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Résumé de l'article

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L'auteur passe en revue la législation régissant les dommages punitifs et il analyse les variations applicables en déterminant quelle loi est susceptible de gouverner une dispute éventuelle sur l'assurabilité du risque de dommage punitif. Il ne manque pas de faire quelques suggestions non seulement aux assureurs mais aussi aux compagnies intéressées à souscrire une garantie à cet égard.

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INSURABILITY OF PUNITIVE DAMAGES – A LEGAL PERSPECTIVE

by Michael D. Hultquist

ABSTRACT

Under the theme of the insurability of punitive damages, this article is a study, from a legal, marketing and underwriting perspective in the United States, varying from state to state. Like a casualty risk, insurers can identify target industries and build statistical models involving punitive damages.

The author reviews the law of insurability of punitive damages, including the varying analyses applied in determining which law controls a potential dispute regarding the insurability of punitive damages, and some suggestions for insurers and companies interested in punitive damage coverage.

RÉSUMÉ

L'assurabilité des dommages punitifs fait l'objet ici d'une étude de l'auteur, sur un arrière-plan légal, de marketing et de souscription aux États-Unis, qui varie d'un État à l'autre. Tout comme les risques de responsabilité, les assureurs peuvent identifier les industries ciblées par ce risque et développer des modèles statistiques sur le risque de dommages punitifs.

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INTRODUCTION

The inconsistent and unpredictable imposition of punitive damages has rendered some litigation outcomes as devastating as a tornado or an earthquake. At some point, the imposition of punitive damages may have been predictably linked only to the most harmful, intentional corporate behavior, but now they are frequently imposed for vicarious liability, against unpopular defendants, or in response to unorthodox or controversial views. Punitive damages are also inflicted as a wildly inefficient method of redistributing wealth. Despite their relative unpredictability, however, punitive damages are imposed in only 6% of all cases. In this context, the insurability of punitive damages takes on a more practicable analysis as a relatively small risk with enormous loss potential not unlike certain casualty risks. Like a casualty risk, insurers can identify target industries and build statistical models involving punitive damages.[1] The following is a review of the law of insurability of punitive damages, including the varying analyses applied in determining which law controls a potential dispute regarding the insurability of punitive damages, and some suggestions for insurers and companies interested in punitive damage coverage.

Public policy considerations play a central role in the analysis of the insurability of punitive damages and these tend to vary from state to state. Some states prohibit or limit the insurability of punitive damages on the grounds that they serve a deterrent effect which would be negated by insurance, while other jurisdictions express a belief that the insurability of punitive damages would transfer risk from the culpable defendant to innocent, premium-paying assureds. These considerations are less persuasive in the event of vicariously-assessed punitive damages which result from another's misconduct for which the insured is held legally liable. Recognizing these distinctions, some jurisdictions which do not allow insurance for certain types of punitive damages ("direct punitive damages") will allow insurance of others ("vicariously-assessed punitive damages").

These general distinctions between what type, if any, of assessed punitive damages should be insurable, is less compelling from an actuarial standpoint as the imposition of punitive damages becomes more inconsistent and arbitrary. Against this backdrop of uncertainty and changing legal and business considerations, certain off-shore insurers have successfully underwritten punitive damage

coverage. An insurer or company interested in insuring against punitive damages must ask itself three threshold questions:

1. What kind of punitive damages can be insured?
2. Where will coverage disputes be resolved?
3. Which law will control?

■ WHAT KINDS OF PUNITIVE DAMAGES CAN BE INSURED?

An insurer and its assured negotiating punitive damages as a covered item in an insurance policy must consider first the kind of damages or risk to be underwritten. This may impact the insurability of punitive damages in a given state. For example, 29 states allow some form of insurability for directly-assessed punitive damages. (Attachment 1.) These are damages imposed directly upon a company as punishment for actions performed by its employees, directors or officers, or at its instruction. In contrast, vicariously imposed punitive damages can be imposed statutorily or strictly, and are not directly linked to the actions of the company. Vicariously imposed punitive damages are insurable in 37 states.[2]

Aside from direct versus vicarious liability, there are degrees of conduct which can lead to the imposition of punitive damages. For example, the most difficult form of punitive damages from a public policy (and therefore, an insurability) point of view are those imposed for intentional conduct. Intentional wrong-doing is distinguishable from gross negligence, wantonness, or recklessness, and eight states recognize this distinction by prohibiting coverage of punitive damages for intentional acts, while generally allowing insurability of punitive damages. This is consistent with insurance practice, which historically excludes intentional acts. Needless to say, the nature of an intentional act is open to widely varying interpretations, as the courts have shown in the context of insurability of "intentional" dumping of toxins which occurred prior to any regulation or corporate knowledge of the ecological ramifications of such "intentional" acts. *FMC Corp. v. Plaisted and Companies*, 61 Cal. App. 4th 1132, 72 Cal. Rptr.2d 467 (1998).

Given the current trend toward insurability of vicariously assessed punitive damages, an insurance policy which extended

coverage to these damages would be generally accepted in a majority of jurisdictions. An insurance policy limited to acts of gross negligence, wanton or reckless acts as well as vicarious punitive damages would tread a middle ground, whereas policies endeavoring to cover intentional acts would need to take additional precautions with choice of forum and choice of law clauses to limit situations in which a court might void coverage. These clauses are worth considering in any policy which provides coverage for punitive damages.

■ WHERE WILL COVERAGE DISPUTES BE RESOLVED?

□ Forum selection and choice of law clauses

Forum selection clauses can direct a coverage conflict to a jurisdiction which allows insurability of punitive damages. If a dispute arises concerning coverage, it is unlikely that the assured or the insurer would challenge their selected forum absent an ambiguity. It is more likely that a co-defendant or other third party would raise the issue.

A closely related issue is the parties' choice of law. Like the forum selection clause, the parties can agree in the policy to be guided by the law of a state or other jurisdiction which allows insurability of punitive damages. Absent a challenge in court, that clause will prevail. If, however, the clause is challenged and it turns out to be the only "contact" to the selected jurisdiction, a potential public policy analysis emerges if a competing forum has a strong public policy against insurability of punitive damages. The touchstone for a choice of law analysis where the parties have freely agreed to a choice of forum, is the parties' intent as witnessed by their contract. Arguably, the public policy favoring freedom of contract is a fundamental and universal public policy, whereas any public policy against the insuring of punitive damages is at best conflicting. The general rule is that the right of private parties to freely negotiate the terms of a contract is given great deference. Three states, Hawaii, Montana and South Carolina recognize the importance of the parties' intent by allowing coverage of punitive damages if it is expressly stated in the policy. If an assured and its insurer choose to enter into a contract with a

forum selection clause which designates a jurisdiction friendly to the insurability of punitive damages, such a clause is presumptively valid but may still be subject to judicial scrutiny. If the choice of forum is challenged, an analysis separate from the contract must be undertaken.

☐ Private Contracts vs. Public Policy

The United States Supreme Court addressed the issue of forum selection clauses in *Bremen v. Zanata Off-Shore Co.*, 407 U.S. 1 (1972). Zapata was a Houston-based American corporation which had contracted with the petitioner Unterweser, a German corporation, for transporting Zapata's drilling rig from Louisiana to a point off Ravena, Italy in the Adriatic Sea. The contract between the parties provided that any dispute which arose must be adjudicated before the London Court of Justice. The issue presented to the Court was whether Zapata should be able to ignore the forum selection clause and litigate the dispute in the United States. In its analysis, the Supreme Court stated:

> There are compelling reasons why a freely negotiated private international agreement, unaffected by fraud, undue influence, or overweening bargaining power, such as that involved here, should be given full effect... Manifestly much uncertainty and possibly great inconvenience to both parties could arise if a suit could be maintained in any jurisdiction in which an accident might occur or if jurisdiction were left to any place where the Bremen or Unterweser might happen to be found. The elimination of all such uncertainties by agreeing in advance on a forum acceptable to both parties is an indispensable element in international trade, commerce and contracting. There is strong evidence that the forum clause was a vital part of that agreement, and it would be unrealistic to think that the parties did not conduct their negotiations, including fixing the monetary terms, with the consequences of the forum clause figuring prominently in their calculations.
>
> *Bremen*, 407 U.S. at 12-14.

The court added a footnote in the context of the above discussion :

> At the very least, the clause was an effort to eliminate all uncertainty as to the nature, location, and outlook of the forum in which the companies of differing nationalities might find.themselves. Moreover, while the contract here did not specifically provide that the substantive law of England should be applied, it is the general rule in English courts that the

> parties are assumed, absent contrary indication, to have designated the forum with the view that it should apply its own law. [Cite omitted.] It is therefore reasonable to conclude that the forum clause was also an effort to obtain certainty as to the applicable substantive law.
>
> *Bremen*, 407 U.S. at 13, n.15.

The Supreme Court further recognized that "In the light of present-day commercial realities and expanding international trade, we conclude that the forum clause should control absent a strong showing that it should be set aside." Bremen at 15. The Court further stated that a contractual choice of forum clause should only be held unenforceable if enforcement would contravene a strong public policy of the forum in which the suit is brought, whether declared by statute or by judicial decision. As there was no such public policy consideration which would hold this clause unenforceable, the Supreme Court found that the forum selection clause was enforceable, valid and binding.

In *Interamerican Trade Corp. v. Companhia Fabricadoro De Pecas*, 973 F.2d 487 (6th Cir. 1992). A federal appellate court reviewed the Ohio District Court's decision dismissing plaintiffs lawsuit because of a forum selection clause in the written agreement between the two parties. The plaintiff was a Delaware corporation with its principal place of business in Dayton, Ohio and the defendant was a Brazilian corporation with a subsidiary corporation in Ohio. The agreement contained a Brazilian forum selection clause. In its analysis, the court noted that in *Bremen v. Zapata Off-Shore*, 407 U.S. 1 (1972), the U.S. Supreme Court stated that the forum clause should control absent a strong showing that it should be set aside. *Interamerican Trade Corp.*, 973 F.2d at 489. The Interamerican Trade Corp. court held that Brazil had a logical connection to the agreement in that Brazil was a principal place of business of one of the parties, the clause appeared in a freely-negotiated, private international agreement and the contract required that Brazilian law be applied. While plaintiff ITC argued that an Ohio statute provided a strong public policy of protecting local business from victimization by non-resident businesses for the failure to pay commission which should prevent enforcement of the forum selection clause, the court found that that argument was unpersuasive in light of the forum selection clause. *Interamerican Trade Corp.* at 490.

☐ How Courts Approach Conflicting Public Policies

Since public policy is the primary consideration courts and legislatures rely upon when disallowing insurance for punitive damages, a balancing of public policies will take place when a private contract conflicts with public policy. In the case of a forum selection clause in an insurance policy covering punitive damages, the right of the parties to choose the terms of their contract potentially clashes with a stated public policy against the insurability of punitive damages.

The difficulty of defining "public policy" was long ago recognized by the United States Supreme Court:

> The theory of public policy embodies a doctrine of vague and variable quality, and, unless deducible in a given circumstance from constitutional or statutory provisions, should be accepted as the basis of a judicial determination, if at all, only with the utmost circumspection. The public policy of one generation may not under changed conditions be the public policy of another.

Patton v. United States, 281 U.S. 276, 306 (1930). The Supreme Court has further cautioned that, "as the term 'public policy" is vague, there must be a definite indication in the law of the sovereignty to justify the invalidation of a contract as contrary to public policy." *Muschany v. U.S.*, 324 U.S. 49, 66 (1945). To justify invalidating a contractual agreement, public policy must be "well-defined and dominate." *W.R. Grace & Co. v. Local Union 759*, 461 U.S. 757, 766 (1983).

The use of public policy by a court to invalidate a private contract will be done sparingly. The public policy against the insurability of punitive damages, where it exists, does not exist in a vacuum. Competing public policies must be weighed and compared including requiring an insurance company to honor its obligations in return for a premium accepted and the public policy in favor of the freedom of private parties to contract.

Public policy in favor of the freedom to contract is strong. Parties entering into a contract will expect, at the very least, and subject perhaps to rare exception, that the provisions of the contract will be binding upon them. These expectations should not be disappointed by application of the local rule of a state which would strike down the contract or a provision thereof unless the value of protecting the expectations of the parties is substantially outweighed in the particular case by the interest of the state with the invalidating rule in having this rule applied. Restatement (2d)

Conflict of Laws, Section 188, cmt. (b) (1971). Recent cases have applied some version of a rule of validation in holding insurance companies liable to indemnify their insured against punitive damage awards despite statutes which limit or prohibit insurance against punitive damages. See *Meijer, Inc. v. General Star Indem. Co.*, 826 F. Supp. 241 (W.D. Mich. 1993), aff'd, 61 F.3d 903 (6th Cir. 1995); *Stonewall Surplus Lines Ins. Co. v. Johnson Controls*, 17 Cal. Rptr. 2d 713 (Ct. App. 1993); and *American Home Assur. Co. v. Safway Steel Products Co., Inc.*, 743 S.W.2d 693 (Tex. Ct. App. 1987),.writ denied. In *Meijer* and *American Home*, the courts held the insurer liable on the contract, while in *Stonewall*, the court excused the insurers from liability.[3]

The focus of the public policy analysis on a jurisdictional interest basis, and not on the act of contracting itself, is well-illustrated by decisions in which courts, located in jurisdictions which limit or prohibit insurability, have found in favor of insurability. For example, both by case law and statute, California has a public policy against the insurability of punitive damages. However, depending on the applicable law, California courts have found both for and against the insurability of punitive damages.

In Stonewall Surplus Lines Ins. Co. v. Johnson Controls. Inc., 17 Cal. Rptr.2d 713 (4th Dist. 1993), the California court dealt with the issues of choice of law, insurability of punitive damages and public policy. In that case, a San Diego jury returned a verdict assessing $6.5 million in punitive damages against Johnson Controls, a Wisconsin corporation. Johnson Controls' liability insurers were residents of Connecticut, Alabama, Texas and Illinois. They filed a declaratory relief action in California claiming that they were not required to provide the corporation with any indemnity for punitive damages. The parties agreed that in California an insured may not seek indemnity from an insurer for punitive damages. However, Johnson Controls maintained that because it was a Wisconsin corporation, that Wisconsin law would allow insurers to indemnify for both compensatory and punitive damages. The California court began its analysis by noting that there was a conflict between the laws of California and the laws of Wisconsin. In California, an insurer is not liable for any portion of judgment which includes punitive damages. The public policy of California with respect to punitive damages would be frustrated by permitting the party against whom they are awarded to pass on the liability to its insurance carrier.

The California court held that because the defective battery which gave rise to the underlying claim was manufactured in California and caused injury in California to a California resident, California had an interest as a matter of public policy which supported application of its law and the restriction of insurance coverage.

The California court went on to recognize that Wisconsin law differed significantly in that Wisconsin public policy did not prevent indemnity for punitive damages. Brown v. Maxey, 369 N.W.2d 677 (Wis. 1985). Arguably, this result would not occur in a state where punitive damages are insurable, or where the issue has not been decided.[4]

The court wrote:

> We believe Johnson Controls and its insurers would reasonably expect not only that the corporation's liability to a third-party might be governed by the law of a state with significant interests at stake, but that Johnson Controls's [sic] right to indemnity for such a claim also be governed by that state's law.

Johnson Controls Inc., 17 Cal. Rptr. 2d at 720. Applying California law, the court prohibited indemnification for punitive damage claims even though the policy covered a corporate insured headquartered in Wisconsin where indemnification was permissible.

Similarly, Reliance filed a declaratory judgment action in California in July 1994 seeking a determination as to whether it was obligated to indemnify Transamerica for punitive damages ordered in a California tort action. *Reliance Ins. Co. of Illinois v. TIG Ins. Co.*, No. BC108855 (Apr. 16, 1996). The professional liability insurance policy at issue included a provision requiring punitive claims to be construed according to Delaware law which generally permits the insurability of punitive damages. The California Superior Court granted Reliance's motion for summary judgment holding that California law applied and, therefore, that Reliance was not liable to indemnify the plaintiffs for the $28 million punitive damage award in an underlying California tort action.

The Northern District of California, however, took a different approach. In *Continental Cas. Co. v. Fibreboard Corp.*, 762 F. Supp. 1368 (N.D. Cal. 1991), aff'd., 953 F.2d 1386 (9th Cir. 1991), *appeal dismissed and remanded*, 4 F.3d 777 (9th Cir. 1993), Continental brought a declaratory judgment action asserting it was

not obligated to indemnify its insured for punitive damages awarded in a jury trial in Texas. The insured, Fibreboard, was a California company and the insurance policy was signed and negotiated and payments were made in California. In this instance, Texas law would allow insurance reimbursement of the punitive damage award while California law would prohibit it. The court applied a "governmental interest approach" to resolve the conflict. *Fibreboard Corp.*, 762 F. Supp. at 1376-77. Under this test, the goal is to determine which state's policy is more significantly impaired by the application of the law of the other state. The court recognized the "predominant interest of the state of the place of the wrong" in deciding to apply Texas law following the governmental interest analysis.

> When a California corporation commits a tort in another state, the state in which the tort occurred has the greater interest in establishing policies which it believes best safeguard and promote the interest of the citizens of that state.

Fibreboard Corp. at 1377. The primary principle underlying this decision was the premise that the interest of any state in protecting and safeguarding its citizens outweighed the interest of a state regulating the out-of-state conduct of California entities. On this basis, the court held:

> Since the torts here at issue occurred in Texas, we hold that Texas' interests described above outweigh California's attenuated interest in punishing and deterring the wrongful behavior of California manufacturers. Application of the California policy to the instant case would greatly impair the Texas policies outlined above which Texas courts have defined as in the best interest of their own citizens. This impairment outweighs the impairment to California's relatively weak interest in punishment and deterrence which would result from the application of Texas law.

Fibreboard Corp. at 1379.

This conclusion should, however, be compared with the decision in *Zurich Ins. Co. v. Shearson Lehman Hutton, Inc.*, 642 N.E.2d 1065 (N.Y. 1994) in which a New York court held that punitive damages awarded in a Texas case were not covered under a policy issued in New York. See also, *Home Ins. Co. v. American Home Products Corp.*, 550 N.E.2d 930 (N.Y. 1990) (requiring insurer to reimburse insured for punitive damages awarded in out-of-state action would violate New York public policy); *National Union Fire Ins. Co. v. Ambassador Group, Inc.*, 556 N.Y.S.2d 549

(1st Dept. 1990), appeal dismissed, 571 N.E.2d 85 (N.Y. 1991) (portion of settlement representing punitive damages not insurable).

In a more direct analysis, North Dakota recognized the clash of public policy interests in *Continental Casualty v. Kinsey*, 499 N.W.2d 574 (N.D. 1993). ompensatory and punitive damages were awarded against Kinsey, an attorney, and in favor of his client. Continental filed a declaratory judgment action asserting that its policy provided no coverage for punitive damages. There was no specific statute and no state appellate decision in North Dakota addressing the issue of insurability of punitive damages. However, a statute enacted in 1943 exonerated insurance companies from liability for the willful acts of their insureds. N.D. Cent. Code § 26-06-04 (1843) (repealed and reenacted as § 26.1-32-04 (1989). In *Hins v. Heer*, 259 N.W.2d 38, 40 (N.D. 1977), the North Dakota Supreme Court interpreted this statute as a statement of public policy that "an insured cannot be indemnified for losses caused by his own willful acts."

In *Kinsey*, the North Dakota Supreme Court recognized that insurance coverage for punitive damages is generally against public policy. However, the court found that the public policy in favor of the freedom to contract outweighed the public policy against insurance coverage for fraud or willful acts. The legislature did not intend to "benefit insurance companies by allowing them to collect premiums for coverage they do not intend to provide." The court's resolution balanced the competing public policies. The court required Continental to indemnify Kinsey for the punitive damage award but allowed Continental to pursue an indemnification action for the punitive damages awarded as a consequence of Kinsey's willful fraud and deceit. Thus, based on the Kinsey decision, it appears North Dakota will allow insurance coverage for punitive damages, provided that such coverage is expressly written in the policy.

Since New York law is such a significant jurisdiction with respect to domestic insurers and insureds, a brief discussion of New York law on these issues is appropriate. In general, New York courts only use New York public policy restricting the insurability of punitive damages when the insurance activity transpires in the state of New York.

Directly assessed punitive damages are not insurable in New York. See *Public Service Mut. Ins. Co. v. Goldfarb*, 53 N.Y.2d 392, 425 N.E.2d 810 (1st Dept. 1981); *Hartford Accident & Indem. Co. v Village of Hempstead*, 48 N.Y.2d 218, 397 N.E.2d 737 (1979);

Soto v. State Farm Ins. Co., 600 N.Y.S.2d 407 (4th Dept. 1993), aff'd, 83 N.Y.2d 718 (1994); *National Union Fire Ins. Co. of Pittsburgh. Pa. v. Ambassador Group, Inc.*, 556 N.Y.S.2d 549 (1st Dept. 1990), appeal dismissed, 77 N.Y.2d 873 (1991). In addition, the court in *Home Ins. Co. v. American Home Products Corp.*, 75 N.Y.2d 196 (1990), *aff'd in part, rev'd in part*, 902 F.2d 1111 (2d Cir. 1990), applied the prohibition to out-of-state punitive damages awards for which the insured seeks coverage in New York. The court pointed out that "the punitive nature of the award, coupled with the fact that a New York insured seeks to enforce it in New York against a New York insurer... calls for the application of New York public policy." See *Zurich Ins. Co. v. Shearson Lehman Hutton. Inc.*, 601 N.Y.S.2d 276 (1st Dept. 1993), order aff'd as modified, 84 N. Y.2d 309 (1994) (noting that only when a state allowing indemnification awards damages that serve a wholly punitive, and not compensatory, purpose are they precluded by New York policy).

The New York Department of Insurance has confirmed that insurance coverage for punitive damages may not be written by an insurer licensed in the State of New York. (New York General Counsel Opinion 9-26-89). The New York Department of Insurance took the position in 1970 in response to an inquiry that it would be against public policy for liability insurance to provide coverage for punitive damages awarded in New York. (New York general Counsel opinion, 9-27-97; New York Insurance Bulletins and related materials - General Counsel Opinions).

Despite the fact that punitive damages are not insurable under New York public policy, a general counsel opinion issued in 1991 supports the issuance of punitive damage coverage by an out-of-state insurance company. In this instance, the punitive damage coverage, offered in conjunction with a media special perils policy, would be issued (1) in a state where punitive damages were insurable; (2) the premiums would be paid in that state; and, (3) the policy would be delivered in the state in which coverage was available. The general counsel's office indicated that such insurance would be acceptable assuming the insurance company issuing such insurance was not avoiding doing business in New York pursuant to insurance law, § 1101, which defines those acts which "constitute doing an insurance business in the state."[5]

Although the insurance commission would not consider such insurance illegal or impermissible, it did note that this was no guarantee that a New York court might not void the punitive

damage coverage as violative of public policy, should the parties seek enforcement of the coverage in the New York court system. (New York General Counsel Opinion, March 12, 1991 (No. 2); New York Insurance Bulletins and related materials). In 1991, the New York Department of Insurance was asked for its legal opinion regarding the question of whether an insurance company can avoid liability in excess of policy limits (because of a provision of the insurance law). The Department recognized that, based on its policy, an insurer cannot be obligated to pay above policy limits.

However, the Department went on to address the question of whether an insurer can do so voluntarily. The Department reached the conclusion that, pursuant to § 2324 of New York's insurance law, payment must be limited to policy limits, subject to a few limited exceptions. In the course of this discussion, the General Counsel's office noted the following with regard to punitive damages:

> In 1982, the Department was asked whether an insurer would be allowed to pay punitive damages, a prohibited coverage in this State. The payment of punitive damages is a violation of this State's public policy on liability insurance. Punitive damages do not compensate the injured party for his or her injuries, but rather punish the defendant for willful or intentional conduct. Willful and reckless behavior on the part of an insured is not intended to be covered by the policy. Consequently, the Department determined that a licensed insurer which pays out on a punitive damage claim in New York would be in violation of § 188, for making a contract of insurance other than as plainly expressed in the policy. Additionally, if punitive damage awards were not paid by the insurer to all of its insureds holding identical insurance policies, there would be discrimination.

New York General Counsel Opinion, June 3, 1991 (New York Insurance Bulletin and related materials — General Counsel Opinions).

It would appear on its face that this opinion would be limited to policies which exclude claims arising out of intentional conduct and would not apply to a policy specifically covering punitive damages. However, as noted, other opinions from the Department of Insurance indicate that punitive damage coverage is impermissible in New York based upon public policy although this public policy is most specifically directed at Insurers licensed and doing business in the State of New York.

☐ Underwriting Considerations

The effect of this case law is that if a dispute arises, a choice of forum or choice of law clause in a policy will be paid strong deference by a United States court which might be in a position to address a policy providing coverage for punitive damages. This is particularly true where the contract is an international commercial transaction. However, this deference can be eroded in the absence of other contacts to the chosen state's law by a strong and conflicting public policy. Therefore, if the parties have significant ties to any of the states listed in Attachment 1 of this paper, a choice of law or choice of forum clause would strengthen the argument in favor of one of those jurisdictions. Conversely, if a choice of forum or choice of law clause in the insurance policy calling for coverage of punitive damages is the only contact the parties have to the jurisdiction or law in question, and if there is an argument that a strong public policy militates against enforcement of that policy, there is a chance that the coverage may be compromised by the conflicting public policy. This results in the rather dissatisfying realization that when the parties would most need their forum selection and/or choice of law clause in order to enforce the insurability of punitive damages, the clauses could be at their least effective. Therefore, these clauses should be a part of an insurer's or assured's punitive damage coverage analysis, but they are not a "silver-bullet" answer to problems which could arise.

■ OTHER SOLUTIONS

☐ Arbitration Clause

An arbitration clause can go a long way toward avoiding the kind of analysis applied in *Stonewall Surplus Lines*. This is true whether the policy at issue is a commercial contract between parties of differing nationalities or is one between domestic parties so long as the policy contains an arbitration clause. In the first instance, the Federal Arbitration Act and the Convention on the Recognition and Enforcement of Foreign Arbitral Awards ("Convention"), 9 U. S.C. § § 201-208 (1988) would govern the action in a U.S. court. In the latter instance (between domestic parties), the Federal Arbitration Act would govern. See, e.g., *Borden. Inc. v Meiji Mike Prods. Co., Ltd.*, 919 F.2d 822 (2d Cir. 1990), *cert. denied*, 500 U.S. 953 (1991). The Convention ratified

an international treaty promoting arbitration of international commercial disputes and, along with the Federal Arbitration Act, 9 U.S.C. § 1, *et. seq.* (1988), as amended, establishes a substantive body of federal law that promotes a strong public policy favoring arbitration.

Under the Convention, a stay of any action involving an international policy is mandatory pursuant to Article II (3) of 9 U.S.C. § 201 which provides:

> The court... shall, at the request of one of the parties, refer the parties to arbitration, unless its finds that the said agreement is null and void, inoperative or incapable of being performed. See also 9 U.S.C. § III; *C. Itoh & Co. (America) Inc. v. Jordan Int'l Co.*, 552 F.2d 1228, 1232 (7th Cir. 1977) (a District Court has no discretion to deny a petitioner's timely application for a stay when a valid arbitration agreement exists"); *McCreary Tire & Rubber Co. v. Ceat S.p.A.*, 501 F.2d 1032, 1037 (3d Cir. 1974) (held that it was reversible error to deny a stay request).

The Convention and the Federal Arbitration Act contemplate a limited inquiry by courts when considering a motion to compel arbitration:

1. Is there an agreement in writing to arbitrate the dispute?
2. Does the agreement provide for arbitration in the territory of a Convention signatory?
3. Does the agreement to arbitrate arise out of a commercial legal relationship?
4. Is the party to the agreement not an American citizen?

There is no consideration of the relative merits of individual clauses in the agreement, and therefore, the existence of a punitive damage coverage clause would not effect the arbitration clause or the choice of forum or choice of law clause in remanding the case to arbitration. If the above requirements are met, the Convention and the Federal Arbitration Act require the courts to order arbitration. *Sedco, Inc. v. Petroleos Mexiconos Mexican National Oil Co.*, 767 F.2d 1140, 1144-1145 (5th Cir. 1985). Thus, the arbitration clause provides the first and best approach that the policy will be properly construed in an arbitration in a jurisdiction of the parties' choice using the law chosen by the parties, rather than by a U.S. court which might be forced to consider local law or public policy.

restricting the insurability of punitive damages. However, limits on punitive damage coverage may limit the possibility of such judicial compromise. Limiting insurance to vicariously-assessed punitive damages is the least risky form of this insurance coverage, because a majority of jurisdictions allow insurability of vicariously-assessed punitive damages. Limiting coverage to acts of gross negligence, or wanton and reckless acts, is a middle ground; and coverage of intentional wrongdoing is the most blanket-type form of this insurance, and would be the most likely of the three to be subject to compromise in the face of a competing public policy.

☐ Geographical Restrictions on Policies Covering Punitive Damages

A final consideration can be to limit issuance of policies covering punitive damages to states in which the insurer has significant contact, and which also allow insurability of punitive damages. This, coupled with a forum selection and choice of law clause selecting those states, may insulate the insurer from a charge of forum shopping. However, this restricted coverage may be of limited value to an international or national assured who might suffer a loss (and punitive damage exposure) fortuitously in any one of a number of jurisdictions.

■ CONCLUSION

Insurers are successfully underwriting punitive damage exposure. These policies are custom products subject to professional underwriting guidelines and often include an arbitration clause, a forum selection clause, and a choice of law clause. From both a legal and marketing perspective, it is important that insurers and insureds have confidence that their intentions are not only reflected in the insurance policy, but that they have been the subject of legal analysis before a dispute arises.

In the course of analyzing a potential assured from an underwriting or risk perspective, underwriters should determine the assured's significant contacts with various states. The location of the assured's headquarters, the location of its manufacturing facilities, and its main distribution points are some factors to be considered. Assureds in states with strong policies against the insurability of punitive damages, like New York and California,

should be especially conscientious that its policies as well as its dispute resolution practices safeguard against litigation under those states' laws.

While coverage for punitive damages arising from egregious willful conduct or fraud may still retain an element of controversy, some insurers have been prudent to recognize that many punitive damage awards are more like a tornado; arbitrary, devastating and capricious, but ultimately, actuarially predictable and insurable.[6]

ATTACHMENT I

States which allow insurance for directly assessed punitive damages.

ALABAMA	*Employers Ins. Co. v. Brock*, 233 Ala. 551, 172 So. 671 (1937);
ALASKA	*Aetna Casualty and Surety Co. v. Marion Equipment Co.*, 894 P.2d 664 (Alaska 1995);
ARIZONA	*Price v. Hartford Accident & Indemnity Co.*, 108 Ariz. 485, 502 P2d 522 (1972);
ARKANSAS	*Southern Farm Bureau Casualty Insurance Co. v. Daniel*, 246 Ark. 849, 440 S.W. 2d 582 (1969) (punitive damages insurable unless conduct is intentional);
CONNECTICUT	*Dinapoli v. Cooke*, 43 Conn. App. 419, 682 A.2d 603 (Conn. Ct. App. 1996) (punitive damages limited to expenses of litigation minus taxable costs); *St. Paul Fire & Marine Ins. Co. v. Shernow*, 222 Conn. 823, 610 A.2d 281 (1992) ("wanton misconduct not insurable");
DELAWARE	*Whalen v. On-Deck, Inc.*, 514 A.2d 1072 (Del. 1986);
GEORGIA	*Greenwood Cemetery v. Travelers Indemnity Co.*, 238 Ga. 313, 232 S.E.2d 910 (1977);.
HAWAII	Haw. Rev. Stat., § 431:10-240 (2000) (Policies "shall not be construed to provide coverage for punitive or exemplary damages unless specifically included");
IDAHO	*Abbie Uriguen Oldsmobile Buick, Inc. v. U.S. Fire Ins. Co.*, 95 Idaho 501, 511 P.2d 783 (1973);
IOWA	*Skyline Harvestore Systems. Inc. v. Centennial Ins. Co.*, 331 N.W.2d 106 (Iowa 1983);
KENTUCKY	*Continental Ins. Co. v. Hancock*, 507 S.W.2d 146 (Ky. 1973) (intentional acts not insurable);

LOUISIANA	*Sharp v. Daigre*, 555 So.2d 1361 (La. 1990);
	Randall v. Chevron U.S.A., Inc., 13 F.3d 888 (5th Cir. 1994); *Modified,* ***22*** *F.3d. 568 (1994), cert. dismissed, 115 S. Ct. 5 (1994), cert. denied,* ***115*** *S. Ct. 498 (1994) (reversed on other grounds);*
MARYLAND	First National Bank of St. Mary's v. Fidelity and Deposit Co., 283 Md. 228, 389, A.2d 359 (1978);
MICHIGAN	*Meijer, Inc. v. General Star Indemnity Co.*, 826 F. Supp. 241 (W.D. Mich. 1993), *aff'd, 61 F. 3d. 903 (6th* ***Cir.*** *1995);*
	Yamaha Motor Corp. v. Tri-City Motors, 171 Mich. App. 260, 429 N.W.2d 871 (Mich. Ct. App. 1988) (coverage of "exemplary damages" as additional element of compensation to plaintiff);.
MISSISSIPPI	*James W. Sessums Timber Co., Inc. v. McDaniel*, 635 So.2d 875 (Miss. 1994);
MISSOURI	*Colson v. Lloyds of London*, 435 S.W.2d 42 (Mo. Ct. App. 1968);
MONTANA	*First Bank (NA)-Billings v. Transamerica Ins. Co., 209 Mont.* 93, 679 P.2d 1217 (1984) (punitive damages insurable when imposed for negligence);
	Smith v. State Farm Ins. Co., 264 Mont. 129, 870 P.2d 74 (1994), ("willful misconduct" not insurable); Mont. Code Ann. § 33-15-317 (1989) (insurance for punitive damage must be included in the contract);
	Nev. Rev. Stat., § 681A. 095 (1995) ("an insurer may insure against legal liability for exemplary or punitive damages that do not arise from a wrongful act of the assured committed with the intent to cause injury to another");
	American Home Assurance Co. v. Fish, 122 N.H. 711, 451 A.2d 358 (1982);
NEW MEXICO	*Baker v. Armstrong*, 106 N.M. 395, 744 P.2d 170 (1987);
NORTH CAROLINA	*Mazza v. Medical Mutual Ins. Co.*, 311 N.C. 621, 319 S.E.2d 217 (1984) (wanton or grossly negligent conduct is insurable);
OREGON	*Harrell v. Travelers Indemnity Co.*, 279 Or. 199, 567 P.2d 1013 (1977) (grossly negligent or reckless conduct insurable);

	Snyder v. Nelson, 278 Or. 409, 564 P.2d 681 (1977) ("intentional conduct in inflicting injury upon another" not insurable);.
SOUTH CAROLINA	*Carroway v. Johnson*, 245 S.C. 200, 139 S.E.2d 908 (1965); S.C.;
	Budget Control Board v. Prince, 304 S.C. 241, 403 S.E.2d 643 (1991) (coverage for punitive damages based on intentional acts implied by contract will be enforced);
TENNESSEE	*Lazenby v. Universal Underwriters Ins. Co.*, 214 Tenn. 639, 383 S.W.2d 1 (1964) (punitive damages covered, but coverage unavailable for intentional conduct);
TEXAS	*Dairyland County Mutual Ins. Co. v. Wallgren*, 477 S.W.2d 341 (Tex. Civ.App. Fort Worth 1972);
VERMONT	*State v. Glens Falls*, 137 Vt. 313, 404 A.2d 101 (1979);
WEST VIRGINIA	*Hensley v. Airy Ins. Co.*, 168 W. Va. 172, 283 S.E.2d 227 (1981) (coverage for punitive damages arising out of gross, reckless or wanton negligence);
WISCONSIN	*Brown v. Maxey*, 124 Wis. 2d 426, 369 N.W.2d 677 (Wis. 1985) (coverage for wanton, willful or reckless disregard of plaintiff's rights or interests);
WYOMING	*Sinclair Oil Corp. v. Columbia Casualty Co.*, 682 P.2d 975 (Wyo. 1984) (coverage for willful or wanton conduct).

☐ Notes

1. See e.g. Viscusi, *The Social Costs of Punitive Damages Against Corporations in Environmental and Safety Torts*, 87 Geo. L.J. 285 (1998).

2. The states which do not allow insurance coverage for directly assessed punitive damages, but do allow coverage for vicariously assessed punitive damages are: California, Florida, Illinois, Indiana, Kansas, New Jersey, Oklahoma, and Pennsylvania.

3. It is important to recognize the distinction between cases in which the parties intended coverage of punitive damages, and cases in which the insurer simply failed to express its intent to exclude punitive damages.

4. States which have not decided whether punitive damages are insurable are: District of Columbia, North Dakota, South Dakota, and Washington.

5. Under subparagraph B(2)(e) of § 1101, transactions with respect to policies of insurance on risks located within New York do not constitute doing insurance business in the State of New York if the policies are principally negotiated, issued and delivered in a foreign jurisdiction. If an insurer does do insurance business in the state of New York, § 1102 of the New York Ins. Code requires that the insurer be licensed and its policy forms approved.

6. The original version of this article was first published in the PLUS (Professional Liability Underwriters Society) Journal in November 1999.