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## Are Punitive Damages Insurable in Texas? High Court: Definitely Maybe

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March 20, 2008

In *Fairfield Insurance Co. v. Stephens Martin Paving, LP*, the [Texas Supreme Court](#) addressed, for the first time, whether punitive damages were insurable in Texas. No. 04-0728, 2008 Tex. LEXIS 123 (Tex. Feb. 15, 2008). The certified question was whether Texas public policy prohibits a liability insurer from paying a punitive damages award imposed on its insured because of gross negligence.

The underlying case involved a spouse's claim that a paving company's gross negligence resulted in her husband's death when a highway-paving machine rolled over on him. The workers' compensation insurer argued that punitive damages cannot be indemnified because they are intended to punish a grossly negligent defendant.

The broad issue framed by the Fifth Circuit dictated a battle of public policy: enforcement of contracts by their express terms versus punishing a wrongdoer for its act of gross negligence. The Supreme Court held that in the workers' compensation circumstance, Texas public policy does not prohibit insurance coverage for exemplary damages.

The legal background is that the Texas Labor Code provides that the workers' compensation administrative process is not an exclusive remedy when the plaintiff is entitled to recover exemplary damages because an employee's death is caused by the employer's gross negligence. Furthermore, under the Texas Department of Insurance's mandatory policy, a participating employer would have coverage for workers' compensation claims and claims based on gross negligence.

The Texas Supreme Court noted that the Legislature's expressed intent is that Texas public policy does not prohibit insurance coverage for claims of gross negligence in this context. That ended the necessary inquiry in the case. It should be noted that all of the Justices (Wainwright, Jefferson, Hecht, O'Neill, Brister, Medina, Green, Willett, and Johnson) agreed with this outcome.

The Fifth Circuit, however, framed its certified question as a broad inquiry about Texas public policy and the coverage of exemplary damages. Although it did not resolve the broad issue, the Court provided some guidance.

In the majority, the Texas Supreme Court first described Texas' long public policy of enforcing contracts as written. The Court stated that it would not lightly void a contractual provision for public policy reasons. The Court then looked at the other side of the coin and reviewed the purposes of punitive damages - to punish an individual or entity. The Court went through the punitive damages statute and described the care that the legislature took in making sure that punitive damage awards were individually based. Having an insurer pay for punitive damages would undermine the punishment purpose of punitive damages.

Notwithstanding, the Court noted that the Texas Legislature has not made a general statement regarding the public policy of insuring punitive damage awards. The Court held that in the absence of expressed direction from the Legislature, whether a promise or agreement will be unenforceable on public policy grounds will be determined by weighing the interest in enforcing agreements versus the public policy interest against such enforcement. The Court did not make a broad statement of public policy in *Fairfield* but instead provided some considerations for other cases.

### What about non-workers' comp policies?

In *Fairfield's* majority, the Court dodged the bigger issue of whether in general a party could insure against punitive damage awards and limited its holding to workers' compensation insurance. However, the Court's opinion does give some indication of where it is leaning.

For example, in the underinsured and uninsured context, the Court seemed to agree with precedent that found that the insurer

should not have to pay for punitive damages awarded against a third-party tortfeasor:

"[I]t may be appropriate for policyholders to share in the burden of injuries caused by underinsured motorists, but not their punishment. In other words, the purpose of exemplary damages may not be achieved by penalizing those who obtain the insurance required by law for the wrongful acts of those who do not."

However, the Court found that the considerations may apply differently in the context of a corporate defendant paying for exemplary damages for the conduct of one or more of its employees:

"Where other employees and management are not involved in or aware of an employee's wrongful act, the purpose of exemplary damages may be achieved by permitting coverage so as not to penalize many for the wrongful act of one. When a party seeks damages in these circumstances, courts should consider valid arguments that businesses be permitted to insure against them."

The Court leaned towards not enforcing punitive damage insurance agreements where the effect would be to allow the culpable party to escape his punishment, and in so doing spread the cost of that punishment to other innocent parties. However, where the insured is arguably innocent and merely vicariously liable for others' culpable conduct, or there is an expression of legislative intent, the Court may enforce a punitive damage insurance provision. The concurring Justices would support this conclusion.

### **What is there to glean from *Fairfield*?**

Over the past year, the Court has generally come down on several themes in its insurance cases. One, the Court generally does not find much merit in equity or equitable arguments that deviate from the express language of a policy.

For example, in *Mid-Continent Insurance Co. v. Liberty Mutual Insurance Co.*, the Court did not find merit in one insurer's contribution and subrogation claims against a co-insurer for not paying a pro rata portion of a settlement. 236 S.W.3d 765 (Tex. 2007).

In *Fortis Benefits v. Cantu*, the Court found that a policy's express contractual subrogation provision outweighed the equitable made-whole doctrine such that a medical expense insurer could enforce its subrogation claim against its insured's settlement even though the insured was not made whole by the settlement. 234 S.W.3d 642 (Tex. 2007).

In *Excess Underwriters at Lloyd's v. Frank's Casing Crew & Rental Tools*, the Court did not find that an insurer was entitled to equitable claims that would allow the insurer to sue for reimbursement for settlement funds after the settlement where the insured did not expressly allow the insurer to reserve that right. No. 02-0730, 2008 Tex. LEXIS 92 (Tex. February 1, 2008).

In all of these cases, the Court confined its analysis to policy language and was not swayed by other equitable considerations. In *Fairfield*, the Court once again looked to the policy language, that it assumed covered punitive damages for gross negligence, and found that the language trumped other equitable policy considerations in this case.

Two, the Court's opinions have generally favored business insureds over insurers, but have not been as favorable to individual insureds.

For example, in *Frank's Casing*, the insured was a business, and the Court favored the insured over the insurer regarding the issue of reimbursement after settlement. 2008 Tex. LEXIS at 92.

In *Lamar Homes, Inc. v. Mid-Continent Casualty Co.*, the Court favored the business insured regarding whether certain event was covered. 239 S.W.3d 236 (Tex. 2007).

However, in *Cantu*, the Court favored an insurer over an individual insured regarding the application of the made-whole doctrine. 234 S.W.3d at 642.

In *Fairfield*, the Court once again expressed language that would favor the enforcement of punitive damage insurance agreements where the insured was a business, but the opinion also contained language that would not have favored the enforcement of the same provisions against individual insureds.

One could glean that the Court is continuing to follow its recent trends against equitable/policy arguments trumping express insurance provisions and in continuing to side with business insureds against insurers but not so much for individual insureds.

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