
Liability Insurance/ Punitive Damages

Texas Public Policy Does Not Prohibit Employer's Liability Insurance Coverage for an Employer's Statutory Liability for Exemplary or Punitive Damages for Grossly Negligent Conduct

*Concurring Opinion and Dicta in Majority Opinion
Sketch How Texas Supreme Court Will Approach
Broader Question of Insurance Coverage for
Punitive Damages in Future*

*Fairfield Insurance Company v. Stephens Martin Paving, L.P.,
___ S.W.3d ___, 2008 WL 400397 (Tex. February 15, 2008)*

Case at a Glance

In answering a certified question from the Fifth Circuit about the insurability of punitive damages, the Texas Supreme Court noted that facts of the case before the Fifth Circuit presented a very narrow question: Does an employers' liability policy's coverage for exemplary damages awarded to the survivors of a worker who dies as a result of an employer's gross negligence violate public policy? The court answered this narrow question in the negative, noting that the Texas workers compensation scheme authorizes exemplary or punitive damages for grossly negligent conduct in certain circumstances and permits the Texas Department of Insurance to approve insurance policies that provide coverage for such damages. Thus, the Texas Legislature had already established a public policy in favor of the insurability

of punitive damages awarded pursuant to the state's workers' compensation scheme. However, recognizing the importance of insurance coverage for punitive damages in other contexts, the court commented on "some of the considerations relevant to determining whether Texas public policy prohibits insurance coverage of exemplary damages . . . in the absence of a clear legislative opinion."

Summary of Decision

Roy Edward Bennett was employed as a brooming machine operator by Stephens Martin Paving ("Stephens"), a highway paving contractor. Bennett died from injuries suffered when a brooming machine rolled over. Fairfield Insurance Company provided worker's compensation and employer's liability insurance to Stephens, and it paid worker's compensation benefits to the surviving wife and children. However, just over a month after the accident, the family sued Stephens under Texas Labor Code § 408 seeking recovery of exemplary damages for gross negligence. Texas Labor Code § 408, subsection (a), makes workers compensation an injured employee's exclusive remedy but subsections (b) - (c) permit the surviving spouse and heirs of a deceased employee to recover exemplary damages for death caused by an intentional act or omission of the employer or by the employer's gross negligence. Stephens sought a defense and, if necessary, indemnity for the Bennett family's Labor Code § 408 exemplary or punitive damages claim under the employer's liability portion of the Fairfield insurance policy. Significantly, the policy Fairfield issued to Stephens excluded coverage for intentional acts but not for gross negligence, and the Texas Department of Insurance (TDI) had approved the policy pursuant to its authority under the state's workers compensation laws, which require TDI approval before a policy can be sold in Texas.

A month after the Bennett family sued Stephens, Fairfield also sued it, seeking a declaratory judgment—this time in federal court—establishing that Fairfield owed Stephens no duties to defend or indemnify against liability for exemplary or punitive damages in the Bennett family's suit. Relying on *Ridgway v. Gulf Life Insurance Co.*, 578 F.2d 1026, 1029 (5th Cir.1978), the federal district court concluded that the language in Fairfield's policy

covers exemplary damages and that Texas public policy does not prohibit insurance coverage of those damages. Fairfield appealed, but the Fifth Circuit certified the question of the insurability of exemplary or punitive damages to the Texas Supreme Court. The Texas high court unanimously held that Texas public policy allows employers to purchase insurance for punitive/exemplary damages awarded in a statutorily authorized gross negligence case.

In so ruling, the supreme court outlined a two-step analysis for determining the insurability of exemplary or punitive damages. The first step examines whether the policy covers such damages. Because the Fifth Circuit's question concerned only the second prong of the analysis—whether public policy allows or prohibits punitive damages—the court presumed that the Fairfield policy covered exemplary damages awarded under Labor Code § 408 and proceeded to an analysis of Texas public policy. The court first looked to express statutory provisions to determine whether the Legislature had already made a policy decision. Since the Texas Legislature had authorized actions for exemplary/punitive damages based on gross negligence in Labor Code § 408, and the TDI had approved a policy covering gross negligence pursuant to its authority under the state workers' compensation laws, the court was able to answer the Fifth Circuit's question without inquiry into the general public policy of Texas. However, Justice Wainwright, writing for eight of the nine justices, indicated that the court "recognize[d] the import of th[e] issue and [would] therefore discuss some of the considerations relevant to determining whether Texas public policy prohibits insurance coverage of exemplary damages in other contexts in the absence of a clear legislative policy decision." Only Justice Johnson objected to the court's broad-ranging analysis of insurance coverage for punitive damages. Justice Johnson did not believe it appropriate under the Texas Constitution for the court to publish a judicial essay on any topic beyond what was needed to answer the certified question, as limited by the facts of the actual case.

The hallmark of Justice Wainwright's "judicial essay" on insurance for punitive damages is his refusal to adopt an across-the-board rule. Public policy, he explained, is to be determined by "weighing the interest in enforcing agreements versus the public policy interest against such enforcement." Texas has

a very strong public policy favoring freedom of contract, and the Texas Supreme Court had long recognized this right as central to liberty and close to sacred, although—of course—it is not “unbounded.” This public policy supports enforcement of agreements to insure punitive damages. Balanced against the public policy favoring freedom of contract is concern that insurance coverage would undermine the purpose of punitive damages. Although punitive damages traditionally have been ascribed the dual purpose of punishing and deterring wrongful conduct, Justice Wainwright found that recent legislative enactments “downplay the role of deterrence and focus squarely on the punitive aspect”—which can be achieved only if the damages are paid by the wrongdoer. Specifically, he pointed to statutory provisions requiring juries to make punitive damages awards specific as to each defendant and prohibitions against imposing punitive damages on a defendant for the criminal acts of another. He further pointed to various subjective factors set forth in § 41.011(a) of the Texas Civil Practice and Remedies Code for determining the amount of punitive damages, including the degree of culpability of the wrongdoer; the situation and sensibilities of the parties concerned; and the net worth of the defendant. These subjective factors, he pointed out, “are relevant to a determination of the amount of exemplary damages only if the *defendant* must pay it to the *plaintiff*. If exemplary damages are to be paid by insurance, it is less relevant to set the amount based on whether the plaintiff was trusting or the defendant calculating or wealthy.”

Given this focus on punishing the defendant, Justice Wainwright suggested that the culpability of defendant’s conduct should affect the insurability of punitive damages based on that conduct. For example, he observed that insuring against punitive damages is less likely to raise public policy concerns when the basis for the award is the conduct of a defendant’s employees or agents. Disallowing coverage in those circumstances, in Justice Wainwright’s view, means that punitive damages “will inevitably be passed on to the consumers of its product—who are also innocent,” also contrary to the damages’ purpose.” (Citation omitted). Although acknowledging that “extreme circumstances may prompt a different analysis,” he observed that as a general rule business should be allowed to spread the

risk of punitive damages based on employee conduct done without the knowledge of management or shareholders, “so as not to penalize many for the wrongful act of one.”

The fact that this analysis would permit corporations and large business organizations, but not individuals, to insure against punitive damages liability was not lost on Justice Wainwright. He noted with apparent approval that the Texas appellate court’s have “uniformly rejected as against public policy coverage under uninsured or underinsured motorist policies when the insured seeks to recover from his own insurer exemplary damages assessed against a third-party tortfeasor.” Permitting insurance for punitive damages that policyholder might recover from a third-party, in Justice Wainwright’s view, would place the burden of punitive damages “entirely on the insurer and its policyholders, not on the tortfeasor, thereby defeating the purpose of such damages.” The fact that the tortfeasor may remain exposed to the insurer’s subrogation action played no role in Justice Wainwright’s analysis.

Justice Hecht—writing for four justices—wrote a second judicial essay. His essay addresses the broader parts of the Fifth Circuit’s question. He begins with the following premises:

P₁: People should have the “utmost liberty of contracting,” although that right is not unbounded.

P₂: Public policy is a “very unruly horse, and when you get astride it, you never know where it will carry you[,]” and the horse may throw you anyway, and the injury will be legal error, at least.

P₃: Texas public policy must be narrowly deduced from the state constitution, state statutes, and judicial decisions. “The requirement of deduction is critical; it circumscribes judicial authority. Courts are to derive public policy from existing law, not create it. And courts must also recognize that public policy may change over time.”

Turning to the certified question, he begins with the purpose of punitive damages, and retraces much

of the ground covered in Justice Wainwright's opinion. In the end, he is not sure what to do about innocent business entities that have only vicarious liability. Perhaps they should be permitted to insure validly against punitive damages principally assessed against employees. On the other hand, Justice Hecht is certain that in the absence of guidance from the Legislature or the Commissioner it would violate Texas public policy to permit actual wrongdoers to use insurance to protect themselves from the punishment inherent in punitive damages

Comment

The decision in this case has been summarized here only briefly. Together the majority and concurring opinions are quite lengthy. They may even set a record. When it comes to general considerations, however, neither of them purports to be a holding, although Justice Hecht's concurring opinion comes the closest. Given the distribution of visions reflected in the opinions, it would be rational to bet that this court, if it is ever confronted with the general question about the insurability of punitive damages, will rule that the public policy underlying punitive damages trumps the freedom of contract, at least for a wrongdoer. Given the punishment function of punitive damages, this is the right decision. See Michael Sean Quinn, *Punitive Damages and Liability Insurance*, 18 INS. LITIG. RPTR 121 (1996). // Quinn