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## Texas Public Policy on Insuring Punitive Damages: Time for a Fresh Look

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# TEXAS PUBLIC POLICY ON INSURING PUNITIVE DAMAGES: TIME FOR A FRESH LOOK

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## I. INTRODUCTION

Insurance coverage for punitive damages clearly undermines the justifications for awarding punitive damages: punishment and deterrence. It allows a wrongdoer to escape what is essentially a criminal punishment. "If punitive damages are supported by any sound policy, that policy would appear to demand that they shall not be covered by liability insurance."<sup>1</sup> Nevertheless, beginning in the 1970's, some Texas appellate courts held that public policy did not preclude liability policies from covering punitive damages.<sup>2</sup> Other appellate courts, however, have reached the opposite result.<sup>3</sup> The Texas Supreme Court has yet to render its opinion on the issue of whether public policy allows liability insurance to cover punitive damages. Recent supreme court decisions, closely related statutory enactments, and an examination of existing appellate court decisions should result in the

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1. W. PAGE KEETON ET AL., PROSSER AND KEETON ON THE LAW OF TORTS § 2 (5th ed. 1984).

2. *American Home Assurance Co. v. Safway Steel Prods. Co.*, 743 S.W.2d 693 (Tex. App.—Austin 1987, writ denied); *Home Indem. Co. v. Tyler*, 522 S.W.2d 594 (Tex. Civ. App.—Houston [14th Dist.] 1975, writ ref'd n.r.e.); *Dairyland County Mut. Ins. Co. v. Wallgren*, 477 S.W.2d 341 (Tex. Civ. App.—Fort Worth 1972, writ ref'd n.r.e.).

3. *Government Employees Ins. Co. v. Lichte*, 792 S.W.2d 546 (Tex. App.—El Paso 1990, writ denied).

supreme court overruling decisions that have allowed insurance of punitive damages when it considers this issue.

Punitive damages have existed in English common law for more than 200 years,<sup>4</sup> in American jurisprudence since the 1800's,<sup>5</sup> and in Texas since at least 1847.<sup>6</sup> American courts have long disputed whether punitive damages have a place in the law.<sup>7</sup> This comment avoids that battle, given that punitive damages appear firmly entrenched in American jurisprudence.<sup>8</sup> However, the practice of insuring against punitive damages is not as firmly grounded, thus this comment examines the purpose of the punitive damages doctrine, and whether that doctrine can rationally allow insurance to cover punitive awards.

The terms "punitive" and "exemplary" are interchangeable and embrace the idea of deterrence.<sup>9</sup> The three goals of punitive damages are punishment, deterrence, and example. Together, these elements satisfy the concept of punitive damages; each has the salutary effect of fulfilling the other. If the stated purpose is to punish, the award also deters the defendant from similar conduct in the future, and by example, deters others from such conduct. If the stated purpose is for example's sake, the award likewise punishes and deters the defendant. If deterrence is the purpose of punitive damages, this also fulfills the goals of punishment and example. Where insurance is not involved, punitive damages based on a compensation rationale (allowing recovery for insult and suffering, attorneys' fees, and other remote losses) also serve the punishment, exemplary, and deterrence purposes of the doctrine. Thus, it is normally not critical to precisely affix one primary purpose, or establish the independent or dependent relationships between these purposes, to have a unitary theory of punitive damages.

This comment takes the position that the modern purposes of punitive damages are punishment, example, and deterrence.<sup>10</sup> When in-

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4. *See generally* *Wilkes v. Wood*, 98 Eng. Rep. 489 (C.P. 1763); *Huckle v. Money*, 95 Eng. Rep. 768 (K.B. 1763).

5. THEODORE SEDGWICK, *MEASURE OF DAMAGES* 36 (3d rev. ed., N.Y., Voorhies 1858).

6. *Graham v. Roder*, 5 Tex. 141 (1849).

7. *Fay v. Parker*, 53 N.H. 342, 382 (1873) (calling the doctrine of allowing punitive damages wrong: "It is a monstrous heresy.").

8. Forty-six states allow recovery of punitive damages. RICHARD L. BLATT ET AL., *PUNITIVE DAMAGES: A STATE BY STATE GUIDE TO LAW AND PRACTICE* § 8.2 (1991).

9. *Hofer v. Lavender*, 679 S.W.2d 470 (Tex. 1984) (Spears, J., dissenting). "The separate aims of punishing the tortfeasor and providing an example to deter others are mirrored by the interchangeable use of the terms 'punitive' and 'exemplary' to describe these damages." *Id.* at 477.

10. *But see* *Flanagan v. Womack*, 54 Tex. 45 (1880). Justice Bonner's dicta typifies the school of thought that punitive damages are primarily intended as compensation for the injured party.

Frequently the mere physical injury sustained, and which ordinarily is the test of actual damages, would of itself be comparatively insufficient, but the

insurance enters the picture, a factor not in existence when the doctrine developed, the punishment and recompense purposes collide. Insuring punitive damages clearly destroys all the purposes of punitive damages except the compensation purpose. Modern courts must take this factor into consideration in determining what purposes punitive damages should serve today, rather than simply recite reasons given in the past by courts that were not faced with the insurance issue.

To the extent there is a separate "recompense" justification for punitive damages, public policy supports insuring punitive damages. This comment considers whether the recompense justification of punitive damages is sufficient to stand alone,<sup>11</sup> and whether the legislature has addressed the issue.

The comment will first define the threshold requirement of actual knowledge of the wrong as an indicator that punitive damages are intended as punishment. Next, the comment will look at how Texas case law has defined punitive damages to determine whether the compensation aspect of punitive damages is an independent justification such that insuring punitive damages does not contravene public policy. The comment will consider statutory law as a basis for finding that public policy bars insuring punitive damages. Finally, this comment explores how the supreme court's latest pronouncement on the purpose of punitive damages, *Transportation Insurance Co. v. Moriel*,<sup>12</sup> lays the foundation for denying insurance of punitive damages.

## II. EXEMPLARY DAMAGES ARE NOW ASSESSED SOLEY FOR PUNISHMENT AND DETERRENCE BECAUSE ACTUAL SUBJECTIVE KNOWLEDGE OF THE WRONG IS REQUIRED

Despite a split in state case law as to whether punitive damages are insurable,<sup>13</sup> the majority of U.S. cases reflect the proposition that it is

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outrage upon the feelings . . . would be of such gross character or under such indignant circumstances as should require ample reparation from the offender . . . Indulgence was extended by the courts to such verdicts, as they tended to prevent breaches of the peace, and to encourage, by a resort to the law of the land, the settlement of difficulties which otherwise might have ended in personal conflicts. To this extent the public also was interested.

This indirect result to the public good, led some courts into the error of assuming as one of the grounds why such damages should be allowed at the suit of a private party, that it was intended as a public punishment to the offender, thus making that an active cause which originally was but a passive result, and in this way converting private recompense into public punishment.

*Id.* at 48.

11. *Hofer*, 679 S.W.2d 470 (Pope, C.J., dissenting). "If those are the varied purposes, then awards for punitive damages are not anchored to sound doctrinal underpinnings." *Id.* at 479.

12. 879 S.W.2d 10 (Tex. 1994).

13. BLATT, *supra* note 8, § 8.3.

contrary to public policy to insure oneself against punitive damages based on one's own conduct where state law requires a showing that the wrongdoer was aware of the wrong.<sup>14</sup> In other words, states requiring knowledge of the wrong find the purpose of punitive damages is punishment, and those states deny insurance coverage of the damages. If the law of a particular state does not require such a finding (and thus focuses solely on the tortfeasor's conduct, rather than awareness), the conduct that is the basis for the punitive damage award is virtually indistinguishable from the conduct that comprises the underlying wrong.<sup>15</sup> Without an actual knowledge requirement, the claim is fundamentally one of negligence. Because the purpose of awarding damages in negligence suits is compensation, a court must find a compensatory purpose in punitive damages to justify insuring punitive damages. Since these awards are given to make the victim whole, it follows that insurance coverage does not subvert the purpose of punitive damages.<sup>16</sup> The emphasis, then, is whether a finding of knowledge is based on an objective reasonable person standard (knew or should have known), or whether actual subjective knowledge must be found before awarding punitive damages. By its nature, an objective standard can serve to compensate. Such a standard would support insurance coverage of punitive damages, whereas an actual awareness standard would not support coverage.

In the past, Texas case law allowed the jury to infer, based on an objective standard,<sup>17</sup> that the defendant had knowledge of the wrong.<sup>18</sup> One recent opinion expressed concern about defendants unwittingly crossing the "fine line" from ordinary negligence to gross negligence, and exposing themselves to a punitive damage award because of the objective knowledge standard.<sup>19</sup> However, in 1987, the Texas legislature amended the Texas Civil Practice and Remedies Code, and raised the knowledge requirement to actual awareness.<sup>20</sup>

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14. Michael A. Rosenhouse, Annotation, *Liability Insurance Coverage as Extending to Liability for Punitive or Exemplary Damages*, 16 A.L.R. 4th 11, 17 (1982).

15. *Id.*

16. *Hensley v. Erie Ins. Co.*, 283 S.E.2d 227, 233 (W. Va. 1981).

17. *Transportation Ins. Co. v. Moriel*, 879 S.W.2d 10 (Tex. 1994).

18. *Southern Cotton Press & Mfg. Co. v. Bradley*, 52 Tex. 587, 600 (1880) ("Gross negligence, to be the ground for exemplary damages, should be that entire want of care which would raise a presumption of a conscious indifference . . ."); *Missouri Pac. Ry. v. Shuford*, 10 S.W. 408, 411 (Tex. 1888) ("Gross negligence, to be the ground for exemplary damages, should be that entire want of care which would raise the belief that the act . . . was the result of a conscious indifference . . ."); see also *Burk Royalty Co. v. Walls*, 616 S.W.2d 911, 920 (Tex. 1981).

19. *American Home Assurance Co. v. Safway Steel Prods. Co.*, 743 S.W.2d 693, 704 (Tex. App.—Austin 1987, writ denied).

20. TEX. CIV. PRAC. & REM. CODE ANN. §§ 41.001-.003 (Vernon Supp. 1994).

(3) "Exemplary damages" means any damages awarded as an example to others, as a penalty, or by way of punishment. "Exemplary damages" includes punitive damages.

(4) "Fraud" means fraud other than constructive fraud.

Under this analysis, an actual knowledge standard supports the rationale that punitive damages are intended to punish the tortfeasor. Consequently, it follows that to allow punitive damages to be insured would be to defeat the purpose of punitive damages.

Specifically, there was no impetus for the legislature to change the common law in this fashion, unless it was the intent of the legislature to clarify who should be subjected to exemplary damage awards: only those aware of their wrong. The logical reason for including this awareness distinction may be that the purposes of punitive damages are punishment and deterrence. There was no need for such a change if the legislature intended that punitive damages also serve as compensation. A comparison of case law to Chapter 41 of the Texas Civil Practice and Remedies Code illustrates the legislative intent.<sup>21</sup>

Most early Texas cases on punitive damages involved intentional torts with an additional element of committing the tort in a willful, wanton, or reckless manner, or for fraudulent or malicious conduct.<sup>22</sup> Under the common law, fraudulent conduct justified a punitive damage award.<sup>23</sup> Some cases required actual knowledge as an element of

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(5) "Gross negligence" means more than momentary thoughtlessness, inadvertence, or error of judgment. It means such an entire want of care as to establish that the act or omission was the result of actual conscious indifference to the rights, safety, or welfare of the person affected.

(6) "Malice" means:

(A) conduct that is specifically intended by the defendant to cause substantial injury to the claimant; or

(B) an act that is carried out by the defendant with a flagrant disregard for the rights of others and with actual awareness on the part of the defendant that the act will, in reasonable probability, result in human death, great bodily harm, or property damage.

... (a) Exemplary damages may be awarded only if the claimant proves that the personal injury, property damage, death, or other harm with respect to which the claimant seeks recovery of exemplary damages results from:

(1) fraud;

(2) malice; or

(3) gross negligence.

*Id.* §§ 41.001(3)-(6), .003(a).

21. *Crimmins v. Lowry*, 691 S.W.2d 582, 584 (Tex. 1985) (legislative intent determined by examining "the old law, the evil, and the remedy") (quoting TEX. REV. CIV. STAT. ANN. art. 10, § 6 (Vernon 1969)).

22. *Shaw v. Brown*, 41 Tex. 446 (1874) (sheriff adding his "commission" to the execution of judgment was clearly unlawful); *Hughes v. Brooks*, 36 Tex. 379 (1872) (attachment must be sued out maliciously to recover exemplary damages); *Neill v. Newton*, 24 Tex. 202 (1859) (no exemplary damages for refusal to pay over money collected absent aggravating circumstances of misrepresentation and deception); *Reed v. Samuels*, 22 Tex. 114 (1858) (no exemplary damages for wrongful suit of attachment without malice); *Cook v. De la Garza*, 9 Tex. 358 (1853) (willful and wrongful ejection from one's land); *Cole v. Tucker*, 6 Tex. 266 (1851) (malicious trespass); *Smith v. Sherwood*, 2 Tex. 460 (1847) (fraudulent conduct, wanton violence, malicious outrage justify exemplary damages).

23. *Sherwood*, 2 Tex. at 463.

fraud.<sup>24</sup> Others held no such requirement existed.<sup>25</sup> Tort reform amendments adopted in 1987 emphasize the actual knowledge requirement in the definitions of fraud.<sup>26</sup> Under the Texas Civil Practice and Remedies Code, fraud is one basis for an award of exemplary damages.<sup>27</sup> Section 41.001 defines fraud as "fraud other than constructive fraud."<sup>28</sup> Here, the legislature adopted the common law definition of fraud, but specifically excluded constructive fraud. Constructive fraud does not require a defendant's knowledge of the wrongfulness of his conduct as an element of proof.<sup>29</sup> Thus, by excluding constructive fraud, the legislature emphasized actual knowledge of the fraud as a requirement for exemplary damages.

A second way to obtain punitive damages under section 41.003 is by showing malice in law or malice in fact. The common law defined malice in fact (i.e., actual malice) as conduct specifically intended by the defendant to cause substantial injury to the claimant.<sup>30</sup> Obviously, specific intent indicates actual awareness of the wrong. The legislature adopted this definition.<sup>31</sup>

While the common law defined malice in law as occurring when the will or intent to injure could be inferred from the conduct of the wrongdoer,<sup>32</sup> the 1987 addition of section 41.001 raised the common law standard to actual knowledge. Section 41.001 defines malice in law as "an act that is carried out by the defendant with a flagrant disregard for the rights of others and with actual awareness on the part of the defendant that the act will, in reasonable probability, result in human death, great bodily harm, or property damage."<sup>33</sup> The legislature apparently sought to inflict punishment only on those defendants who were morally culpable by the fact of their actual knowledge of the wrong. Theoretically, this higher burden of proof will decrease

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24. *Dittberner v. Bell*, 558 S.W.2d 527, 533 (Tex. Civ. App.—Amarillo 1977, writ ref'd n.r.e.). *Contra* *Graves v. Hartford Accident & Indem. Co.*, 161 S.W.2d 464 (Tex. 1942).

25. *White v. Bond*, 355 S.W.2d 225 (Tex. Civ. App.—Amarillo), *rev'd on other grounds*, 362 S.W.2d 295 (Tex. 1962); *Stark v. R.B. George Mach. Co.*, 41 S.W.2d 1023 (Tex. Civ. App.—Fort Worth 1931), *aff'd*, 73 S.W.2d 519 (Tex. 1934) (person making statement is responsible for its truthfulness and speaker's knowledge of falsity will be imputed when he makes statement without knowing whether it is false); *Klindworth v. O'Connor*, 240 S.W.2d 470 (Tex. Civ. App.—Dallas 1951, writ ref'd n.r.e.).

26. TEX. CIV. PRAC. & REM. CODE ANN. § 41.001 (Vernon Supp. 1994).

27. *Id.* § 41.003.

28. *Id.* § 41.001.

29. *E.g.*, *Archer v. Griffith*, 390 S.W.2d 735, 740 (Tex. 1964).

30. *Clements v. Withers*, 437 S.W.2d 818 (Tex. 1969).

31. TEX. CIV. PRAC. & REM. CODE ANN. § 41.001(6)(A) (Vernon Supp. 1995).

32. *LaCoure v. LaCoure*, 820 S.W.2d 228, 235 (Tex. Civ. App.—El Paso 1991, writ denied); *Tennessee Gas Transmission Co. v. Moorhead*, 405 S.W.2d 81, 86 (Tex. Civ. App.—Beaumont 1966, writ ref'd n.r.e.); *Schutz v. Morris*, 201 S.W.2d 144, 146 (Tex. Civ. App.—Austin 1947, no writ).

33. TEX. CIV. PRAC. & REM. CODE ANN. § 41.001(6)(B) (Vernon Supp. 1994).

the number of successful punitive damage awards. Thus, had the legislature viewed punitive damages as compensatory, logic dictates it would not have raised the burden of proof.

The same legislative focus on actual awareness is apparent in the statutory definition of gross negligence.<sup>34</sup> The common law definition of gross negligence, as grounds for exemplary damages, was "that entire want of care which would raise a presumption of a conscious indifference to consequences."<sup>35</sup> Until recently, this inference of knowledge had changed little over the years. The Texas Supreme Court has stated,

Gross negligence, to be the ground for exemplary damages, should be that entire want of care which would raise the belief that the act or omission complained of was the result of a conscious indifference to the right (sic) or welfare of the person or persons to be affected by it.<sup>36</sup>

The common law, by use of the words "raise the belief" or "raising a presumption," used an inferred knowledge test based on an objective standard. Thus, the common law focused on the tort itself, rather than the actor's actual state of mind.

However, gross negligence under the Texas Civil Practice and Remedies Code means "more than momentary thoughtlessness, inadvertence, or error of judgment."<sup>37</sup> This wording excludes the common law definition of negligence, which had no knowledge requirement. Most significantly, the Code further distinguishes ordinary negligence from gross negligence.<sup>38</sup> Under section 41.001, gross negligence is defined as "such an entire want of care as to establish that the act or omission was the result of *actual conscious indifference* to the rights, safety, or welfare of the person affected."<sup>39</sup> By adding the word "actual" to the common law definition of conscious indifference, the legislature clearly delineated when punitive damages are justified. The standard shifted from an objective, reasonable person test to a subjective awareness test. Again, if the legislature did not intend for punitive damages to serve as punishment, there was no need to change the common law definition.

Indeed, Senator John Montford, primary sponsor of the tort reform bill, explained in debate that the decision to add "actual" to the common law "conscious indifference" standard was to assure that only knowing tortfeasors would be punished.<sup>40</sup> Adding "actual" to the def-

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34. *Id.* § 41.001(5).

35. Southern Cotton Press & Mfg. Co. v. Bradley, 52 Tex. 587, 600 (1880).

36. Burke Royalty Co. v. Walls, 616 S.W.2d 911, 920 (Tex. 1981) (citing Missouri Pac. Ry. v. Shuford, 10 S.W. 408, 411 (Tex. 1888)).

37. TEX. CIV. PRAC. & REM. CODE ANN. § 41.001(5) (Vernon Supp. 1995).

38. *Id.* § 41.003.

39. *Id.* § 41.001(5) (emphasis added).

40. Debate on Tex. S.B. 287 on the Floor of the Senate, 70th Leg. 3-9 (May 6, 1987), cited in John T. Montford & Will G. Barber, 1987 Texas Tort Reform: The



inition of gross negligence adversely affects any compensation justification for punitive damages, as compensation then takes a subordinate role to the punishment purpose. Raising the standard means there will be no awards for the same conduct absent actual knowledge. The only logical reason the legislature added an actual awareness requirement to exemplary damage awards was because in its view, punitive damages are for punishment, not compensation.

After tort reform,<sup>41</sup> the Texas Supreme Court emphasized this subjective knowledge distinction in *Moriel* by comparing the statutory definition to the common law.<sup>42</sup> The court held the test for gross negligence was actually two-fold: 1) whether the conduct itself created an extreme risk, and 2) whether the defendant was actually aware of or acted with conscious indifference to the risk.<sup>43</sup> The court then explained that the emphasis prior courts placed on the act itself allowed an inference of knowledge.<sup>44</sup> This in effect eliminated knowledge as the distinguishing factor between a finding of negligence and gross negligence. Thus, one can conclude under *Transportation* that it is knowledge of the wrong that justifies punishment.

To summarize thus far, states without an actual awareness requirement allow insurance of punitive damages because gross negligence becomes indistinguishable from ordinary negligence.<sup>45</sup> If there is no difference, then the punitive damages can be viewed as compensation, as are actual damages. However, the Texas legislature and Texas Supreme Court have both indicated punitive damage awards are justified *only* when there is actual subjective awareness of the wrong. Theoretically, then, Texas should now fall in that group of states that do not allow insurance coverage for punitive damages. The actual knowledge requirement is the method by which the legislature distinguishes which defendants should be punished and which should pay only actual damages to the plaintiff. Had it been the intent of the legislature to allow punitive damages to serve as compensation, there would have been no need to change the common law requirements. By creating a different standard altogether, which does not focus exclusively on the underlying tort, the legislative definition of culpable conduct supports an underlying rationale of punishment only.

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*Quest for a Fairer and More Predictable Civil Justice System*, 25 HOUS. L. REV. 245, 323 (1988). "MONTFORD: [W]hat we're trying to do is go back to what [exemplary damages] was intended to be[:] . . . the imposition of punishment . . . ." *Id.*

41. TEX. CIV. PRAC. & REM. CODE ANN. § 41.001 (Vernon Supp. 1994).

42. 879 S.W.2d at 19-20.

43. *Id.* at 23.

44. *Id.* at 20.

45. Rosenhouse, *supra* note 14.

### III. THE NATURE OF PUNITIVE DAMAGES — BACKGROUND

#### A. Introduction

Although courts first justified punitive damages as compensation and punishment, the doctrine has evolved over the past two hundred years to one of punishment.<sup>46</sup> This is true in the common law of England, the United States, and Texas. When modern courts rely on early cases as justification for a compensatory rationale, they ignore the evolution of the doctrine and changes in the law of actual damages.

#### B. England

Some early English cases used the term “exemplary damages” to describe judgments designed to punish the defendant,<sup>47</sup> while other cases implied punitive damages also served a compensatory rationale.<sup>48</sup> From the beginning, there was a split in the courts as to whether punitive damages were given for punishment, or for compensation.<sup>49</sup> At the time, the common law allowed recovery only for actual pecuniary loss sustained. Punitive damages became a means of compensating the plaintiff since mental anguish was not an element of actual damages.<sup>50</sup> Today, mental anguish is recoverable as actual damages,

46. 1 LINDA L. SCHLUETER & KENNETH R. REDDEN, *PUNITIVE DAMAGES*, § 1.4 (2d ed. 1989).

47. *Huckle v. Money*, 95 Eng. Rep. 768 (K.B. 1763). Although the personal injury to the plaintiff during his wrongful imprisonment was slight, the jury awarded him an amount well in excess of his actual injury sustained. In response to a motion to set aside the judgment as excessive, the Chief Justice stated,

[T]he small injury done to the plaintiff . . . did not appear to the jury in that striking light in which the great point of law touching the liberty of the subject appeared to them at the trial; they saw a magistrate over all the King's subjects, exercising arbitrary power, violating Magna Charta, and attempting to destroy the liberty of the kingdom . . . . These are the ideas which struck the jury on the trial; and . . . they have done right in giving exemplary damages.

*Id.* at 769.

48. *Beardmore v. Carrington*, 95 Eng. Rep. 790 (K.B. 1764). The court reviewed the plaintiff's award in light of both the actual and nonpecuniary damages he suffered.

[C]an we say that 1000l. are monstrous damages as against him, who has granted an illegal warrant to a messenger who enters into a man's house, and prys [sic] into all his secret and private affairs, and carries him from his house and business, and imprisons him for six days. . . . [sic] Can any body say that a guinea per diem is sufficient damages in this extraordinary case . . . ? We cannot say the damages of 1000l. are enormous . . . .

*Id.* at 793-94.

49. 1 SCHLUETER & REDDEN, *supra* note 46, § 1.4. The authors note that “early American cases reflected the common law confusion over the issue of whether punitive damages were penal in nature or for compensation.” *Id.* See also Roy R. Anderson, Jr., *Indemnity Against Punitive Damages: An Examination of Punitive Damages, Their Purpose, Public Policy, and the Coverage Provisions of the Texas Standard Automobile Liability Insurance Policy*, 27 Sw. L.J. 593, 594 (1973). To a like degree, the same confusion has been imported into Texas common law.

50. *Stuart v. Western Union Tel. Co.*, 18 S.W. 351 (Tex. 1885).

and to the extent actual damages exist, punitive damage awards are redundant. To a large degree, the original compensation justification is no longer applicable.

Punishment eclipsed the recompense justification of punitive damages in English common law (and American common law) in the mid-1800's. This was commensurate with the availability of damages for mental anguish.<sup>51</sup> A 1964 decision ended the confusion in the English courts by holding that punitive damages were non-compensatory in character.<sup>52</sup>

### C. United States

The switch in American jurisprudence to a punishment rationale of punitive damages came a hundred years earlier in *Day v. Woodworth*.<sup>53</sup> *Day* declared that punitive damages were allowed "in view [of] the enormity of his offence rather than the measure of compensation to the plaintiff."<sup>54</sup> "By the common as well as by statute law, men are often punished for aggravated misconduct or lawless acts, by means of a civil action, and the damages, inflicted by way of penalty or punishment, given to the party injured."<sup>55</sup> More recently, Justice O'Connor has stated, "punitive damages are, by definition, punishment."<sup>56</sup>

Why the switch? Perhaps the judges who first considered the doctrine of punitive damages felt they needed to justify what was, under the existing rule of actual damages, a windfall to the plaintiff.

Another explanation is that these judges realized a compensation justification did not explain why similarly injured plaintiffs should be compensated differently. For example, consider a scenario where two plaintiffs, in separate accidents, sustained the same direct losses when two different defendants ran red traffic lights and collided with the respective plaintiffs' automobiles. The first plaintiff was injured because the defendant driver failed to notice that the traffic signal turned red before the defendant entered the intersection. In the second accident, the defendant driver was intoxicated. The drunk driver

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It may be, and is, most likely true, that the whole doctrine of punitive or exemplary damages has its foundation in a failure to recognize as elements upon which compensation may be given many things which ought to be classed as injuries entitling the injured person to compensation. . . . At the present time, however, the fact that it may be found difficult to ascertain the exact amount of compensation . . . is not considered . . . sufficient reason why compensation should not be given.

*Id.* at 353-54. See also 1 SCHLUETER & REDDEN, *supra* note 46, § 1.3(C).

51. 1 SCHLUETER & REDDEN, *supra* note 46, § 1.4(A).

52. 1 All E.R. 367 (A.C. 1964).

53. 54 U.S. 363 (1851).

54. *Id.* at 371.

55. *Id.*

56. *Pacific Mut. Life Ins. Co. v. Haslip*, 499 U.S. 1, 47 (1991)(O'Connor, J., dissenting).

defendant will most likely be found grossly negligent, and the second plaintiff most likely will recover punitive damages in addition to actual damages. A compensation justification alone cannot explain why the plaintiff injured by the drunk driver will receive more in damages than the plaintiff injured by the sober defendant. Both plaintiffs are probably equally irritated or insulted that these thoughtless defendants caused an accident. But is there really more injury, insult, or harm in need of compensation because one plaintiff learned he was injured by a drunk driver?

The difference in the awards to the hypothetical plaintiffs is clearly justified when punitive damages are based on a punishment rationale. The defendant charged with driving under the influence pays more because society is punishing and deterring drunk driving, not because one plaintiff is due more compensation than the other.

#### D. Texas

Just as the common law confusion about the purpose of punitive damages was imported into early United States common law,<sup>57</sup> so too was the confusion brought into Texas. Texas cases have recognized various purposes for punitive damages: punishment of the defendant,<sup>58</sup> deterrence of the defendant,<sup>59</sup> deterrence of others acting in a similar manner,<sup>60</sup> as an example to others,<sup>61</sup> protection of the public "against the violation of personal rights and social order by corporations,"<sup>62</sup> to compensate "for losses too remote to be considered elements of strict compensation,"<sup>63</sup> and reimbursement of attorney's fees.<sup>64</sup> The confusion in this litany is the failure to delineate cause and effect: punishment that justifies the award, versus the additional payments the plaintiff perceives as compensation for the loss.

Although they serve two distinct functions, actual damages and punitive damages are interrelated. The avowed purpose of actual damages is to compensate the plaintiff. Nevertheless, forcing the defendant to compensate the plaintiff also punishes the defendant and serves to deter similar conduct in the future. Conversely, although the purpose of punitive damages is punishment, these damages also compensate the plaintiff in the form of a larger award. "The point is that

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57. See *supra* note 49 and accompanying text.

58. *Burk Royalty Co. v. Walls*, 616 S.W.2d 911 (Tex. 1981); *Graham v. Roder*, 5 Tex. 141 (1849).

59. *Bernal v. Seitt*, 313 S.W.2d 520 (Tex. 1958); *Cole v. Tucker*, 6 Tex. 266 (1851).

60. *Hofer v. Lavender*, 679 S.W.2d 470, 477 (Tex. 1984).

61. *Id.*; *Cavnar v. Quality Control Parking, Inc.*, 696 S.W.2d 549, 555 (Tex. 1985).

62. *Fort Worth Elevators Co. v. Russell*, 70 S.W.2d 397, 402 (Tex. 1934).

63. *Mayer v. Duke*, 10 S.W. 565, 569 (Tex. 1889). See also *Bisso v. Southworth*, 10 S.W. 523 (Tex. 1888); *Wright Titus, Inc. v. Swafford*, 133 S.W.2d 287, 295 (Tex. Civ. App.—Austin 1939, writ *dism'd* *judgm't* *cor.*).

64. *Hofer v. Lavender*, 679 S.W.2d 470 (Tex. 1984); *Pan Am. Petroleum Co. v. Hardy*, 370 S.W.2d 904 (Tex. Civ. App.—Waco 1963, writ *ref'd* *n.r.e.*).

the essential, primary objectives of punitive damages are not to fulfill the plaintiff's need for compensation, but to fulfill the separate purposes of a quasi-criminal nature of punishment and deterrence."<sup>65</sup>

Unlike a punishment rationale, however, the compensation justification cannot independently support an award of punitive damages. If the word "punishment" is taken out of the definition of exemplary damages, then the award of more compensation is based on a different level of culpability (i.e., negligence versus gross negligence, versus acting with intent). The question then becomes, why does a different level of culpability justify more compensation? This query brings the argument full circle to a justification of punishment, deterrence, or example.

Nevertheless, while one line of Texas cases holds that the purposes of punitive damages are punishment, deterrence, and example,<sup>66</sup> another line of cases supports the same type of award with dual purposes of punishment and compensation.<sup>67</sup> To justify insurance coverage of punitive damages, there must be an independent compensatory purpose for punitive damages. If an independent compensatory purpose can be found, then public policy permits insuring punitive damages despite the destruction of the punitive purpose. Following is a review of Texas cases to determine whether a separate compensation rationale can be found.

#### IV. TEXAS CASE LAW DOES NOT SUPPORT COMPENSATION AS AN INDEPENDENT JUSTIFICATION OF PUNITIVE DAMAGES

As previously noted, when courts allow insurance to cover a punitive damage award, they undermine the punishment justification for those damages. The damage award does not punish the offender or deter similar conduct in the future. In the insurance context, the issue is whether there is a freestanding compensation justification sufficient to support such an award. If not, the defendant should not be allowed to avail himself of an insurance policy to escape punishment.

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65. *Id.* See also *Foster v. Bourgeois*, 253 S.W. 880 (Tex. Civ. App.—Austin 1923), *aff'd*, 259 S.W. 917 (Tex. 1924).

66. *Transportation Ins. Co. v. Moriel*, 879 S.W.2d 10, 16-17 (Tex. 1994); *Cavnar v. Quality Control Parking, Inc.*, 696 S.W.2d 549, 555 (Tex. 1985); *Pace v. State*, 650 S.W.2d 64, 65 (Tex. 1983); *Sheffield Div. Armco Steel Corp. v. Jones*, 376 S.W.2d 825, 831 (Tex. 1964); *Bernal v. Seitt*, 313 S.W.2d 520, 523 (Tex. 1958); *Bennett v. Howard*, 170 S.W.2d 709, 713 (Tex. 1943); *Hays v. Houston & Great N.R.R.*, 46 Tex. 272, 279-80 (1876); *Southern Cotton Press & Mfg. Co. v. Bradley*, 52 Tex. 587, 600-01 (1880); *Cotton v. Cooper*, 209 S.W. 135, 138 (Tex. Comm'n App. 1919, judgment adopted); *Wright Titus, Inc. v. Swafford*, 133 S.W.2d 287, 295 (Tex. Civ. App.—Austin 1939, writ dismissed judgment corrected); *Piper v. Duncan*, 131 S.W.2d 397, 398 (Tex. Civ. App.—Dallas 1939, writ refused); *Express Publishing Co. v. Hormuth*, 5 S.W.2d 1025, 1026 (Tex. Civ. App.—El Paso 1928, writ refused); *Evans v. McKay*, 212 S.W. 680, 685 (Tex. Civ. App.—Dallas 1919, writ dismissed).

67. *Hofer v. Lavender*, 679 S.W.2d 470 (Tex. 1984); *Flanagan v. Womack*, 54 Tex. 45 (1880); *Mayer v. Duke*, 10 S.W. 565 (Tex. 1889); *Cole v. Tucker*, 6 Tex. 266 (1851).

The common threads throughout Texas case law are the punishment and deterrence functions of punitive damages,<sup>68</sup> but the compensation justification seems to appear and disappear as needed.<sup>69</sup> Some courts find the purpose of punitive damages is purely punishment.<sup>70</sup> Others, however, view exemplary damage awards as serving a twofold purpose: punishment to the defendant, and compensation to the plaintiff for elements of damages considered too remote to be included in actual damages.<sup>71</sup>

Case law does not support compensation as an "equally important" justification for punitive damages awards.<sup>72</sup> A review of case law reveals that the compensatory function, when mentioned at all, takes a dependent role to the extent that compensation is not allowed to interfere with the punishment function of punitive damages. The latest court ruling on punitive damages, *Transportation Insurance Co. v. Moriel*,<sup>73</sup> held that the purpose of punitive damages is to punish, and ignored any other purpose.<sup>74</sup> *Transportation* began its analysis of the rationale behind punitive damages with *Smith v. Sherwood*,<sup>75</sup> one of the earliest cases in Texas jurisprudence addressing punitive damages.

*Smith* set out the circumstances in which punitive damages were appropriate, citing a treatise by Theodore Sedgwick<sup>76</sup> (frequently cited by the supreme court in the late 1800's). In citing Sedgwick, the *Smith* court stated "there is a large class of cases where the common law in giving relief loses sight of the principle of compensation, and gives damages by way of punishment, for acts of malice, vexation, fraud and oppression."<sup>77</sup> There is no reference to compensation in *Smith*.

Two years after *Smith*, *Graham v. Roder*<sup>78</sup> fully discussed the purpose of punitive damages. The court held that in cases of fraud, "[t]he measure of damages was not only compensation for the direct pecuniary loss sustained, but [also] such further vindictive or exemplary damages by way of punishment as in the judgment of the jury the conduct of the defendant might merit."<sup>79</sup> *Graham* quoted a prior decision of the Pennsylvania Supreme Court to explain: "The authorities teach

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68. *Hofer*, 679 S.W.2d at 480 (Pope, J., dissenting).

69. See Anderson, *supra* note 49, at 594.

70. *Transportation Ins. Co. v. Moriel*, 879 S.W.2d 10, 16-17 (Tex. 1994); *Smith v. Sherwood*, 2 Tex. 460 (1847).

71. *Bisso v. Southworth*, 10 S.W. 523 (Tex. 1888); *Dallas Joint Stock Land Bank v. Britton*, 114 S.W.2d 907 (Tex. Civ. App.—Waco 1938), *rev'd on other grounds*, 135 S.W.2d 981 (Tex. 1940).

72. *Contra Hofer v. Lavender*, 679 S.W.2d 470 (Tex. 1984).

73. 879 S.W.2d 10 (Tex. 1994).

74. *Id.* at 16-17.

75. 2 Tex. 460 (1847).

76. SEDGWICK, *supra* note 5.

77. 2 Tex. 461 at 464 (citing THEODORE SEDGWICK, MEASURE OF DAMAGES 32 (3d rev. ed., N.Y., Voorhies 1858)) (emphasis added).

78. 5 Tex. 141 (1849).

79. *Id.* at 150 (emphasis added).

that damages may be given [sic] in peculiar cases, not merely [sic] to compensate, but to punish."<sup>80</sup> The *Graham* court carefully cited to the case law of other states that reflected a pure punishment rationale.<sup>81</sup> Like *Smith*, *Graham* also cited to Sedgwick's treatise, but more extensively than *Smith*. The *Graham* opinion, quoting Sedgwick, stated, "[the law] permits the jury to give what is termed punitive, [sic] vindictive, or exemplary damages; in other words, blends together the interests of society and the aggrieved individual, and gives damages not only to recompense the sufferer, but to punish the offender."<sup>82</sup> This is the most frequently cited quotation in Texas case law on the purpose of punitive damages. Taken out of context, it does appear to support the argument that punitive damages may be awarded at least in part for compensation purposes. But a study of Sedgwick's treatise reveals that he was referring to the broad topic of damages as a whole, which includes both actual and punitive damages. The quoted statement is thus consistent with the proposition that punitive damages are for punishment. Those who use it to justify punitive damages based on compensation use it for a proposition not purported by Sedgwick. Sedgwick's frequent references to the punishment rationale in other sections of the treatise clearly indicate his proposition is that punishment is the sole justification for punitive damages.<sup>83</sup>

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80. 5 Tex. at 150 (quoting *McBride v. McLaughlin*, 5 Watts 375, 376 (Penn. 1836)).

81. *E.g.*, *Graham v. Roder*, 5 Tex. 141, 150 (1849)(citing *McBride v. McLaughlin*, 5 Watts 375 (Penn. 1836). "[W]here the defendant's circumstances are brought into account, something else than individual reparation is contemplated. Nor can it be said the wrongdoer is to suffer in order to appease the resentment of the injured; and that even vindicatory damages are, in truth, compensatory." *McBride*, 5 Watts at 376.

82. 5 Tex. at 149 (citing THEODORE SEDGWICK, *MEASURE OF DAMAGES* 36 (3d rev. ed., N.Y., Voorhies, 1858)).

83. SEDGWICK, *supra* note 5. In Chapter 1, Sedgwick explains that damages, absent aggravating circumstances, are given to compensate the injured party. "There is, as has already been said, a large class of cases where the common law, in getting relief, loses sight of the principle of compensation, and gives damages *by way of punishment* for acts of malice, vexation, fraud, or oppression." *Id.* at 32 (emphasis added).

In the next section, Sedgwick sets out the range of damages a plaintiff may incur: actual direct pecuniary loss; indirect pecuniary loss; mental suffering; the value of time consumed in establishing the contested right by process of law; attorneys' fees and court costs; and the sense of wrong, or insult. Sedgwick notes that actual pecuniary loss directly sustained and some of the actual expenses incurred in the process of law (costs) are generally the measure of damages and are all the law will allow. *Id.* at 33.

Sedgwick then introduces punitive damages as additional amounts on top of the compensation due to the plaintiff.

Thus far we have been speaking of the great class of cases where no question of fraud, malice, gross negligence, or oppression intervenes. Where either of these elements mingle in the controversy, the law, instead of adhering to the system, or even the language of compensation, adopts a wholly different rule. It permits the jury to give what it terms punitive, vindictive, or exemplary damages; in other words, blends together the interest of society and of

Nevertheless, a line of cases supporting a compensatory purpose of punitive damages begins with *Cole v. Tucker*.<sup>84</sup> *Cole* indicated that punitive damages are given to compensate the sufferer as well as punish the offender.<sup>85</sup> The *Cole* court, obviously paraphrasing Sedgwick, stated: "When the ordinary rules of compensation are dispensed with the damages may be denominated exemplary, for the reason that if high they deter from the commission of similar offenses; but they also effect the purpose of compensation. . . ." <sup>86</sup> Thus, the *Cole* court implied that a higher level of culpability on the part of the defendant determines which plaintiffs recover more for the same or similar injuries. *Cole* overlooked the fact that in this instance, it is not the plaintiff who should be rewarded, but rather it is the tortfeasor's aggravated conduct that justifies punishment.

*South Texas Coaches, Inc. v. Eastland*<sup>87</sup> better explained Sedgwick's famous quotation, indicating "[e]xemplary damages . . . necessarily involves [sic] a blending of the general interest of society with those peculiar to the aggrieved party."<sup>88</sup> Society's main interests are punishment and deterrence. The plaintiff's primary interest, on the other hand, is to recover more money. The court in *Cole* appeared to confuse the cause and effect relationship between punishment and the

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the aggrieved individual, and gives damages not only to recompense the sufferer but to punish the offender.

*Id.* at 36.

In this context, the concept "not only to recompense the sufferer" refers to the actual damages awarded. The introduction of the aggravating circumstances justifies a larger award "to punish the offender." The reference to recompense pertains to all damages, not merely punitive damages. Beyond these introductory remarks, Chapter 18 specifically discusses why punitive damages are allowed.

And I have stated the rule to be, that where gross fraud, malice, or oppression appears, the jury are not bound to adhere to the strict line of compensation, but may, by a severer verdict, at once impose a punishment on the defendant and hold up an example to the community.

*Id.* at 477.

Sedgwick further reiterates, "but it will appear from the cases we now proceed to examine, that the idea of compensation is abandoned and that of punishment is introduced." *Id.* at 482. From a reading of the treatise as a whole, it appears Sedgwick espoused nothing more than a punishment justification for punitive damages. Commentators agree. See GERALD W. BOSTON, PUNITIVE DAMAGES IN TORT LAW, § 1:9 (1993) (referring to the debate between Professor Greenleaf and Theodore Sedgwick). While Professor Greenleaf "endeavored to explain judgments that ostensibly included punitive damages as in reality no more than full compensation for the plaintiff's injury," Sedgwick's theory that punitive damages were allowed for example and punishment prevailed. *Id.* See also 1 SCHLUETER & REDDEN, *supra* note 46, § 1.4.

84. 6 Tex. 266 (1851).

85. *Id.* The petitioner/appellant sought to have the punitive damage award vacated because he was subject to a contingent criminal fine arising out of the same behavior. The court stated, "this is not sufficient to relieve him from exemplary damages in a civil action should the facts justify such damages." *Id.* at 271.

86. *Id.* at 271.

87. 101 S.W.2d 878 (Tex. Civ. App.—Dallas 1937, no writ).

88. *Id.* at 883 (emphasis added)(quoting 17 C.J. *Damages* § 268 (1919)).



fact the plaintiff keeps the award.<sup>89</sup> Furthermore, the compensatory rationale supporting punitive damages in *Cole* was obviously absent in *Flanagan v. Womack*.<sup>90</sup>

In *Flanagan*, the issue was whether a criminal fine assessed for the same act prosecuted in a subsequent civil trial was relevant to the jury's consideration of the appropriate amount of punitive damages. The *Flanagan* court noted: "[T]hat exemplary damages are in the nature of punishment, has long been the recognized doctrine in this state."<sup>91</sup> The court concluded "[i]f exemplary damages are allowed as punishment and not strictly as compensation, then all the facts and circumstances of the case which would enable the jury to act advisedly in inflicting the appropriate punishment, would be proper for their consideration."<sup>92</sup> The court allowed evidence of the criminal fine in the civil trial. Thus, *Flanagan* denied a compensation justification for punitive damages. The *Flanagan* court also refuted compensation was an equally important consideration for punitive damages, a proposition *Hofer v. Lavender*<sup>93</sup> later implied in its reading of *Cole*.

Another situation in which the Texas Supreme Court has emphasized punishment rather than compensation to support an award of punitive damages has been by limiting the doctrine of *respondeat superior*. *Fort Worth Elevators Co. v. Russell*<sup>94</sup> stands for the proposition that punishment is the justification for punitive damages. Implicitly, the court found that the compensatory purpose, if it existed at all, was subordinate to and would not be allowed to thwart the punishment rationale. *Fort Worth Elevators* considered whether a corporation was liable for punitive damages assessed against the corporation's employees under a *respondeat superior* theory. The court held the doctrine of *respondeat superior* did not extend liability to the corporation for punitive damages (unlike compensatory damages) absent a finding the principal adopted, ratified, or directed the agent's actions, or where there was a lack of supervision that allowed the tort to occur.<sup>95</sup>

In reviewing rules of other states, the court noted that the jurisdictions which made no exceptions to vicarious corporate liability for punitive damages refrained because "[it] seems to be an outgrowth of the original conception of the purpose of exemplary damages, that is, compensation . . . for the injured party rather than as a punishment for the offender."<sup>96</sup> *Fort Worth Elevators* rejected this theory, ruling in-

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89. See *supra* notes 57-64 and accompanying text.

90. 54 Tex. 45 (1880).

91. *Id.* at 50 (quoting *Hays v. Houston & Great N.R.R.*, 46 Tex. 272, 280 (1876)).

92. *Id.*

93. 679 S.W.2d 470, 475 (Tex. 1984).

94. 70 S.W.2d 397, 409 (Tex. 1934).

95. *Id.* at 406. See also *Ramos v. Frito-Lay, Inc.*, 784 S.W.2d 667 (Tex. 1990); *Hays v. Houston & Great N.R.R.*, 46 Tex. 272 (1876).

96. *Fort Worth Elevators*, 70 S.W.2d at 403.

stead that the acts which were the basis for a punitive damage award must have been those of the offending corporation, and not merely those of the agent. The corporation was not liable for punitive damages caused by the acts of the agent unless it could be shown that the employee's specific behavior was at the direction of the corporation. Thus, *Fort Worth Elevators* rejected a compensation purpose for punitive damages. If the compensatory aspect of punitive damages was independent of the punishment purpose, the court would have allowed the plaintiff to reach the deep pockets of the employer by not limiting the *respondeat superior* doctrine.

Similarly, punitive damages have been limited against municipalities, at the expense of a compensation theory, because of concern for the punishment aspect of punitive damages. A municipality is not vicariously liable for punitive damages assessed against its employee unless the employee's "conduct can be imputed directly to the governing body of the municipality."<sup>97</sup> While a corporation may be liable for punitive damages when any level of management directs the employee's acts,<sup>98</sup> a municipality is liable only when it can be shown the agent's acts were "expressly authorized by the municipal government or that they were done 'bona fide in pursuance of general authority to act for the municipality on the subject to which they relate.'"<sup>99</sup> The rule for municipalities is more narrowly drawn than the rule for corporations because the financial burden of the judgment award falls on taxpayers. Nevertheless, an award of exemplary damages serves the punishment and deterrent objectives in the municipal setting because it is a wake-up call to city officials to examine policies that led to the damage award. Furthermore, because the award punishes the taxpayer, the political process brings pressure to bear on the situation to assure similar behavior is avoided in the future. Like the rule for corporations, if compensation had been controlling in the circumstance, *respondeat superior* would have allowed recovery of punitive damages resulting from employee activities that occurred in the course and scope of employment. Here again is another example where the court has subordinated the compensation justification for punitive damages.

*Lunsford v. Morris*<sup>100</sup> placed special emphasis on the punishment role of punitive damages. *Lunsford* held that the defendant's net worth was discoverable because "[t]hat which could be an enormous penalty to one may be but a mere annoyance to another."<sup>101</sup> This reflects the further refinement of a doctrine directed at punishment. The court did not discuss punishment versus compensation, but indi-

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97. *City of Gladewater v. Pike*, 727 S.W.2d 514, 522 (Tex. 1987).

98. *Ramos v. Frito-Lay, Inc.*, 784 S.W.2d 667 (Tex. 1990).

99. *City of Gladewater*, 727 S.W.2d at 523 (quoting *Christopher v. City of El Paso*, 98 S.W.2d 394, 397 (Tex. Civ. App.—El Paso 1936, writ dismissed)).

100. 746 S.W.2d 471 (Tex. 1988).

101. *Id.* at 472.

cated that in determining the amount of punitive damages, compensation was again subordinate. If compensation was a concern in awarding punitive damages, defendant wealth would be immaterial, as it is in actual damages.

The most extensive discussions of the purpose of punitive damages are the majority and dissenting opinions in *Hofer v. Lavender*.<sup>102</sup> In a five-four decision, the court held that under the Texas Survival Statute,<sup>103</sup> punitive damages could be assessed against the estate of a deceased tortfeasor.<sup>104</sup> The defendant in *Hofer* died of unrelated causes before the case came to trial. The defendant was found grossly negligent.<sup>105</sup> The question in *Hofer* was whether the word "damages" in the Texas Survival Statute included exemplary damages. The court, in reviewing the law of other jurisdictions, determined that if the purpose of exemplary damages was solely to punish or deter, then "damages" under the Survival Statute did not include exemplary damages.<sup>106</sup> *Hofer* found that Texas case law recognized the purposes of punitive damages are three-fold: 1) for punishment, 2) as an example to others, and 3) for compensation, that is, for reimbursement of losses such as inconvenience and attorney fees that are too remote to be considered elements of strict compensation.<sup>107</sup> The court determined, punishment aside, the other purposes of punitive damages were "equally important considerations" for allowing punitive damages.<sup>108</sup>

If the court had specified which purpose was to be served in allowing the Hofers to recover punitive damages, the analysis in this case would be easier. Clearly, with the death of the wrongdoer, there is no punishment or deterrence of the tortfeasor to be served. It does not deter or serve as an example to other dead tortfeasors. The court does not make clear in the opinion whether it believes the purposes of deterrence or example would affect the behavior of potential tortfeasors. If the award was given as deterrence or to serve as an example to others, then the compensation issue was not determinative, and the award would be justified. But the threat of an award against one's estate does not seem to be much of a threat at all. Thus it seems likely there was nothing more than a compensation function

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102. 679 S.W.2d 470 (Tex. 1984).

103. Act of May 4, 1895, 24th Leg., R.S., ch. 89 § 1, 1895 Tex. Gen. Laws 143, repealed by Act of Sept. 1, 1985, 69th Leg., R.S., ch. 959, § 9(1), 1985 Tex. Gen. Laws 3322 (current version at TEX. CIV. PRAC. & REM. CODE ANN. § 71.021 (Vernon Supp. 1995)).

104. *Hofer*, 679 S.W.2d at 475.

105. *Id.* at 471. The defendant's blood alcohol content at the time of the accident was .27. *Id.*

106. *Id.* at 473-74.

107. *Id.* at 474.

108. *Id.* at 475.

served in the case. If so, the court in effect found that compensation was an independent reason for the award of punitive damages.

To find that compensation was an independent justification of punitive damages amounts to an unjustified extension of the doctrine. The court's misconception of authority for the proposition can be blamed on its reliance upon *Cole*,<sup>109</sup> in confusing cause and effect,<sup>110</sup> as well as failing to recognize that *Flanagan v. Womack*<sup>111</sup> had limited *Cole*. The dissent in *Hofer* pointed out that when the punishment, deterrence and exemplary goals were stripped away from the punitive damages doctrine, all that remains is another category of compensatory damages.<sup>112</sup> Ultimately, there is no reason to allow similarly situated plaintiffs to recover different amounts of compensation without reference to punishment or deterrence.<sup>113</sup> Similarly, the court's reliance on *Mayer v. Duke*<sup>114</sup> and *Allison v. Simmons*<sup>115</sup> runs into similar problems. Both of these cases fail to distinguish between *why* the damages were awarded and *what* the measure of damages is. The "why" (i.e., the justification) was punishment. The "what" was recovery of remote losses, inconvenience, or attorneys' fees. Again, there is a court's confusion between cause and effect.<sup>116</sup>

A clear distinction of "why" and "what" (or the cause and effect of punitive damages) is made in the Pattern Jury Charges. The State Bar of Texas Pattern Jury Charge for exemplary damages plainly states why punitive damages are assessed: "Exemplary damages" means an amount that you may in your discretion award as an example to others and as a penalty or by way of punishment, in addition to any amount that you may have found as actual damages."<sup>117</sup> The jury charge demonstrates the difference between the cause (the fact that the damages are motivated by punishment) and effect (the jury can base the award on anything). The plaintiff can show evidence of other remote losses, attorney's fees, or defendant wealth to guide the jury award. But the basic distinction is still between why punitive damages are assessed—punishment; and what the award includes—the measure of damages.

*Hofer v. Lavender*<sup>118</sup> is better justified as an exception to the punishment rationale. Basing a punitive damage claim on whether the

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109. 6 Tex. at 271 (holding that criminal punishment or the potential thereof does not relieve defendant from exemplary damages in civil action).

110. *Supra* note 49 and accompanying text.

111. 54 Tex. 45 (1880).

112. 679 S.W.2d at 479 (Pope, C.J., dissenting on motion for rehearing).

113. *See supra* notes 53-56 and accompanying text.

114. 10 S.W. 565 (Tex. 1889).

115. 306 S.W.2d 206 (Tex. Civ. App.—Waco 1957, writ ref'd n.r.e.).

116. *See supra* note 49 and accompanying text.

117. 1 STATE BAR OF TEXAS, TEXAS PATTERN JURY CHARGES, PJC 7.06 and comment (2d ed. 1987 & Supp. 1989). This pattern jury charge is essentially the same charge always given by the court. *E.g.*, *Jones v. Matthews*, 12 S.W. 823 (Tex. 1889); *Carrington Co. v. Borner*, 610 S.W.2d 450 (Tex. 1980).

118. 679 S.W.2d 470 (Tex. 1984).

tortfeasor survives puts an untenable burden on the plaintiff. The plaintiff will not know if he has a maintainable cause of action until judgment is rendered. Without such an exception, the plaintiff could lose his cause of action years later if the defendant died before judgment. Viewed as a necessary exception, the rule removes uncertainty.

Following *Hofer*, the supreme court again considered punitive damages in *Cavnar v. Quality Control Parking, Inc.*<sup>119</sup> In *Cavnar*, the issue was whether prejudgment interest was available for actual and punitive damages. The court clearly distinguished between punitive and actual damages by noting that punitive damages are for punishment, and actual damages are for compensation. Concerning actual damages, the court stated, "if a judgment provides plaintiffs only the amount of damages sustained at the time of the incident, plaintiffs are not fully compensated."<sup>120</sup> Thus, a defendant "ought not to be able to use someone else's money as it pleases . . . thereby enjoying a very considerable benefit, and then pay nothing for the use of the money."<sup>121</sup> The court held that in order to fully compensate the plaintiff, prejudgment interest accrues in personal injury cases and survival actions six months after the event occurs.<sup>122</sup> However, *Cavnar* denied prejudgment interest for punitive damages.<sup>123</sup>

If the court had believed a compensation purpose existed for punitive damages, it would have included prejudgment interest on the punitive damages. Since the court reasoned that punitive damages are inflicted as punishment, it held prejudgment interest was not needed to make the plaintiff whole.<sup>124</sup> Thus, *Cavnar* implicitly denied any compensatory purpose for punitive damages.

*Burk Royalty Co. v. Walls*<sup>125</sup> is cited primarily for its definition of the gross negligence standard. However, it also refers to the penal nature of exemplary damages, without citing a compensatory justification.<sup>126</sup>

The latest discussion on the purpose of punitive damages is found in *Transportation Insurance Co. v. Moriel*.<sup>127</sup> The *Transportation* opinion put to rest the theory that punitive damages are to compensate for remote losses. The court found actual damages compensate the

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119. 696 S.W.2d 549 (Tex. 1985).

120. *Id.* at 552.

121. *Id.* at 552 n.1 (quoting *Phillips Petroleum Co. v. Stahl Petroleum Co.*, 569 S.W.2d 480, 485 (Tex. 1978) (citing 1975 case involving *Phillips Petroleum Co.* decided under similar facts)).

122. *Id.* at 555.

123. *Id.* This ruling was adopted by the legislature: "Prejudgment interest may not be assessed or recovered on an award of exemplary damages." TEX. CIV. PRAC. & REM. CODE ANN. § 41.006 (Vernon Supp. 1994).

124. 696 S.W.2d at 555.

125. 616 S.W.2d 911 (Tex. 1981).

126. *Id.*

127. 879 S.W.2d 10 (Tex. 1994).

plaintiff, and punitive damages punish the defendant.<sup>128</sup> In this opinion, there was no overlap of actual and punitive damages. Further, in precisely outlining the purpose of punitive damages, *Transportation* made an argument that would destroy itself if recompense was read into the meaning.

*Transportation* drew a bright line delineation regarding the nature of punitive damages by first contrasting them with compensatory damages. The court stated that money damages were justified as compensation to the injured plaintiff, to make the plaintiff whole, but punitive damages had an altogether different purpose.<sup>129</sup> The *Transportation* court indicated that punitive damages were assessed as punishment for quasi-criminal or morally criminal conduct.<sup>130</sup> The court recognized a "close connection" between punitive damages and the criminal law.<sup>131</sup> The legal justification is quasi-criminal only because the damages are assessed in a civil court. Thus, the purpose of punitive damages is the same as a penalty assessed in a criminal court. The Texas Criminal Code acknowledges punishment and deterrence as the purposes of the Criminal Code.<sup>132</sup> This admits no compensatory purpose of punitive damages.

The *Transportation* opinion, in setting out the purposes of punitive damages as punishment and deterrence, denied that punitive damages compensate by explaining why a plaintiff is allowed to keep a punitive damage award: The award is simply a windfall to the plaintiff.<sup>133</sup> The opinion avoided the confusion of cause and effect found in other opinions that tried to justify the plaintiff's retention of the award by calling it compensation. If the effect of the "windfall" is to cover attorney's fees, etc., then so be it. The *Transportation* majority made a clear delineation that effectively negates the compensatory theory used to justify punitive damages in Texas. Thus, *Transportation* appears to overrule any compensation purposes for punitive damage awards.

#### V. TEXAS COURT INTERPRETATIONS OF PUBLIC POLICY UNDER STATUTES AND CONTRACT CONSTRUCTION

The Texas Supreme Court has not yet considered whether public policy allows insurance to cover punitive damages. In Texas, the issue was first considered in *Dairyland County Mutual Insurance Co. v. Wallgren*.<sup>134</sup> Using essentially a contract construction analysis, the court explained in a two-page opinion that public policy did not pre-

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128. *Id.* at 16-17.

129. *Id.* at 16.

130. *Id.*

131. *Id.* at 16-17.

132. TEX. PENAL CODE ANN. § 1.02 (Vernon 1994).

133. 879 S.W.2d at 17.

134. 477 S.W.2d 341 (Tex. Civ. App.—Fort Worth 1972, writ ref'd n.r.e.).

clude insuring punitive damages.<sup>135</sup> The *Dairyland* court reasoned that public policy could be found in the state's statutes, as enlarged upon by state administrative agencies.<sup>136</sup> In this case, the sole statute under consideration was the Motor Vehicle Safety Responsibility Act.<sup>137</sup> The Insurance Commission prescribes policy wording, pursuant to its legislatively delegated authority.<sup>138</sup> The *Dairyland* court held that the policy wording was expansive enough to include punitive damages, and thus public policy did not preclude insuring punitive damages.<sup>139</sup> The case was wrongly decided under the pretence that public policy had addressed this issue. In reality, the opinion side-stepped a discussion of the purposes of punitive damages, an essential element in defining the words of the automobile liability policy. The court could have reached a different result had it considered current case law relating to the purposes of punitive damages. With the benefit of subsequent decisions and legislative enactments, it is likely a court deciding this case today would find that public policy precludes insuring punitive damages.

There are several reasons why the court erred in finding coverage for punitive damages in the contract wording. First, the personal auto policy under consideration read: "To pay on behalf of the insured all sums which the insured shall become legally obligated to pay as damages because of . . . bodily injury . . ." <sup>140</sup> The *Dairyland* court focused on the phrase "all sums" rather than looking at the restrictor "bodily injury." The words "all sums because of bodily injury" are not ambiguous. Punitive damages are not awarded because of bodily injury, but for punishment due to the defendant's gross negligence, which requires an awareness of his wrong.<sup>141</sup> Under this analysis, other courts have found punitive damages are not covered by the policy.<sup>142</sup>

Secondly, it is doubtful that the legislature at that time considered the phrase "bodily injury" to mean anything other than actual damages. In 1951, there had been no court cases considering punitive damages with which the legislature might have been concerned and

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135. *Id.* at 343. See also *Home Indem. Co. v. Tyler*, 522 S.W.2d 594 (Tex. Civ. App.—Houston [14th Dist.] 1975, writ ref'd n.r.e.) (holding an automobile uninsured motorist coverage with substantially the same insuring agreement as found in the *Dairyland* liability policy provided coverage for punitive damage awards against an uninsured motorist). The opinion follows the *Dairyland* analysis.

136. 477 S.W.2d at 342.

137. TEX. REV. CIV. STAT. ANN. art. 6701h (Vernon Supp. 1995).

138. TEX. REV. CIV. STAT. ANN. art. 5.06, 5.35 (Vernon Supp. 1994).

139. 477 S.W.2d at 342.

140. *Id.* at 343. The Insurance Commission drew the prescribed words of the insuring agreement from the Motor Vehicle Safety Responsibility Act. TEX. REV. CIV. STAT. ANN. art. 6701h (Vernon Supp. 1995).

141. See Anderson, *supra* note 49, at 615.

142. Cf. *Government Employees Ins. Co. v. Lichte*, 792 S.W.2d 546 (Tex. App.—El Paso, 1990, no writ) (punitive damages not covered under an almost identical insuring agreement for uninsured motorist). See also *Tedesco v. Maryland Cas. Co.*, 18 A.2d 357 (Conn. 1941); *Universal Indem. Ins. Co. v. Tenery*, 39 P.2d 776 (Colo. 1934).

desired to legislatively overrule. Most likely, the legislature's intent was to cover the vast majority of cases where citizens were unable to recover any actual damages because the wrongdoer was uninsured.<sup>143</sup>

Third, the court should have given meaning to the words "all sums as a result of bodily injury" by analyzing the words in light of Texas case law available at that time relating to punitive damages.<sup>144</sup> Had the court done this, it most likely would have concluded that punitive damages served as punishment to the tortfeasor, and thus allowing insurance to cover the damages would destroy the very purpose of awarding punitive damages.<sup>145</sup>

The *Dairyland* court did not have the benefit of the Deceptive Trade Practices Act<sup>146</sup> ("DTPA") as a legislative reflection<sup>147</sup> that punitive damages are assessed for a punishment purpose. The DTPA is relevant because it offers insight into the legislature's intent: Punitive damages are awarded as punishment, not compensation. The DTPA does not expressly state treble damages are punishment, but it appears clear the legislature was contemplating punishment when the Act was passed.

Section 17.44 of the DTPA indicates the statute's purpose is to protect consumers and to provide efficient and economical procedures to secure such protection. The Act accomplishes this by providing a statutory cause of action<sup>148</sup> to plaintiffs who would otherwise be subjected to the onerous burden of proof and numerous defenses encountered in common law fraud or breach of warranty actions.<sup>149</sup> Section 17.50(b)(1) allows "the amount of actual damages found by the trier of fact" and directs the court to "award two times that portion of the actual damages that does not exceed [one thousand dollars] \$1,000." This section does not require awareness of wrongdoing on the part of the tortfeasor, only a finding that the specific act occurred. Including attorney's fees<sup>150</sup> gives meaning to the Act since many condemnable actions would otherwise escape punishment because it was not economically feasible to pursue them. In this aspect, allowing an award of attorneys' fees and trebling of a modest amount of actual damages (up to \$1,000) encourages citizens to function as private attorney

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143. See *supra* note 21 and accompanying text.

144. See *supra* notes 68-133 and accompanying text.

145. *Id.*

146. TEX. BUS. & COM. CODE ANN. § 17.41-63 (Vernon 1987 & Supp. 1994).

147. *Pace v. State*, 650 S.W.2d 64 (Tex. 1983). "[T]reble damages under the DTPA are punitive damages. Punitive damages . . . punish the wrongdoer and are an example to others." *Id.* at 65.

148. TEX. BUS. & COM. CODE ANN. § 17.46 (Vernon 1987). The DTPA creates a cause of action when specified acts such as the following are committed: (1) false, misleading, or deceptive acts; (2) breach of express or implied warranty; (3) unconscionable acts or courses of action; and (4) any act in violation of Article 21.21 of the Insurance Code. See also TEX. REV. CIV. STAT. ANN. art. 21.21 § 1 (Vernon 1981).

149. *Smith v. Baldwin*, 611 S.W.2d 611, 616 (Tex. 1980).

150. TEX. BUS. & COM. CODE ANN. § 17.50(b)(1) (Vernon 1987).



generals and help prevent the condemned behavior. The legislature accomplishes this by creating economics that encourage suits in smaller claims. It is difficult to imagine in such limited actual damage claims that the plaintiff suffered any "remote loss" worthy of compensation in the form of punitive damages. Therefore, it appears likely that compensation had little to do with adopting this part of the Act. This leaves only punishment and deterrence as reasons for the damage award.

Damage awards under the DTPA for knowingly committing the proscribed acts come closer to reflecting the common law of punitive damages. Actual damages above \$1,000 may be trebled (at the discretion of the trier of fact) only if committed knowingly. "Knowingly" is defined as "actual knowledge of the wrong."<sup>151</sup> Here again, it appears the addition of "knowingly" as a required finding is to determine who should be punished. It is incorrect to say that the defendant's state of mind determines which plaintiffs are compensated. Rather, the defendant's state of mind determines which *defendants* are *punished*. This is because it is inconsistent to label punitive damages as compensation while limiting recovery among plaintiffs with similar injuries. If compensation were a controlling factor, then the defendant's awareness would not limit the award. Thus, the legislature appears to have included the knowledge requirement in the DTPA with punishment in mind rather than compensation.

Nor did the *Dairyland* court have the benefit of the legislature's addition of Chapter 41, Exemplary Damages, to the Texas Civil Practice and Remedies Code.<sup>152</sup> The Act indicates the legislature's intent to impose exemplary damages as punishment because it states that punitive damages are assessed against only those defendants with actual subjective awareness of their wrong. The Act specifically defines the three reasons exemplary damages are awarded: example, punishment, and penalty.<sup>153</sup> Allowing insurance of punitive damages would be contrary to the statute, by effectively undercutting each of the statutory justifications for punitive damage awards.<sup>154</sup> This is why the definition "exemplary damages includes punitive damages"<sup>155</sup> does not import the compensation rationale found in the common law. Importing a compensation purpose would destroy the legislative pur-

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151. *Id.* § 17.45(9).

152. TEX. CIV. PRAC. & REM. CODE ANN. § 41.001-009 (Vernon Supp. 1994).

153. *Id.* § 41.001(3) ("Exemplary damages" means any damages awarded as an example to others, as a penalty, or by way of punishment."). The statutory definition of exemplary damages closely parallels the Texas pattern jury charge, long used in some form. The pattern jury charge provides: "Exemplary damages" means an amount that you may in your discretion award as an example to others and as a penalty or by way of punishment, in addition to any amount that you may have found as actual damages." 1 STATE BAR OF TEXAS, TEXAS PATTERN JURY CHARGES PJC 7.06 (2d ed. 1987 & Supp. 1989).

154. TEX. CIV. PRAC. & REM. CODE ANN. § 41.001 (Vernon Supp. 1994).

155. *Id.*

poses of example, penalty, and punishment if insurance was allowed to cover punitive damage awards.

The statutory definition of exemplary damages clarifies the common law confusion on the purposes of punitive damages. The Act does what many judicial decisions failed to do in the past: delineate, vis-a-vis the elements of exemplary damages (which may include plaintiff's remote losses), exactly why the damages are awarded. Based upon this unambiguous language, which clearly spells out that exemplary damages are for punishment and deterrence, it is contrary to legislative intent to allow wrongdoers to escape punishment by insuring the awards against them.

A result consistent with the new statutory definition of exemplary damages was reached in *Government Employees Insurance Co. v. Lichte*.<sup>156</sup> In *Government Employees*, the El Paso Court of Appeals held that the uninsured motorist provisions of the personal automobile policy did not cover exemplary damage awards.<sup>157</sup> Similar to the liability insuring agreement in *Dairyland*,<sup>158</sup> the uninsured motorist provision considered by *Government Employees* was prescribed by the Insurance Commission.<sup>159</sup> The wording of the uninsured motorist provision was nearly identical to the liability insuring agreement considered in *Dairyland*. The uninsured motorist provision provided coverage for damages sustained by the insured as a result of bodily injury caused by an uninsured motorist.<sup>160</sup> The El Paso Court of Appeals held: "[D]amages which a covered person is legally entitled to recover from an uninsured motorist because of *bodily injury* incurred does not include coverage for an award of exemplary damages."<sup>161</sup> Relying upon *Cavnar*,<sup>162</sup> the court stated: "The purpose of allowing the recovery of punitive damages is to punish the wrongdoer."<sup>163</sup> Since the purpose of punitive damages is punishment, public policy should not allow punitive damages to be insured.

## VI. OTHER PUBLIC POLICY CONSIDERATIONS OF INSURING PUNITIVE DAMAGES

In one case, a product liability policy contained a provision stating, "The company will pay on behalf of the insured all sums which the insured shall be legally obligated to pay as damages because of . . .

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156. 792 S.W.2d 546 (Tex. App.—El Paso, 1990, writ denied).

157. *Id.* at 549.

158. *Dairyland County Mut. Ins. Co. v. Wallgren*, 477 S.W.2d 341 (Tex. Civ. App.—Fort Worth 1972, writ ref'd n.r.e.).

159. TEX. REV. CIV. STAT. ANN. art. 5.06, 5.35 (Vernon Supp. 1994).

160. *Government Employees*, 792 S.W.2d at 549.

161. *Id.*

162. 696 S.W.2d at 549.

163. *Government Employees*, 792 S.W.2d at 549 (citing *Cavnar v. Quality Control Parking, Inc.*, 696 S.W.2d 549, 555-56 (Tex. 1985)).

bodily injury . . . .”<sup>164</sup> The court held the contract language included punitive damages. *American Home* is interesting because the opinion correctly stated that the purposes of punitive damages are punishment and deterrence, but then tried to find a way to allow coverage for punitive damages without sacrificing the punishment and deterrence goals.<sup>165</sup> Consequently, the path *American Home* took to reach its conclusion is questionable.

The court first found that the policy language was ambiguous, and thus there would be coverage for punitive damages under the contract unless the public policy prohibited such coverage.<sup>166</sup> The court rejected the argument that gross negligence is the equivalent of intent to cause harm and thus excluded under the policy.<sup>167</sup> The usual definition of an “occurrence” insured under a liability policy is “an event that . . . [is] ‘neither expected nor intended from the standpoint of by the insured.’”<sup>168</sup> With the emphasis on creation of an extreme risk under *Burk Royalty Co. v. Walls*,<sup>169</sup> the *American Home* court did not have to find actual knowledge of the wrong. Thus, it would have been a stretch to exclude coverage because “intent” under an objective standard is not equal to actual awareness. Consequently, it was reasonable to include coverage on this basis.

However, the analysis would have been different using the rationale later espoused by *Moriel*. *Moriel*’s requirement of actual *subjective* awareness<sup>170</sup> strongly suggests that the policy exclusion for acts intended or expected by the insured is applicable to exclude punitive damage awards under a policy. An actual knowledge finding would mean the insured either intended to cause harm or was aware his act would likely cause harm, and then proceeded with conscious indifference as to the risk.<sup>171</sup> Thus, the exclusion for intentional acts of the insured is now directly on point as to why a policy should not cover punitive damages.

*American Home* sidestepped the above argument as “technical analysis,” finding instead that to deny coverage for punitive damages was against the expectations of the average policyholder.<sup>172</sup> The opinion does not explain why policyholder expectations should trump public policy on punitive damages. This would be analogous to enforcing an illegal contract because of the parties’ expectations.

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164. *American Home Assurance Co. v. Safway Steel Prods. Co.*, 743 S.W.2d 693, 696 (Tex. App.—Austin 1987, no writ).

165. *Id.* at 704.

166. *Id.* at 701-02.

167. *Id.* at 701.

168. *Id.*

169. 616 S.W.2d 911 (Tex. 1981).

170. 879 S.W.2d 10 (Tex. 1994).

171. *Id.*

172. 743 S.W.2d at 701-02.

The *American Home* court was concerned that a business guilty of only simple negligence might still be liable for punitive damages because of an unclear threshold of gross negligence. A sympathetic jury might find punitive damages when in fact the conduct was not grossly negligent. "A fine line separates conduct that justifies imposition of punitive damages from conduct that does not."<sup>173</sup> "After *Burk Royalty*, the ability of a plaintiff to allege and obtain a punitive damage award has undoubtedly been enhanced. As a consequence, business and professional persons, firms and corporations constantly face the risk that where gross negligence is alleged, a verdict for punitive damages might well follow."<sup>174</sup> *Burk Royalty* focused on the extreme risk created and allowed for an inference of conscious indifference to find gross negligence.<sup>175</sup> The burden on the plaintiff to prove gross negligence has been increased by the decision in *Moriel*.<sup>176</sup> Where *Burk Royalty* allowed an inference of conscious indifference, *Moriel* required a finding of actual conscious indifference before the conduct was considered gross negligence.<sup>177</sup> The "fine line" that separated negligence and gross negligence—a matter of paramount importance to the *American Home* court—has been changed to a bright line distinction by *Moriel*. Thus, the concern over an indefinite standard of gross negligence is no longer useful to justify insurance for punitive damages.

Second, the *American Home* court was concerned that denying insurance coverage for punitive damages against a business might result in "permanent financial collapse,"<sup>178</sup> that is, a sort of quasi-criminal death penalty. Since the defendant's net worth is now discoverable,<sup>179</sup> a jury can consider the financial impact of punitive awards. If the award is so large as to drive the corporation out of business, then it can only be a reflection that society simply does not want this corporation to continue operating. Thus, *American Home's* concern over financially disastrous awards<sup>180</sup> also appears to be negated.

Third, the *American Home* court expressed concern that a corporation might be penalized for an isolated act of one of its employees. The court implied that neither the punishment purpose nor the deterrence rationale is served when the punitive award against a business is based on an anomalous employee act. The *American Home* court ignored standing case law which limits vicarious liability of corporations

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173. *Id.* at 704.

174. *Id.*

175. *Burk Royalty Co. v. Walls*, 616 S.W.2d 911, 915, 922 (Tex. 1981).

176. 879 S.W.2d 10 (Tex. 1994).

177. *Id.* at 23.

178. 743 S.W.2d at 704.

179. *Lunsford v. Morris*, 746 S.W.2d 471 (Tex. 1988).

180. 743 S.W.2d at 704.

for the acts of agents and employees.<sup>181</sup> Thus, this also fails as a valid argument.

*American Home* made several arguments about the incidence of punitive damages. The court addressed the public policy argument of *Northwestern National Casualty Co. v. McNulty*.<sup>182</sup> In *McNulty*, the court stated that allowing insurance of punitive damages meant that the insurance company was punished instead of the wrongdoer, and ultimately policyholders were punished in the form of higher premiums.<sup>183</sup> *American Home*, responding to *McNulty*, pointed out that allowing punitive damages to be insured was hardly punishing the insurance company that agreed to insure the offending business against such claims.<sup>184</sup> The argument is well taken, but misses the point. The issue remains as to whether the purpose of punitive damages is to punish the defendant.

It may very well be profitable for an insurance company to cover punitive damages.<sup>185</sup> Since a company's premium rates are based on losses paid, increases in losses paid will justify a rate hike approval by the Texas Department of Insurance. An insurance company is similar to a clearinghouse. Premium dollars flow in the front door. Profits and operating expenses are removed. Any remaining dollars flow out the back door in the form of claim payments.<sup>186</sup> The increase in rates to cover punitive damages means more dollars flow in the front door, resulting in more dollar profits taken out (given a constant profit margin).<sup>187</sup> Thus, the issue does not turn on whether insurance companies should be let off the hook by denying coverage of punitive damages. But to the extent the coverage is profitable, it is in the insurance companies' best interest to cover punitive damages.

Alternatively, to the extent punitive damages awards are unpredictable, insurance companies may withdraw from the market in Texas when faced with excessive losses. This in turn leads to fewer choices for the consumer, and eventually higher premiums.<sup>188</sup> Additionally,

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181. See *supra* note 95 and accompanying text.

182. 307 F.2d 432 (5th Cir. 1962).

183. *Id.* at 440-441.

184. 743 S.W.2d at 704.

185. To the extent the aggregate losses and costs are predictable, accompanied by adequate rates, punitive damage insurance could be profitable. See generally ROBERT I. MEHR & EMERSON CAMMACK, *PRINCIPLES OF INSURANCE* 32-37 (6th ed. 1976).

186. See DAVID L. BICKELHAUPT, *GENERAL INSURANCE* 33-38 (10th ed. 1979).

187. This analysis assumes that the aggregate punitive damage awards are predictable. Insurance companies base premium calculations on the law of large numbers. This means that while any particular award may not be predictable, the aggregate of punitive damage awards in a given state is predictable because it is proportionately tied to the number of policies issued in a given line of insurance and/or premiums received for that line of coverage. Thus, where punitive damages are predictable, the insurance company profits increase. See *id.*; see also MEHR & CAMMACK, *supra* note 185 at 32-37.

188. This is part of the classic underwriting cycle.

an individual with a past conviction for DUI may be unable to obtain automobile insurance coverage at any price because insurance companies may not be willing to risk a potential punitive damage award.

An increase in premiums would mean society would be paying for the punishment of the wrongdoer, and thus the punishment and deterrence justifications would both be thwarted. While policyholders would likely agree with the need for coverage for compensatory damages due to simple negligence, it is highly unlikely that many drivers would understand why they had to pay additional premiums to cover punitive damage awards against tortfeasors such as drunk drivers. As Judge Wisdom stated, "it is not disputed that insurance against criminal fines or penalties would be void as violative of public policy. The same public policy should invalidate any contract of insurance against the civil punishment that punitive damages represent."<sup>189</sup> Since punitive damages are quasi-criminal in nature,<sup>190</sup> society should not be forced to pay the penalty for that punishment.

Insuring punitive damages has a far-reaching impact on the economic business climate of the state. In addition to forcing businesses to pay higher premiums for the grossly negligent acts of a competitor, this practice may also cause companies considering a relocation to select another state besides Texas.

Moreover, established companies might move out of state to escape escalating premium costs. The stage is set for an overhaul of the system similar to the recent worker's compensation law reform. That reform was driven by the old law's negative effects on the Texas economy, where worker's compensation premiums had significantly increased the cost of doing business in Texas. To the extent that premiums in Texas rise because of punitive damages coverage, corporations are discouraged from doing business in Texas, and jobs are lost.

*American Home* indicated, "[a corporation's] inability to obtain such coverage [for punitive damages] will inevitably be passed on to the consumers of its products."<sup>191</sup> It is true the corporation has only income from customers to pay its expenses. But where punishment is concerned, the *American Home* court's statement is not accurate. Their premise was based on the faulty assumption that retail demand is inelastic, meaning the demand for goods and services of a particular company remain constant although it increases prices.<sup>192</sup> In a competitive market, a company cannot automatically increase its product price to absorb a punitive damage award. If it does so, customers will seek other suppliers. If there is no coverage for punitive damage awards, the corporate wrongdoer is punished because the cost of the

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189. *Northwestern Nat'l Casualty Co. v. McNulty*, 307 F.2d 432, 440 (5th Cir. 1962).

190. *Transportation Ins. Co. v. Moriel*, 879 S.W.2d 10, 16 (Tex. 1994).

191. 743 S.W.2d at 704.

192. See EDWIN MANSFIELD, *PRINCIPLES OF MICROECONOMICS*, 84-88 (6th ed. 1989).

award must be paid out of existing profits. Even if prices are raised as demand increases, the corporate offender is still punished because its profit margin is comparatively less than its competitors. Therefore, where no insurance is available for punitive damages, the punishment purpose is fulfilled because the cost cannot be passed on automatically. Hence, it would be more accurate to state the opposite of the *American Home* proposition: If punitive damages are insured, the cost will inevitably be passed on to consumers. Insuring punitive damage awards will result in higher fixed costs (due to increased premiums) borne by corporations across the board, making it easier for the market to increase consumer prices since corporations operate under similar fixed costs.

*American Home* attempted to reconcile how insuring punitive damages did not destroy the punishment and deterrence purposes of punitive damages. The court asserted these goals were still served because of the threat that a punitive damage award may exceed insurance coverage, or that the company will be forced to pay increased premiums in the future.<sup>193</sup>

First, the more likely effect is that corporate risk managers will simply select higher liability policy limits to cover a worst case scenario. Second, the *American Home* court assumes that an insurance company and the Department of Insurance can track punitive damage awards so that higher premiums, based on loss experience, can be assessed. The court assumes that the insurer and the corporation can determine how much of any given premium increase is attributable to punitive damage settlements or awards.

Under Department of Insurance mandate, insurers report loss payments in two categories: bodily injury or property damage. There is no punitive category. In determining rates, insurers record aggregate experience based on bodily injury payments. Since bodily injury loss history will reflect increases in medical care coverage, as well as other inflationary factors, the corporation and insurer may not be able to determine what part of the bodily injury payments are for punitive damages. Alternatively, aggregate bodily injury payments may not go up because other components are less in a particular year, effectively masking the punitive damage payments. Thus, the punishment and deterrence message may be lost, and no change in corporate behavior will likely be forthcoming if the punitive damage award is insured.

The corporation (or its directors) may simply shrug off responsibility to the stockholders by blaming a premium increase on the many factors that cause bodily injury payments to rise. Likewise, the deterrence function of punitive damages may be defeated because no change in the behavior would be accomplished.

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193. 743 S.W.2d at 704.

On the other hand, this is not the case when a separate check must be written by the corporation to pay a punitive damage award. Clearly, the responsibility for the act and its consequences are driven home to corporate officials and stockholders when the corporation pays the award. Most likely, upper management would become involved in the payment of a sizable punitive award, and could therefore demand an explanation of the tortious conduct. Where there is no coverage for punitive damages, the pressure to actively change behavior to avoid a punitive damage award is fully realized. Thus, *American Home's* attempt to salvage punishment and deterrence goals, while allowing insurance coverage of punitive damages, was unconvincing.

In light of the tort reform amendments concerning exemplary damages, the subsequent decision in *Moriel*, and a faulty economic analysis, the *American Home* opinion no longer appears valid.

## VII. CONCLUSION

Insuring punitive damages is against public policy in Texas as the policy has developed in recent years. By the time it was approved and adopted by the judiciary in Texas, the doctrine of punitive damages had evolved with the primary goal of punishment. The compensation purpose, although mentioned in the early cases, was never an independent justification for awarding punitive damages. Adding compensation to the litany of reasons cited for why punitive damages were assessed did not present a real conflict. Whether viewed as punishment or compensation, each had the salutary effect of fulfilling the other. But the two purposes came into direct conflict when purchasing liability insurance coverage became a standard business practice. The effectiveness of the stated justifications for punitive damages (punishment, deterrence, and example) is severely undermined when punitive damages are insurable. If punitive damages are not awarded for the above stated reasons, the only reasons remaining today are whether the compensation rationale survives, and if rationale for such an award is compensation. Thus, the issue today is whether the compensation rationale survives, and if so, whether the rationale is an independent justification for punitive damages.

Modern cases that rely on early English common law for the origin and purpose of punitive damage awards ignore the evolution of the doctrine. Although some early cases included a compensation purpose to support a punitive damage award, today the primary emphasis supporting such an award is punishment. The evolution of this theory of punishment may have occurred because judges recognize the inconsistency of giving different monetary awards as compensation to plaintiffs who had sustained virtually identical damages. But the reason for different awards is clearly justified when punishment is the purpose of the award.



In the United States, the only jurisdictions which allow insurance to cover punitive damages do not require actual subjective awareness of the wrong. Without this requirement, the focus is on the defendant's conduct. This is the same standard as an action for ordinary negligence. Texas originally fell into this category, and therefore no subjective awareness of the wrong was required to award punitive damages. However, the addition of Chapter 41, Exemplary Damages, to the Texas Civil Practice and Remedies Code has changed the analysis. Today, Texas requires actual knowledge or actual conscious indifference before punitive damages are available. The only apparent reason for this addition is to determine *which* defendants will be punished. This adds Texas to the list of states that do not allow insurance for punitive damages.

*Graham v. Roder*, an early Texas case, justified punitive damages as punishment. Later, *Cole v. Tucker* had the effect of justifying punitive damages as compensation, but this was implicitly denied in *Flanagan v. Womack*. The independent status of the compensation rationale was not again addressed until *Hofer v. Lavender*. The *Hofer* court did not justify its extension of compensation as a rationale to support punitive damages. As authority, the *Hofer* court relied in part on *Cole*, but ignored *Flanagan*. Furthermore, other cases cited by *Hofer* mention compensation, but they do not define compensation's relationship to the punishment purpose. Thus, *Hofer* had no basis to conclude compensation is an independent purpose of punitive damages.

*Hofer*, like other cases, confused the "why" and the "what" of punitive damages. Why do punitive damages exist? They are levied for the purpose of punishment. If punitive damages are awarded for compensation, the question is "why does this plaintiff recover more than other plaintiffs harmed by ordinary negligence?" This question cannot be answered without reference to punishment. Likewise, what is the measure of punitive damages? The measure of punitive damages is anything the plaintiff presents to the jury, including his remote losses.

Despite the *Hofer* court's confusion, related cases reveal that compensation is not an independent justification for punitive damages. In vicarious liability claims against corporations and municipalities, compensation takes a subordinate role. The purpose of limiting the *respondeat superior* doctrine was driven by an overriding concern to punish the defendant, rather than to compensate the plaintiff. Thus, case law does not support an independent compensation rationale that would justify insuring punitive damages.

*Transportation Insurance Co. v. Moriel* is the Texas Supreme Court's latest pronouncement on punitive damages. The requirement of actual conscious indifference in gross negligence cases follows the *Moriel* court's stated purpose of punitive damages: punishment. In fact, the majority's opinion fails to even mention compensation. Taken together, Chapter 41, Exemplary Damages and *Moriel* set the

stage for overturning recent appellate court decisions allowing insurance for punitive damages.

*Joe McKay*

