Insurance can cover punitive damage claims

By Kirk A. Pasich

There is a rubric frequently repeated by insurers: You cannot insure for punitive damages. However, that simply is not often true. The prevalent standard form general liability insurance policy does not contain an exclusion for punitive damages. See Commercial General Liability Coverage Form (ISO Properties, Inc. 2006). Absent an exclusion, insurers are left to argue that “public policy” prohibits coverage for punitive damage awards. In support of this position, they rely on California Insurance Code Section 533, which states that an insurer “is not liable for a loss caused by the willful act of the insured ...” They also point to decisions such as City Products Corp. v. Globe Indemnity Co., 88 Cal. App. 3d 31 (1979), in which the court held that “the policy of this state with respect to punitive damages would be frustrated by permitting the party against whom they are awarded to pass on the liability to an insurance carrier.”

However, California law actually permits insurance coverage for punitive damage claims in a wide variety of circumstances. First, the public policy prohibition does not apply to an insurer’s duty to defend. “[S]ection 533 precludes only indemnification of willful conduct and not the defense of an action in which such conduct is alleged.” Downey Venture v. LMI Ins. Co., 66 Cal. App. 4th 478 (1998) (quoting B &E Convalescent Center v. State Comp. Ins. Fund, 8 Cal. App. 4th 78 (1992)).

Second, a liability policy that provides coverage on a national basis might cover punitive damages claims because it “may be construed in accordance with the law of the jurisdiction in which a particular claim arises.” Not all jurisdictions prohibit coverage for punitive damage claims. See, e.g., Colson v. Lloyd’s of London, 435 S.W.2d 42 (Mo. Ct. App. 1968) (Missouri public policy permits coverage of compensatory and punitive damages award against insured for false arrest).

Third, even if California law governs interpretation of a policy, the policy still may cover punitive damage awards in other jurisdictions when the laws of those jurisdictions permit an award of punitive damages based on recklessness or without a showing of malice in fact. As the Downey court explained, “There is no reason to believe a California court would not enforce a contractual promise of indemnity against liability for malicious prosecution where the liability was incurred in a jurisdiction that does not require proof the insured acted with malice in fact.” See, e.g., Continental Cas. Co. v. Fibreboard Corp., 762 F. Supp. 1368 (N.D. Cal. 1991) (neither California law nor West Virginia law prohibit coverage for punitive damages award in West
Virginia where award was based on recklessness, and Texas law permits coverage for award of punitive damages in Texas).

Fourth, many liability policies cover an “innocent” insured when it is liable for the acts of another insured under the policy. Indeed, “when a policy covers multiple insureds and the insurer asserts that an exclusion precludes coverage, the fact the exclusion might apply to bar coverage for one of the insureds does not automatically preclude coverage for the other insureds.” Smith Kandal Real Estate v. Continental Cas. Co., 67 Cal. App. 4th 406 (1998). See, e.g., Arenson v. Nati Auto. & Cas. Ins. Co., 45 Cal. 2d 81(1995) (intentional conduct exclusion and Section 533 have “no application to a situation where the plaintiff is not personally at fault”).

California law actually permits insurance coverage for punitive damage claims in a wide variety of circumstances.

Indeed, the California Supreme Court twice has recently upheld coverage for “innocent” co-insureds. See, e.g., Minkler v. Safeco Ins. Co., 49 Cal. 4th 315 (2010) (policy covers mother sued for negligent supervision of son who allegedly molested a boy; her “coverage must be analyzed on the basis of whether she herself committed an act or acts that fell within the intentional act exclusion”); Century-Nat’l Ins. Co. v. Garcia, 51 Cal. 4th 564 (2011) (policy covers insured whose son set fire to their residence; under Section 533, “the standard form fire policy must be construed as including a willful acts exclusion that is protective of innocent insureds”).

Fifth, and finally, corporations and other entities may be entitled to coverage for punitive damages when their liability is premised on the acts or omissions of an officer or employee acting without the sanction of the entity’s board of directors or policy-setting management.


For example, in Dart Industries Inc. v. Liberty Mutual Insurance Co., 484 F.2d 1295 (9th Cir. 1973), a corporation was held liable for libel based on a letter sent by its president. The court acknowledged that while the president was an agent of the corporation acting in the course of his employment and that other corporate officials were consulted, it was not the type of mailer
that would be discussed with the board of directors or senior management and the letter was not discussed at that level “either before being sent or ratified after being sent.” The court concluded that Section 533 did not bar coverage because there was no “proof that the policy-making management of the corporation approved, ratified or had any knowledge of the letter or its libel.”

The *Downey Venture* court cited *Dart* in reaching a similar conclusion: “Although Section 533 bars indemnity of an insured who personally commits an act of malicious prosecution, the statute does not bar indemnity of an insured who does not personally commit the act but who is vicariously liable for another person’s act of malicious prosecution.”

Two federal courts have more recently followed this approach. In *UMG Recordings Inc. v. American Home Assurance Co.*, No. CV 04-04756, Slip op. at 32-33 (C.D. Cal. Nov. 8, 2004), the court, after reviewing extensive briefing on the issue, stated: “Based on the logic and policy articulated in the relevant case law, the Court finds that the prohibition against recovery for punitive damages... contains narrow exceptions involving vicarious liability... [T]he Court finds that California does permit a party to obtain insurance coverage for punitive damages when those damages arise solely from vicarious liability.”

In *Gemstar-TV Guide International, Inc. v. National Union Fire Insurance Co. of Pittsburgh*, No. CV 06-5183-GW (JLTx), Daily Transcript at 3 (C.D. Cal. Jan. 29, 2008), the insurer argued that Section 533 precluded the insured from obtaining indemnity under a directors and officers liability policy for amounts that it had paid in the defense and settlement of claims against an officer that had acted intentionally. The court disagreed. It held, “Section [533] will not preclude coverage where the insured’s liability is premised merely on vicarious liability due to illegal conduct of an employee.”

Thus, insurance policies often will cover claims for punitive damages. This coverage should not be overlooked.

**Kirk A. Pasich** is a partner in the Los Angeles office of Dickstein Shapiro. He represents insureds in complex coverage matters and is the leader of the firm’s insurance coverage practice.

**********

© 2012 Daily Journal Corporation. All rights reserved.