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# Insurance: Insurers Not Liable for Punitive Damages

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sale price, and because it provides precedent for application of Code provisions to certain nonnegotiable or "quasi-negotiable" instruments, which will increase the security and uniformity of commercial transactions.

### Insurance: Insurers Not Liable for Punitive Damages

Plaintiff was injured as a result of insured's gross and wanton negligence in operating his automobile and recovered compensatory and punitive damages. In a subsequent garnishment action against the insurer, the lower court ruled that since the terms of the insurance contract did not expressly exclude liability for punitive damages, the insurer was liable for the total judgment. The Tenth Circuit reversed, *holding* that Kansas public policy would prohibit recovery of punitive damages from an insurer regardless of the express coverage of the insurance contract, for allowing such coverage would defeat the punishment and deterrent effects of punitive damage awards. *American Surety Company v. Gold*, 375 F.2d 523 (10th Cir. 1967).

Although often criticized as an historical relic,<sup>1</sup> punitive damages are awarded in all but a few American jurisdictions<sup>2</sup> when the tortfeasor has been grossly negligent, when his conduct has been wilful, wanton, or reckless, or when he has committed an intentional tort.<sup>3</sup> While sometimes viewed as additional com-

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1. One commentator claims that punitive damages first developed to compensate anguish and mental suffering before those elements were covered by ordinary compensatory damages. Brin, *Punitive Damages and Liability Insurance*, 31 *INS. COUNSEL J.* 265 (1964).

Punitive damages are often criticized because the defendant is subjected to a civil procedure which competes with the function of criminal law but which deprives him of the traditional safeguards of a criminal trial. Moreover, there is a double jeopardy problem since the accused is often subject to criminal prosecution for the same wrong that gives rise to the punitive damage award. However, the constitutional immunity against double jeopardy is considered to be aimed at criminal procedure rather than a civil action in which punitive damages are assessed. See, e.g., *Helvering v. Mitchell*, 303 U.S. 391 (1938); Annot., 42 *A.L.R.2d* 634 § 2(a); C. McCORMICK, *DAMAGES* § 77, at 277 [hereinafter cited as *McCORMICK*].

2. Virtually all states permit some form of punitive damages. However, Illinois, Massachusetts, Nebraska, and Washington allow punitive damages only where specific statutory provisions decree. Louisiana does not accept the doctrine, but uses the similar theory of multiple damages. McCORMICK § 78; H. OLECK, *DAMAGES TO PERSONS AND PROPERTY* § 269 (1961) [hereinafter cited as *OLECK*].

3. See, e.g., *Watkins v. Layton*, 182 Kan. 702, 324 P.2d 130 (1958); *Frasier v. Cities Serv. Oil Co.*, 159 Kan. 655, 157 P.2d 822 (1945). Gross negligence is usually meant to signify "more than ordinary inadvertence

penal,<sup>4</sup> the prevailing view is that punitive damages are solely penal in nature, to be used in deterring future wrongdoers, since the victim has been fully compensated by the damage award based on his actual injuries.<sup>5</sup> The fact that punitive damages are available only either where the tort was intentional or where extreme misconduct was in evidence is a further indication that they are penal.<sup>6</sup>

For most of this century American courts have almost invariably<sup>7</sup> held that automobile insurers were liable for both compensatory damages and punitive damages where an inten-

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or inattention, but less than conscious indifference to consequences . . . . [I]t is, in other words, merely an extreme departure from the ordinary standard of care." Wilful, wanton, and reckless conduct, on the other hand, differs in quality from ordinary negligence. Although it does not go to the point of involving intent to harm, the wrongdoer's conduct indicates that he "has intentionally done an act of an unreasonable character in disregard of a risk known to him or so obvious that he must be taken to have been aware of it, and so great as to make it highly probable that harm would follow." It is conduct involving "a conscious indifference to the consequences, amounting almost to willingness that they shall follow . . . ." W. PROSSER, LAW OF TORTS § 34, at 187 (3d ed. 1964) [hereinafter cited as PROSSER]. For support of Prosser's definitions see RESTATEMENT (SECOND) OF TORTS § 500 & § 282, comment *e* at 10 (1965), where negligence is distinguished from recklessness.

4. See, e.g., *Battle v. Kilcrease*, 54 Ga. App. 808, 189 S.E. 573 (1936); *Wise v. Daniel*, 221 Mich. 229, 190 N.W. 746 (1922); *Wright Titus, Inc. v. Swafford*, 133 S.W.2d 287 (Tex. 1939). It is usually suggested that punitive damages often serve as a reimbursement for the cost of bringing litigation, especially where it is desirable to admonish the defendant but where the actual damage is small. *Morris, Punitive Damages in Tort Cases*, 44 HARV. L. REV. 1173, 1183 (1931). Punitive damages are also considered as compensation to the plaintiff for the "added injury" caused by the maliciousness of the defendant. 1 T. SEDGWICK, MEASURE OF DAMAGES § 347 (9th ed. 1912).

5. E.g., *Holmes v. Holmes*, 64 Ill. 294 (1872); *Motor Equip. Co. v. McLaughlin*, 156 Kan. 258, 133 P.2d 149 (1943); *Stalker v. Drake*, 91 Kan. 142, 136 P. 912 (1913); MCCORMICK § 77; PROSSER § 2, at 9; Note, *Exemplary Damages in the Law of Torts*, 70 HARV. L. REV. 517, 522 (1957).

6. An argument frequently but unsuccessfully made in the past is that punitive damages awarded as a result of gross negligence or wilful, wanton, and reckless conduct should be excluded from insurance coverage because such extreme negligence is the same as an intentional tort which is specifically excluded in most auto liability policies. The courts have consistently rejected this theory on the ground that the intent of the grossly negligent tortfeasor does not compare with that of an intentional tortfeasor. *Pennsylvania Threshermen & Farmers' Mut. Cas. Ins. Co. v. Thornton*, 244 F.2d 823 (4th Cir. 1957); *General Cas. Co. of America v. Woodby*, 238 F.2d 452 (6th Cir. 1956).

7. Two exceptions are *Universal Indem. Ins. Co. v. Tenery*, 96 Colo. 10, 39 P.2d 776 (1934); *Tedesco v. Maryland Cas. Co.*, 127 Conn. 533, 18 A.2d 357 (1941).

tional tort was not involved.<sup>8</sup> Many commentators have, however, encouraged the exclusion of punitive damages from insurance coverage,<sup>9</sup> and over the past five years a strong trend has developed to free insurers from liability for punitive damages.<sup>10</sup>

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8. *E.g.* Pennsylvania Threshermen & Farmers' Mut. Cas. Ins. Co. v. Thornton, 244 F.2d 823 (4th Cir. 1957); General Cas. Co. of America v. Woodby, 238 F.2d 452 (6th Cir. 1956); United States Fidelity & Guar. Co. v. Janich, 3 F.R.D. 16 (S.D. Cal. 1943); Morrell v. Lalonde, 45 R.I. 112, 120 A. 435 (1923), *appeal dismissed sub nom.* United States Fidelity & Guar. Co. v. Morrell, 264 U.S. 572 (1924). See also cases cited note 10 *infra*.

These decisions did not consider the public policy issue upon which *Gold* focused but, like the lower court in the instant case, directed themselves to the question of whether the language of the insurance policy covered punitive damages. Typically, it was decided that the boilerplate language binding the insurer "[t]o pay . . . all sums which the insured shall become legally obligated to pay as damages" covered punitive as well as compensatory damages.

Another line of cases, often cited as holding the insurer liable, is of doubtful value as precedent since the decisions were based on an unusual statute which lumped both compensation and punishment together under the term punitive damages. Thus, it was impossible to determine what part of the judgment should be excluded from insurance coverage. Capitol Motor Lines v. Loring, 238 Ala. 260, 189 So. 897 (1939); American Fidelity & Cas. Co. v. Werfel, 231 Ala. 285, 164 So. 383 (1935). A third case, Employers Ins. Co. v. Brock, 233 Ala. 551, 172 So. 671 (1937), extended the rule beyond the area covered by the unusual statute.

9. For arguments for exclusion of punitive damages see OLECK § 275C; PROSSER § 2, at 13; Logan, *Punitive Damages in Automobile Cases*, 456 INS. L.J. 27 (1961); Note, *Exemplary Damages in the Law of Torts*, 70 HARV. L. REV. 517 (1957); Note, *Insurance Coverage and the Punitive Award in the Automobile Accident Suit*, 19 U. PITT. L. REV. 144 (1957); 16 VAND. L. REV. 435 (1965); 46 VA. L. REV. 1036 (1960).

10. It has been erroneously maintained that the current trend is toward insurance coverage of punitive damages. Lambert, *Does Liability Insurance Cover Punitive Damages?*, 517 INS. L.J. 75 (1966). However, besides the instant case, four decisions since 1962 have excluded punitive damages from automobile insurance coverage. Northwestern Nat'l Cas. Co. v. McNulty, 307 F.2d 432 (5th Cir. 1962); Nicholson v. American Fire & Cas. Ins. Co., 177 So. 2d 52 (Fla. Ct. App. 1965); Crull v. Gleb, 382 S.W.2d 17 (Mo. Ct. App. 1964); Esmond v. Liscio, 209 Pa. Super. 200, 224 A.2d 793 (1966). In the same period only two cases have taken the opposite view. Carroway v. Johnson, 245 S.C. 200, 139 S.E.2d 908 (1965), in holding the insurer liable, completely ignored the public policy issue. Lazenby v. Universal Underwriters Ins. Co., 214 Tenn. 639, 383 S.W.2d 1 (1964), is the strongest recent decision directly opposing the *Gold* rationale. After finding that punitive damages were covered by the terms of the contract, *Lazenby* agreed that the dominant purpose for punitive damages was ostensibly punishment and deterrence but rejected the public policy argument on three grounds. First, the idea that punitive damages actually did deter socially irresponsible drivers was deemed mere speculation, especially in the face of existing criminal sanctions the effectiveness of which was also doubtful. Next, since the language of the insurance policy had been construed by

The *Gold* court carefully examined this recent trend and its underlying policies, and rebutted some of the most compelling attacks advanced against it.

The preliminary step in the *Gold* analysis was to dismiss the language of the insurance contract as immaterial to any decision, on the theory that if public policy forbade a specific type of coverage, it could not be subverted by contract.<sup>11</sup>

The *Gold* court next addressed itself to the nature of punitive damages under Kansas law.<sup>12</sup> The court found that the state regards such damages exclusively as a punishment and a deterrent of extreme misconduct wholly apart from any special merit or need for compensation on the part of the victim.<sup>13</sup> This concept of punitive damages became dispositive of the case because the policy would be undermined if a wrongdoer could pass the burden of the punishment on to his insurer.<sup>14</sup> In support of this concept the court noted that in an earlier case the equitable notion that no one shall benefit from his own wrong was used as the "major premise" for the determination of public policy.<sup>15</sup> Hence recovery from the insurer was undesirable.<sup>16</sup>

The court rejected the pragmatic argument that prohibiting an insurance recovery of punitive damages would fail to deter effectively the reckless or wanton driver. The court reasoned that the effectiveness of the deterrent was not material, and that the court's duty was to try to advance the state's policy of

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most courts to cover both compensatory and punitive damages, policy holders held the reasonable expectation that they were covered against all claims. Finally, the line between simple negligence and the gross negligence upon which an award for punitive damages can be made was deemed too tenuous to permit such damages to go uninsured.

11. 375 F.2d at 525.

12. *Id.*

13. See *Newman v. Nelson*, 350 F.2d 602 (10th Cir. 1965); *Watkins v. Layton*, 182 Kan. 702, 324 P.2d 130 (1953).

14. 375 F.2d at 526.

15. *Id.* at 525. The *Gold* court was referring to similar language quoted in *Northwestern Cas. Co. v. McNulty*, 307 F.2d 432, 440 (5th Cir. 1962). In *McNulty*, however, the court stated that the doctrine was not necessarily applicable to cases of automobile liability insurance covering punitive damages since the public policy is not so much to discourage wrongdoing by obstructing the hopes of profit as it is to discourage wrongdoing through punishment.

16. *Gold* likened insurance against punitive damages to insurance against criminal fines or penalties which would clearly violate public policy. The court reasoned that insuring against punitive damages tended to shift the burden of punishment to insurance companies and through them to the public where it could serve no deterrent purpose. 375 F.2d at 526.

awarding punitive damages as an *attempt* to deter.<sup>17</sup> Moreover, the court saw no merit in the argument that juries may distinguish between ordinary and gross negligence and recklessness by whim rather than sound application of the law to the facts.<sup>18</sup> Acknowledging the potential fallibility of juries, the court maintained that it must assume the ability and accuracy of any given jury in following the law.<sup>19</sup>

Further, the court dismissed the contention that the Kansas Motor Vehicle Safety Responsibility Act<sup>20</sup> superseded the state public policy against insuring for punitive damages. The legislative purpose of the statute, reasoned the court, was to protect the insured against injury by an uninsured motorist only insofar as compensatory damage for bodily injury is concerned. Hence, punitive damages were not contemplated by the Act since they are not awarded as compensation for bodily injury.<sup>21</sup>

The *Gold* policy of barring punitive damages from insurance coverage is a logical result of its view that a punitive damages

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17. 375 F.2d at 527.

18. This argument is that the question of whether the damages are covered by insurance will turn on the degree of misconduct that the jury perceives. If it considers the defendant's act wilful, wanton, and reckless, a portion of the judgment will not be covered by insurance. On the other hand, if the jury finds only ordinary negligence the defendant will be completely covered.

While this contention may be valid, it is important to understand exactly what happens. The compensatory damages, as decided by the jury, will always have complete insurance coverage up to the limits of the policy. If the jury finds wilful, wanton, and reckless conduct it awards additional punitive damages which are not insured but, instead, fall completely upon the wrongdoer. Hence, the jury does not decide whether the damage award should be covered by insurance, but whether punitive damages should be awarded in addition to compensation. For the jury to accurately make these distinctions it is essential that it be clearly instructed by the court as to the definitions of tortious misconduct set forth in note 3 *supra*.

19. 375 F.2d at 527.

20. KAN. STAT. § 8-750(b)(2)( ). The Act states that the policy "shall insure . . . against loss from the liability imposed by law for damages arising out of the ownership, maintenance, or use of such vehicle. . . ."

21. 375 F.2d at 527. The court's analysis is weakened by the absence of discussion of the state legislature's intent in passing this statute. However, this shortcoming is understandable in view of the difficulty in obtaining this type of information at the state level. See C. AUERBACH, L. GARRISON, W. HURST & S. MERMIN, *THE LEGAL PROCESS* 626 (1961).

Instead, the court utilized the alternative of citing cases from two other jurisdictions which had interpreted similar statutes. *Hanna v. State Farm Mut. Auto. Co.*, 233 F. Supp. 510 (E.D.S.C. 1964); *Laird v. Nationwide Ins. Co.*, 243 S.C. 388, 134 S.E.2d 206 (1964).

award is a punishment of and deterrent to the reckless driver.<sup>22</sup> However, the court's argument that "[t]he question is not so much the efficacy of the policy underlying punitive damages; rather it is a question of the implementation of that policy"<sup>23</sup> can be criticized. The court failed to note that if punitive damages do not deter, there is no reason to have a public policy of excluding them from insurance coverage. There is some doubt that punitive damages will ever be a successful deterrent, no matter how the policy is implemented, where they are awarded in cases of gross negligence or recklessness rather than intentional tort. It has been maintained, for instance, that where there is no intent there can be no deterrent.<sup>24</sup>

Conversely, it can be argued that wilful, wanton, and reckless conduct is "quasi intent" since the actor knows that harm is substantially certain to occur.<sup>25</sup> If the latter premise is valid, the deterrent effects of punitive damages logically follow. Moreover, it is possible that all undesirable behavior, including that which is unintentional, can be deterred to some extent if the punishment is sufficiently harsh.<sup>26</sup>

It is questionable whether punitive damages really fulfill a deterrent function in this area. The most effective punishments may often be the social stigma of the accident coupled with the revocation of defendant's drivers license and the cancellation of his insurance. In the instant case, for example, the wrongdoer's insurance policy was cancelled immediately.<sup>27</sup> Moreover, assuming, *arguendo*, that the *Gold* view of punitive damages as a punishment and deterrent is valid, arguments can be made that the practical problems created in implementing such a policy outweigh the deterrent value.<sup>28</sup>

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22. Where punitive damages are levied against an employer-car owner for the wanton and reckless conduct of his employee the possibility of punishing and deterring the defendant does not exist. Thus, the insured may be allowed to shift the burden to the insurer. *Ohio Cas. Ins. Co. v. Welfare Fin. Co.*, 75 F.2d 58 (8th Cir. 1934), *cert. denied*, 295 U.S. 734 (1935) (held that allowing insurance coverage of punitive damages did not violate public policy where the insured was not guilty of any misconduct).

23. 375 F.2d at 527.

24. 7 J. APPLEMAN, *INSURANCE LAW AND PRACTICE* § 4312, at 132 (1965) [hereinafter cited as APPLEMAN].

25. PROSSER § 34, at 188.

26. See Cohen, *Moral Aspects of the Criminal Law*, 49 *YALE L.J.* 987, 1014 (1940); Livermore & Meehl, *The Virtues of M'Naghten*, 51 *MINN. L. REV.* 789, 793 (1967); Michael, *Psychiatry and the Criminal Law*, 21 *A.B.A.J.* 271 (1935).

27. Brief for Appellee at 12.

28. See note 9 *supra*.

A number of these problems stem from the position of the jury in an action for punitive damages. The *Gold* court summarily rejected the argument that the portion of damages covered by insurance would vary with the whim of the jury as it attempts to distinguish between ordinary negligence and recklessness,<sup>29</sup> but the trial transcript in the instant case itself indicates the highly unpredictable nature of the two types of jury awards.<sup>30</sup> Moreover, the function of the jury does pose a serious problem because of the difficulty of effectuating the *Gold* policy within the framework of the rules of court procedure.

First, there is a conflict between the general rule permitting evidence of the financial standing of the defendant to be considered by the jury in assessing punitive damages<sup>31</sup> and the rule against referring to the defendant's insurance in the presence of the jury.<sup>32</sup> Although it would be paradoxical for a jury to award punitive damages with the intention of punishing the defendant while at the same time assuming that his insurance would cover them, it is certainly possible that, without knowledge of the exclusion of punitive damages from the insurance coverage, a jury will follow this inconsistent approach. The result could easily be an award of punitive damages out of proportion to the actual wrong being punished since the jury will assume that the burden will fall on the insurer.<sup>33</sup>

Two possible instructions might clarify this area for the jury without violating the rule against introducing evidence of the defendant's insurance. First, the court could emphasize the *personal* nature of punitive damages thereby implying that the full burden of the punitive damages will fall directly upon the

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29. 375 F.2d at 527.

30. In the original transcript, at page 340, the trial judge stated:

Now in connection with the amount of damages involved, it struck me that the jury could have very well turned this thing around, giving actual damages in the amount of \$10,000.00 and punitive damages in the amount of \$800.00 or whatever amount it was . . . . It is a little large, but it strikes me that this plaintiff is suffering from a rather serious disability. . . .

Brief for Appellee at 12.

31. *E.g.*, *Witte v. Hutchins*, 135 Kan. 776, 12 P.2d 724 (1932); *White v. White*, 76 Kan. 82, 90 P. 1087 (1907); *Pedersen v. Jirsa*, 267 Minn. 48, 125 N.W.2d 38 (1963).

32. *E.g.*, *McGuire v. McGuire*, 152 Kan. 237, 103 P.2d 884 (1940); *Schultz v. Swift & Co.*, 210 Minn. 533, 299 N.W. 7 (1941). For a discussion of the rule see *Annot.*, 4 A.L.R.2d 761 (1949).

33. There is little doubt that juries assume that the defendant is covered by insurance even where no evidence of insurance is admitted to the trial. *Oltarsh v. Aetna Ins. Co.*, 15 N.Y.2d 111, 204 N.E.2d 622, 256 N.Y.S.2d 577 (1965); *Lassiter, Direct Actions Against the Insurer*, 317 *INS. L.J.* 411, 416 (1949).



defendant. Second, it could be clearly stated that neither the plaintiff's nor the defendant's insurance company would be involved in the punitive award as either a payor or as a recipient. While insurance would be mentioned in this latter instance, the difference in context might be sufficient to avoid the evidence rule.

A related difficulty is that the jury verdict is often given as a lump sum<sup>34</sup> without distinction between compensatory and punitive damages.<sup>35</sup> It is, therefore, impossible to determine what portion of the damage award should be covered by insurance.<sup>36</sup> This problem could be resolved by requiring the jury to categorize the damages when returning a verdict which includes punitive damages. Not only would this practice aid in effectuating the rule of the instant case, but it would also clearly define the two types of damage awards. Such a clarification is also necessary because there is some evidence that juries often assess a portion of the judgment as a punishment of the defendant whether or not punitive damages are appropriate under the law.<sup>37</sup> Since the jury usually has a wider discretion in the amount it can award as punitive damages than it does with regard to compensation,<sup>38</sup> it is imperative that courts clearly instruct juries in the distinction between the two types of damages,<sup>39</sup> even though such attempts may sometimes be in vain.<sup>40</sup>

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34. In many jurisdictions the jury is not required to separate compensatory and punitive damages unless a specific allocation is requested by one of the parties. *E.g.*, *Building Trades Council v. Thompson*, 68 Nev. 384, 234 P.2d 581 (1951); *Gallichio v. Gumina*, 35 N.J. Super. 442, 114 A.2d 447 (1955); *Jones v. Citizens Bank*, 58 N.M. 48, 265 P.2d 366 (1954); *Kuhn v. Cooper*, 141 W. Va. 33, 87 S.E.2d 531 (1955).

35. See Note, *Exemplary Damages in the Law of Torts*, 70 HARV. L. REV. 517, 527 (1957).

36. All cases decided prior to 1962 holding that punitive damages were covered by insurance involved a lump sum judgment that could not be divided. See cases cited note 11 *supra*. In *Pennsylvania Threshermen & Farmers' Mut. Cas. Ins. Co. v. Thornton*, 244 F.2d 823 (4th Cir. 1957), for example, the verdict and judgment was \$5,000 with no distinction between compensatory and punitive damages.

37. Thus, where a Wisconsin case was tried three times before different juries each verdict was for the same amount even though punitive damages were allowed in only two of the trials. *Bass v. Chicago & N.W. Ry.*, 36 Wis. 450 (1874); 39 Wis. 636 (1876); 42 Wis. 654, 671-72 (1877). See Note, *Exemplary Damages in the Law of Torts*, 70 HARV. L. REV. 517, 521 (1957).

38. See *Bangert v. Hubbard*, 127 Ind. App. 579, 126 N.E.2d 778 (1955); *Krueger v. City of Fairbault*, 220 Minn. 89, 18 N.W.2d 777 (1945); *Ostertag v. La Mont*, 9 Utah 2d 130, 339 P.2d 1022 (1959).

39. The law in the various jurisdictions, in many instances, has not clearly defined the instructions that should be given to the jury concerning the awarding of punitive damages. *Morris*, *Punitive Damages*

It has been argued that insurance companies would reduce their important role in driver education and safety because of their reduced liability under the *Gold* rule.<sup>41</sup> The possibility of such a reaction is mere conjecture at this point and would seem to be highly unlikely in view of the rising level of compensatory awards<sup>42</sup> which are still the paramount cost to insurers. Moreover, these safety programs have proven much less effective for automotive activities than for other activities associated with casualty insurance.<sup>43</sup>

Other critics have pointed out that release of insurance companies from liability for punitive damages will give them a windfall since they already anticipate payments of these awards in their premium rates. The fact that insurers set their rates on a total cost system based on losses, expenses, and margin<sup>44</sup> supports this claim.<sup>45</sup> Since courts have almost always held them liable in the past,<sup>46</sup> the expense of punitive damage awards has naturally been a part of their total cost computation. The limited amount of litigation in this area also lends support to the conclusion that insurers have not been deeply concerned with these costs which have already been anticipated in their rates. On the other hand, punitive damages, because of the infrequency of their assessment, may well have a negligible effect upon the premium cost.<sup>47</sup> However, if a general acceptance of the policy of excluding punitive damages from insurance coverage did produce a substantial windfall to insurers, it would hopefully be short-lived since the total cost for the insurer would decrease. The rates would be reduced in line with the savings under this new policy,<sup>48</sup> if not voluntarily by the companies themselves, then certainly through the demands of the state regulatory authorities.<sup>49</sup>

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in *Tort Cases*, 44 HARV. L. REV. 1173, 1187-88 (1931). See Note, *Exemplary Damages in the Law of Torts*, 70 HARV. L. REV. 517, 525 (1957).

40. See note 37 *supra*.

41. *Northwestern Nat'l Cas. Co. v. McNulty*, 307 F.2d 432, 444 (5th Cir. 1962) (Gewin, J., concurring).

42. Morris, *Enterprise Liability and the Actuarial Process—The Insignificance of Foresight*, 70 YALE L.J. 554, 567 (1961).

43. F. HARPER & F. JAMES, *THE LAW OF TORTS* § 13.5, at 777 (1956); James & Thornton, *The Impact of Insurance on the Law of Torts*, 15 LAW & CONTEMP. PROB. 431, 440 (1950).

44. See A. MOWERAY & R. BLANCHARD, *INSURANCE: ITS THEORY AND PRACTICE IN THE UNITED STATES* 389 (5th ed. 1961).

45. See 63 COLUM. L. REV. 944, 950 (1963).

46. See cases cited note 8 *supra*.

47. Cf. Morris, *supra* note 42, at 575.

48. See text accompanying note 44 *supra*.

49. Although Congress has the power under the commerce clause

Another practical problem which arises from the *Gold* rule is the conflict of interests which develops between the insurance company and the insured when the insurer has no liability for punitive damages. The insured and insurer may be discouraged from disposing of the case through settlement because of the resulting dispute as to what portion of such settlement is insured. However, the problem is similar to that which develops between joint tortfeasors<sup>50</sup> and, therefore, should be capable of solution by similar means.<sup>51</sup>

It has also been contended that denying an insured coverage for a punitive award frustrates his expectations by voiding the private contract between the insured and the insurer.<sup>52</sup> It is doubtful that the insured has specifically relied on the contract for coverage of punitive damages since there is no mention of punitive awards in the provisions of the standard policy. However, it is more probable that the insured relied upon the standard language which binds the company to defend the insured in all litigation arising out of an accident involving the

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of the Constitution to regulate insurance activities, it has, for the most part, left this task up to the state regulatory commissions. A MOWBRAY & R. BLANCHARD, *supra* note 44, at 49, 485-88. These state regulatory agencies have the authority to review and determine rates. F. CRANE, *AUTOMOBILE INSURANCE RATE REGULATION* 1, 57 (1962).

50. See PROSSER § 47, at 277.

51. Where, for example, the plaintiff is claiming \$10,000 compensatory and \$10,000 punitive damages, and a settlement is made for \$7,500 there is a question as to what portion of that amount should be covered by the insurance. One way to resolve the resulting dispute would be to treat the amount of the settlement as wholly compensatory damages since punitive damages are awarded only at the discretion of the jury and, in the case of a settlement, there has been no trial. Arguably, then, the amount in question must be considered compensatory and within the coverage of liability insurance.

However, such a practice might discourage an insurer from settling since it has less to lose and probably more to gain by allowing the jury to make its determination. In the example, for instance, the insurer can be liable only for a maximum of \$10,000. But if the jury should bring down a verdict of \$8,000 and label half of that as punitive damages, the insurer has benefited from not settling. In light of this conflict, a more practical solution would be to apportion the settlement amount according to the figures in the claim. For instance, if the plaintiff filed a claim for \$5,000 compensatory and \$10,000 punitive damages a settlement would make the insurer liable for one-third and the insured personally liable for two-thirds. This type of arrangement was made in *Ohio Cas. Ins. Co. v. Welfare Fir. Co.*, 75 F.2d 58 (8th Cir. 1934), *cert. denied*, 295 U.S. 734 (1935), although on the basis of a prior jury award.

52. See *Lazenby v. Universal Underwriters Ins. Co.*, 214 Tenn. 639, 383 S.W.2d 1 (1964).

insured vehicle.<sup>53</sup> Since the insurer may feel inclined to defend only its part of the liability, the insured will be forced to secure his own attorney for the punitive portion of the claim. To resolve this problem, the courts should require the insurer, on the basis of its contract provision, to defend both claims.<sup>54</sup> Such a requirement would be fair to insurance companies since they have an interest in minimizing the proofs of recklessness before the jury, the same group of people who are determining the amount of compensatory damages for which the insurer will be liable. Evidence indicating that the defendant was guilty of reckless conduct and gross negligence not only lays a basis for the assessment of punitive damages, but it probably also affects the level of the compensatory award.

Besides being unfair, the insured's ignorance of a *Gold* limitation on his coverage minimizes the deterrent argument underlying punitive damages since a wrongdoer logically cannot be deterred by a potential punishment of which he is unaware.<sup>55</sup> A possible remedy would be the adoption of state statutes specifically excluding punitive damages from coverage and requiring insurance companies to include a provision disclaiming liability for punitive damages in their written contract.<sup>56</sup> By put-

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53. The language generally provides:

[A]s respects such insurance as is afforded by the terms of this policy, the company shall defend in his name and behalf any suit against the insured alleging [a claim covered by the policy] and seeking damages on account thereof even if such suit is groundless, false, or fraudulent; but the company may make such investigation, negotiation and settlement of any claim or suit as it deems expedient.

Roos, *The Obligation to Defend and Some Related Problems*, 13 HASTINGS L.J. 206 (1961); Brief for Appellant at 3.

54. In fact this may already be the law in at least one jurisdiction. In *Gray v. Zurich Ins. Co.*, 54 Cal. Rptr. 104, 419 P.2d 168 (1966), the California Supreme Court held that an insurer was obliged to defend an assault action notwithstanding an exclusionary clause disclaiming liability for intentional torts inasmuch as the language of the policy did not clearly define the application of the exclusionary clause to the duty to defend. The failure to so define the clause, stated the court, gave rise to the insured's reasonable expectation of protection. For further discussion see Roos, *The Obligation to Defend and Some Related Problems*, 13 HASTINGS L.J. 206 (1961); Note, *Insurance Company's Dilemma: Defending Actions Against the Insured*, 2 STAN. L. REV. 383 (1950); Comment, *The Insurer's Duty to Defend Under a Liability Insurance Policy*, 114 U. PA. L. REV. 734 (1966); 49 CAL. L. REV. 394 (1961).

55. This is not to say that there is no deterrent value when the wrongdoers have no prior notice from the provisions of the policy. Presumably anyone against whom punitive damages are assessed is deterred from a repetition of his wrong in the future.

56. The exclusion must be required by statute since it is unlikely that an insurance company would risk the sales loss that might result