968).