Punitive damages in the US: a primer for insurance buyers and brokers
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1. Introduction
While punitive damages have been recognized by the American legal system since 1818, there is surprisingly little information available to insurance brokers and buyers on this complex liability coverage issue. Protection against punitive damage claims is often an important objective for large commercial insurance buyers. This report is designed for insurance purchasers looking to understand punitive damage exposure and gain insight into coverage alternatives.
2. A short history of punitive damages

What do 13th century England, poison, jilted brides, repainted automobiles, oil spills and tobacco litigation all have in common?

They all involve punitive damages.

Punitive damages are awarded in civil cases to punish a defendant who has committed a particularly egregious wrong, and to deter the defendant and others from similar behavior in the future. There is no single test for what kind of behavior justifies an award of punitive damages. As a general matter the usual terms that are used to characterize conduct justifying such an award include bad faith, fraud, malice, oppression, outrageous, violent, wanton, wicked and reckless. These aggravating circumstances typically refer to situations in which the defendant acted intentionally, maliciously or with utter disregard for the rights and interests of the plaintiff.

Punitive damages are nothing new. The Code of Hammurabi – written in Babylon in 1790 BC – and early Roman law in certain cases permitted the recovery of four times the original damages in order to punish wrongdoers. In ancient England, the monarchy created a system of monetary penalties known as amercements which were meant to punish in accord with the gravity of the wrong. The Magna Carta stated there must be a reasonable relationship between a punishment and the offense. This concept was adopted by the drafters of the United States Constitution, who included in the Eighth Amendment a prohibition against excessive fines and penalties and later in the Fourteenth Amendment a guarantee of due process of law for all litigants.

The first documented reference to a punitive damage award in American jurisprudence is a South Carolinas jury’s award of £400 in a case involving a foreigner who was tricked by a doctor into drinking poison. The court instructed the jury “that this was a very wanton outrage upon a stranger in the country” and the plaintiffs suffered “a very serious injury,” which entitled him to very exemplary damages.” Genay v. Norris, 1.S.C.L. (1 Bay) 6, 7 (1784). In considering a suit by a father for the “debauching of his daughter” a New Jersey judge instructed the jury in 1791 to “give damages for example’s sake, to prevent such offences in future,” and that they “might give such a sum as would mark their disapprobation.” Coryell v. Colbaugh, 1 N.J.L. 77 (N.J. 1791).

3. The Supreme Court provides much needed guidance

For more than 150 years between 1818 and the late 1980s, the United States Supreme Court offered very little guidance to litigants regarding punitive damages. That changed in 1996 when a fraud case brought by Ira Gore against BMW reached the Supreme Court. BMW, Inc. v. Gore 517 U.S. 559 (1996). Dr. Gore, of Birmingham, Alabama bought a shiny new BMW 535i in 1990. When he took his car to an auto detailing company nine months later he learned the car had been repainted due to acid rain sustained in transit from the BMW factory in Germany.

Gore was under the impression that the car he purchased was delivered to him unblemished from the factory, and sued BMW of North America claiming that the failure to disclose that the car had been repainted constituted fraud. He sought compensatory as well as punitive damages. At trial, BMW acknowledged that its policy was to repair cars that were damaged during manufacture or transportation without advising the dealer of such repairs when the repair cost did not exceed 3% of the retail price of the car.

The jury found that BMW was liable and awarded $4,000 in compensatory damages and $4 million in punitive damages. On appeal, the Alabama Supreme Court reduced the award to $2 million on the ground that the jury had improperly punished BMW for transactions outside Alabama.

The United States Supreme Court granted certiorari, vacated the award and remanded the case to the Alabama Supreme Court. The BMW Court held that punitive damages could not be assessed for out of state conduct and that reviewing appellate courts are required to consider if punitive damage awards are constitutional based upon three guideposts, namely:
1) the reprehensibility of the conduct, 2) the ratio between the compensatory damages and the punitive damages and 3) the comparison with criminal and civil penalties available for similar conduct. The Court rejected the punitive damages award as simply being too large, finding the actual harm slight and the misconduct to be minor: "None of the aggravating factors associated with particularly reprehensible conduct is present." Id at 576. On remand, the Alabama Supreme Court reduced the punitive damage award to $50,000, in part as only a few re-painted BMW cars were sold in Alabama.

Subsequently, four US Supreme Court decisions expanded the impact of the BMW decision. First, reversing a $5.4 million punitive damage verdict, the Court ruled that appellate, de novo, review is required of the constitutionality of punitive damages in *Cooper Tire v Leatherman Tool Group*, 532 U.S. 424 (2001). Second, the Court repudiated a $145 million bad faith punitive damage verdict and stated that 4 to 1 is the maximum permissible ratio between compensatory damages and punitive damages unless the compensatory damages were substantial when a 1 to 1 ratio should apply in *State Farm v Campbell*, 538 U.S. 408 (2003). Next the Court, reversing a $79.5 million punitive damage verdict, held that a jury’s desire to punish a defendant for harming non-parties was constitutionally improper in *Philip Morris USA v. Williams*, 127 S.Ct. 1057 (2007). Finally, in 2008, the Court found that a 1:1 ratio was a fair upper limit in a maritime case with substantial compensatory damages and effectively reduced a $2.5 billion punitive damage verdict to $500 million in *Exxon Shipping Co. v. Baker*, 128 S. Ct.2605 (2008).

These US Supreme Court decisions have had the effect of changing jury instruction in punitive damages, the evidence that is admitted on punitive damages, approved bifurcation and trifurcation of punitive damage trials and established independent, de novo appellate review of punitive damage awards. Many lower courts now limit punitive damages awards to 1 to 4 times compensatory damages in similar cases. However, while there now are new tools to seek reversal of runaway punitive damage verdicts, the US Supreme Court decisions have confirmed that punitive damage awards will remain a significant feature of US litigation.

4. How common are punitive damage awards? The data may surprise you

A great deal has changed since the 1700s and the seduction suit by a pregnant New Jersey bride left at the altar. Today, newspapers and television news programs often contain lurid headlines regarding billion dollar jury awards and “runaway” juries are a staple of Hollywood movies and popular novels. There is no completely reliable database or registry of punitive damage awards. Further, there is no way to accurately determine how many cases are settled after an award of punitive damages but prior to completion of the appellate process. There are, however, several substantive academic studies which provide valuable empirical data for insurance purchasers regarding the frequency of punitive damage awards in civil cases.

When considering data regarding punitive damage awards, it is important to keep in mind the number of lawsuits filed each year in the United States. The most recent data from the American Bar Association reveals that in 2007 there were 1,116,967 practicing lawyers in the United States or one lawyer for every three hundred people. According to the National Center for State Courts, in 2007 these lawyers filed more than 18.2 million civil lawsuits including probate, small claims and mental health cases. Federal courts keep their own statistics and the most recent data from 2008 indicates 267,257 cases were filed in Federal Courts alone.

In 2009, Alison F. Del Rossi, a professor at St. Lawrence University and Professor W. Kip Viscusi of Vanderbilt University defined a “blockbuster” punitive award as one of $100 million or more and calculated that there had been 100 such awards between 1985 and 2008.¹

Professors De Rossi and Viscusi looked only at verdicts; they did not consider appeals. Their exhaustive analysis included civil cases against criminals (including the murder that inspired the movie *American Beauty*).

According to their research the largest numbers of blockbuster awards in the 23 year period were against the chemical and energy industry, which had 25. The finance and insurance industry was a close second with 23. Sixteen blockbuster punitive awards were levied against the pharmaceutical and health care industry, and nine against automobile manufacturers and five against the tobacco industry.

An excellent source of data for the kind of civil suits that concern insurance buyers can be found in a report by the Bureau of Justice which was released in October 2008. The report analyzed data from 26,950 civil suits in state courts in the 75 most populous counties in the US in 2005. According to the report, only 3 to 5% of the suits filed actually go to verdict and plaintiffs win 54% of the jury trials. Punitive damages were awarded in approximately 5% (700) of the more than 14,000 bench and civil jury trials with plaintiff winners in 2005. It is not clear how many of these awards survived appellate review.

Recently, two professors at Duke University, Neil Vidmar and Mirya Holman, reviewed the 2005 data from the Bureau of Justice Statistics as well as data from Westlaw for all jury trials resolved in 2005. Drs. Vidmar and Holman found that requests for punitive damages were most frequently made in suits involving slander/defamation (45%), real estate property disputes (38%) and employment discrimination (36%). In nonasbestos product liability cases, punitive damages were only requested 11% of the time. Personal injury torts had the fewest requests for punitive damages (6%) and the lowest success rate (19%).

5. Insurability of punitive damages
Numerous law firms, legal scholars and reporting services have drafted helpful guides which examine how various states have resolved the issue of whether insurance coverage is available for punitive damage awards.

When considering whether punitive damages are insurable it is important to distinguish between direct and vicarious punitive damage awards.

When punitive damages are awarded for a policyholder’s own conduct they are referred to as “direct punitive damages.” When punitive damages are awarded against a policyholder because it is being held responsible for the wrongdoing of another, such as an employee, the punitive award is referred to as “vicarious.”

In recent years the trend among courts seems to be towards allowing insurance coverage for punitive damages. For example, between 1982 and 2004 three states amended their position and permitted directly assessed punitives to be insurable, and during the same time 23 states amended their position to allow insurance coverage for vicariously assessed punitive damages. Further, no state allows the insurability of directly assessed punitive damages while disallowing the insurability of vicariously assessed punitive damages.

6. What options are available for insurance buyers?

6.1 Offshore punitive wrap policies
In the mid 1980s Bermuda-based insurers not regulated by state insurance departments in the US began to offer policies to “fill the gap” created by the inconsistent treatment of insurability. These policies became known as “offshore punitive wraps.”

An offshore punitive wrap policy fills the gap when the on-shore “wrapped” liability policy is unable to pay a punitive damage award because punitive damages are uninsurable in a given jurisdiction. The insurance is generally written on an indemnification basis, without any “Duty to Defend” on the part of the carrier. Payments made under the domestic policy generally erode the per occurrence and aggregate limits of the punitive wrap policy.

6.2 Most favored venue clauses in umbrella policies – a growing trend
The last two years have seen a growing trend towards the use of most favored venue clauses.

When applying a most favored venue clause with respect to punitive damage awards, the broadest clauses may provide that the law of the jurisdiction “most favorable” to the insurability of punitive damages will apply, provided the jurisdiction meets certain criteria. Specifically, it must be the jurisdiction where (a) the punitive damages were awarded, (b) the act giving rise to the punitive damages award occurred, (c) the insured is incorporated or maintains its principal place of business, or (d) the insurer is incorporated or maintains its principal place of business.

When this provision is included in a policy that affirmatively covers (or does not exclude) punitive damages it provides assurance that to the greatest extent possible, such damages will be covered by the insurer by relying on the most favorable laws of any relevant jurisdiction, despite the fact that covering punitive damages may be contrary to the laws of other potentially relevant jurisdictions.

Generally speaking most favored venue clauses are issued by admitted carriers and have been filed and approved by the state regulators.5

7. A checklist for insurance purchasers
Punitive damage awards are rare but still an important consideration for risk managers and brokers. When investigating the available alternatives, insurance purchasers may wish to ask the following questions:

- Does the coverage offering satisfy the fundamental objective: to ensure the carrier and policyholder have the same mutual interest in a punitive damage claim scenario?
- How does the punitive damage coverage offering affect the available limits of insurance?
- Are the terms and conditions addressing punitive damage consistent through the excess casualty tower?
- What uncovered loss scenarios may be faced? Are there any policy restrictions which could affect the availability of punitive damage coverage?
- Is coverage written on a “pay on behalf” or “indemnify” basis?
- Does the decision to purchase coverage carry any increased scrutiny from a reputational risk perspective for the policyholder?
- What is the total cost associated with purchasing this broadened coverage for the excess casualty tower?
- Do the coverage triggers in the alternative Most Favored Venue endorsements provide increased coverage assurance via the insurer’s state of domicile?

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5 Certain state regulators only permit restrictive versions of most favored venue endorsements to ensure that punitive damage coverage does not violate applicable state law or public policy.
Are there administrative and/or expense advantages/disadvantages involved in the coverage placement process itself?

Do all policies contain the same “Duty to Defend” or to reimburse defense and allocated costs?

Do the excess layers provide “Drop Down” if underlying aggregate limits are eroded?

8. Conclusion

Some states have laws which continue to restrict or prohibit the insurability of punitive damages, leaving insureds exposed to uncovered losses in the event of an otherwise covered claim. There are alternatives for securing broadened coverage for punitive damages; however, the pricing, terms and claims payment scenarios can differ significantly. Brokers and buyers would be well advised to take the time to understand the critical factors when evaluating what coverage they desire and how much they are willing to pay for it.