

# Recovery of Punitive Damages Against Insurance Companies

STEPHEN E. ARTHUR\*

During this survey period, the Indiana courts again reexamined the prerequisites for maintaining a claim for punitive damages against an insurance company in a first party action. Specifically, the courts refined the elements and evidentiary requirements enunciated by the Indiana Supreme Court in *Travelers Indemnity Company v. Armstrong*,<sup>1</sup> refinements which should have an impact not only upon an insured's burden of proof but also upon the trial court's instructions to the jury.

## I. *Travelers Indemnity Company v. Armstrong* REVISITED

The general rule in Indiana is that punitive damages may not be recovered as an element of damages in breach of contract actions.<sup>2</sup> Exceptions exist when the breach is accompanied by an independent common law tort, or where elements of fraud, gross negligence, or oppression mingle with an insurance company's breach of contract.<sup>3</sup> However, in *Travelers* the Indiana Supreme Court stated,

[Punitive] damages should not be allowable upon evidence that is merely consistent with the hypothesis of malice, fraud, gross negligence or oppressiveness. Rather some evidence should be required that is inconsistent with the hypothesis that the tortious

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\*Associate with the law firm of Bose McKinney & Evans, Indianapolis, Indiana. B.A., Indiana Central University, 1976; J.D., Indiana University School of Law, 1979.

<sup>1</sup>442 N.E.2d 349 (Ind. 1982).

<sup>2</sup>See *Vernon Fire & Casualty Ins. Co. v. Sharp*, 264 Ind. 599, 349 N.E.2d 173 (1976), where the court stated:

The promisor's motive for breaching a contract is generally regarded as irrelevant, . . . because the promisee will be compensated for all damages proximately resulting from the promisor's breach . . . . Where the facts surrounding the promisor's breach indicate sub-standard business conduct, promisee may also enjoy a limited sense of requital in taking his business elsewhere in the future, but he is not entitled to mulct the promisor in punitive damages.

*Id.* at 607-08, 349 N.E.2d at 180; See also *D & T Sanitation, Inc. v. State Farm Mut. Auto. Ins. Co.*, 443 N.E.2d 1207 (Ind. Ct. App. 1983); *Nationwide Mut. Ins. Co. v. Neville*, 434 N.E.2d 585 (Ind. Ct. App. 1982); *Hoosier Ins. Co. v. Mangino*, 419 N.E.2d 978 (Ind. Ct. App. 1981). See also APPLEMAN, *INSURANCE LAW AND PRACTICE* § 11256; Arthur, *Insurance, 1984 Survey of Recent Developments in Indiana Law*, 18 IND. L. REV. 265, 270-73 (1985).

<sup>3</sup>*Travelers Indemn. Co. v. Armstrong*, 442 N.E.2d 349 (Ind. 1982); *Vernon Fire & Casualty Ins. Co. v. Sharp*, 264 Ind. 599, 349 N.E.2d 173 (1976). See Arthur, *Insurance, 1983 Survey of Recent Developments in Indiana Law*, 17 IND. L. REV. 223, 224-28 (1984).

conduct was the result of a mistake of law or fact, honest error of judgment, over-zealousness, mere negligence or other such noniniquitous human failing.<sup>4</sup>

Moreover, the *Travelers* court changed the evidentiary standard for approving a punitive damage claim from a preponderance of the evidence to one requiring clear and convincing evidence.<sup>5</sup> This clear and convincing evidence standard subsequently was codified by the Indiana General Assembly.<sup>6</sup>

## II. *Town & Country Mutual Insurance Company v. Hunter*

The first case of this survey period which discussed punitive damages in first party actions was *Town & Country Mutual Insurance Company v. Hunter*.<sup>7</sup> The facts in *Town & Country* revealed that a collision occurred between a motorcycle driven by the insureds (Hunters) and an automobile driven by an uninsured motorist. The Hunters maintained two policies of insurance which included uninsured motorist coverage. As a result of the accident, Mr. Hunter suffered injuries and his wife, a passenger on the motorcycle at the time of the accident, died. Mr. Hunter testified that the uninsured motorist had been driving negligently and that this negligence had caused the accident.

Town & Country discovered, upon investigation, that Mr. Hunter had been drinking prior to the accident, and the insurer made a determination that the uninsured motorist was not liable for the collision. As a result, Town & Country paid medical payment claims and death benefits under the insurance policies but denied Hunter's uninsured motorist claim, even though Town & Country had established reserves to cover these claims.

Subsequently, the uninsured motorist made an inconsistent statement to Hunter's attorney indicating that the uninsured motorist in fact had been negligent. After reading this statement, Town & Country stated a desire to reach a settlement agreement with Hunter; however, the uninsured motorist later retracted her statement reverting to the original version of the incident wherein she omitted no fault. Town & Country then again denied Hunter's claim under the uninsured motorist provision, and Hunter instituted an action against Town & Country for breach of the insurance contract. The jury awarded Hunter compensatory and punitive damages for Town & Country's failure to settle the uninsured motorist claims.

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<sup>4</sup>*Travelers Indemn. Co. v. Armstrong*, 442 N.E.2d at 362.

<sup>5</sup>*Id.* at 358-63.

<sup>6</sup>IND. CODE §§ 34-4-34-1 to -2 (Supp. 1985).

<sup>7</sup>472 N.E.2d 1265 (Ind. Ct. App. 1984).

On appeal, the Indiana Court of Appeals reversed the punitive damage award. The court stated that punitive damages may be awarded only when an insurance company's conduct reflects malice, fraud, gross neglect, oppression, or bad faith by clear and convincing evidence.<sup>8</sup> A good faith dispute over the amount of damages will not supply the grounds for punitive damages, nor will an incorrect evaluation of an insured's claim.<sup>9</sup> The court stated that an insured may prevail on a request for punitive damages only by proving that the insurer acted with knowledge that it had no legitimate basis for denying coverage.<sup>10</sup> From such actions, a jury may infer malice or oppressive conduct on the part of the insurer.<sup>11</sup>

The court then concluded that evidence existed which supported a hypothesis that the insurer had acted in good faith when denying coverage because of the evidence that Mr. Hunter was contributorily negligent.<sup>12</sup> The court further stated that evidence of inadequate or negligent investigation by the insurance company cannot support a punitive damage claim by clear and convincing evidence when the negligence or insufficiency in the investigation can be attributed to human error.<sup>13</sup> Finally, the court stated that Town & Country's action to establish reserve accounts on the uninsured motorist claims was evidence of good faith, not bad faith as was claimed by the insured.<sup>14</sup>

### III. *Mutual Hospital Insurance Inc. v. Hagner*

In *Mutual Hospital Insurance, Inc. v. Hagner*,<sup>15</sup> an insured brought an action against Mutual Hospital Insurance, Inc. (Blue Cross) for its failure to pay for medical treatments rendered to the insured's son under a medical insurance program provided by General Motors. The evidence revealed that the child had fallen and broken several front teeth, which

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<sup>8</sup>*Id.* at 1268.

<sup>9</sup>*Id.* The Court of Appeals in *Town & Country* stated, "Courts must take care not to discourage honest litigation by allowing punitive damages against a party which is exercising its right to adjudicate a real dispute, even if that party is found to be in error and the litigation injures the other party." *Id.* (citing *First Federal Savings and Loan Ass'n of Indianapolis v. Mudgett*, 397 N.E.2d 1002 (Ind. Ct. App. 1982)).

<sup>10</sup>*Id.* at 1269. See also *State Farm Mut. Auto. Ins. Co. v. Shuman*, 175 Ind. App. 186, 370 N.E.2d 941 (1977); *Sexton v. Meridian Mut. Ins. Co.*, 166 Ind. App. 529, 337 N.E.2d 527 (1975); *Rex Ins. Co. v. Baldwin*, 163 Ind. App. 308, 323 N.E.2d 270 (1975); *Physicians Mut. Ins. Co. v. Savage*, 156 Ind. App. 283, 296 N.E.2d 165 (1973).

<sup>11</sup>*Town & Country*, 472 N.E.2d at 1269 (citing *Hoosier Ins. Co. v. Mangino*, 419 N.E.2d 978 (Ind. Ct. App. 1981)). See also *Miller Pipeline Corp. v. Broeker*, 460 N.E.2d 177 (Ind. Ct. App. 1984).

<sup>12</sup>*Town & Country*, 472 N.E.2d at 1269.

<sup>13</sup>*Id.*

<sup>14</sup>*Id.*

<sup>15</sup>475 N.E.2d 32 (Ind. Ct. App. 1984).

resulted in subsequent medical complications. As a result of the complications, a dentist was required to place the child under general anesthesia, to remove dead pulp from each broken tooth, to fill the open wounds, and to cover the broken teeth with steel crowns. Following this treatment, the insured filed a claim with Blue Cross for the hospital and medical expenses. The initial claim for hospital expenses was paid; however, when the insured submitted a claim for the remaining medical expenses, the claim was denied, and Blue Cross demanded a refund for the initial payments made to the insured based on an opinion that "no concurrent medical hazard" existed, which was an exception under the policy. Subsequently, the insured requested a review of the claim and submitted to Blue Cross a physician's letter verifying the health-related problems suffered by the child as a result of his injuries. In response to this letter, Blue Cross withdrew its refund request, stating that the claim was payable because it was accident-related. The insured resubmitted the claim for the doctor's services, but the claim was again denied, and Blue Cross made another refund demand. Further correspondence failed to resolve the conflict, and the insured wrote to the president of Blue Cross requesting assistance. Blue Cross again reviewed the claim, determined that the claim should be denied, and outlined the basis of its denial in a detailed letter mailed to the insured. Additionally, Blue Cross dropped its request for a refund of the payment for hospital services.

Unsatisfied, the insured instituted an action against Blue Cross. The trial court awarded compensatory and punitive damages, basing its punitive damage award on a finding that Blue Cross had avoided payment of a claim deliberately and in bad faith.

The Indiana Court of Appeals reversed the punitive damage award, determining that the record disclosed no more than a good faith dispute between the parties.<sup>16</sup> The court stated that punitive damages may not be awarded when a dispute arises in good faith because of the "prohibitive social cost" of making such claims indisputable.<sup>17</sup> Additionally, the court restated the language of *Travelers* that clear and convincing evidence to support an award of punitive damages requires some evidence which is inconsistent with a hypothesis that the tortious conduct was the result of an honest mistake, error, over-zealousness, or negligence.<sup>18</sup> The court stated that the insurer's vacillation on the question of the refund, while perhaps supportive of a finding of malice, was not inconsistent with a hypothesis of honest error or over-zealousness.<sup>19</sup> Because the insured

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<sup>16</sup>*Id.* at 36.

<sup>17</sup>*Id.*

<sup>18</sup>*Id.*

<sup>19</sup>*Id.*

failed to disprove affirmatively the good faith hypothesis, the court concluded that the evidence failed to satisfy the *Travelers* clear and convincing evidence standard.<sup>20</sup>

#### IV. *Bymaster v. Bankers National Life Insurance*

Finally, in *Bymaster v. Bankers National Life Insurance Company*,<sup>21</sup> applicants for life insurance brought an action against the insurance company (Bankers), its agent at the time of solicitation (CNC), and that agent's agent, for compensatory and punitive damages arising from the defendants' failure to refund an advanced premium following Bankers' denial of the applications for life insurance. The trial court entered judgment against the plaintiff as to punitive damages, and that judgment was affirmed by the Indiana Court of Appeals.

The facts presented in the plaintiffs' case revealed that Bankers had entered into a General Agent's Agreement with CNC to sell Bankers' life insurance policies. In turn, CNC appointed an officer of CNC as its agent. The general agency agreement provided that all moneys received by CNC for premiums would be held in a premium trust account and that ten percent of the premiums would be due and payable immediately to Bankers. Bankers also had a right to audit the account. CNC was entitled to retain the balance of ninety percent once the policy was delivered to the insured.

CNC's agent wrote an insurance application for the insureds (Bymasters). The application reflected that Mrs. Bymaster had a history of cancer and that Mr. Bymaster had a history of heart trouble. The insurance policies were heavily conditioned, including a requirement that the Bymasters pass medical examinations. The Bymasters wrote a check to CNC for the first year premiums, and CNC issued a written guarantee to the Bymasters for the return of the premiums if the policies were not issued. Pursuant to the agency agreement, ninety percent of the premiums was retained by CNC and ten percent was remitted to Bankers.

The Bymasters submitted to medical examinations, but Bankers requested additional information concerning the Bymasters health histories. When such information was not forthcoming, Bankers notified the Bymasters that their applications had been denied. When the Bymasters had not received a return of their premiums after approximately one month, they began telephoning and writing Bankers to demand the return of their premiums. Bankers remitted a check to the Bymasters for ten percent of the premiums paid and instructed the Bymasters that all

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<sup>20</sup>*Id.* See also *Orkin Exterminating Co. v. Traina*, 486 N.E.2d 1019 (Ind. 1986) (clear and convincing evidence standard also applicable to imposition of punitive damages for pure tort cases under the good faith hypothesis).

<sup>21</sup>480 N.E.2d 273 (Ind. Ct. App. 1985).

additional moneys should be paid by CNC. Until that time, the Bymasters had not been aware of the ninety percent/ten percent agreement between Bankers and CNC.

During this period, Bankers commenced an audit of the premium trust account and terminated the agency agreement with CNC. Thereafter, Bankers filed a formal complaint against CNC with the Illinois Department of Insurance alleging that CNC repeatedly had misrepresented the terms of certain policies and had violated regulations concerning the return of moneys held in the premium trust accounts. During this same period, Bankers was unaware that CNC had not remitted the ninety percent premiums to the Bymasters.

The court noted that the acts of an agent can be charged to a principal insurance company and that an insurer's recklessness in employing or retaining an agent may make the insurer liable for punitive damages.<sup>22</sup> The court also noted, however, that no fiduciary relationship arises between an insurer and an insured which entitles the insured, after a dispute has arisen, to rely upon the insurer's interpretation of an insurance contract.<sup>23</sup> Moreover, while an insurer has a duty not to make fraudulent representations to its insured, it is not required to be correct in its interpretation of the policy.<sup>24</sup> Because the Bymasters had failed to establish that Bankers, CNC, or its agent had misrepresented the policies or any terms thereunder, and the controversy centered only on the return of premiums after the Bymasters' application for life insurance had been denied, there was no fiduciary duty upon which a claim for punitive damages could be based.<sup>25</sup>

With respect to the failure to return the premiums to the Bymasters, the court stated that Bankers could not be charged with CNC's failure to return the ninety percent premium.<sup>26</sup> The court stated that an agent who commits an independent fraud for his own benefit ceases to act as an agent for his principal and that punitive damages cannot be maintained against the insurer principal who is innocent of any wrongdoing.<sup>27</sup> Noting that CNC's acts of conversion had advanced no interest of Bankers and that Bankers had never condoned CNC's conduct, the court concluded that the Bymasters were not entitled to an award of punitive damages against Bankers.<sup>28</sup>

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<sup>22</sup>*Id.* at 276.

<sup>23</sup>*Bymaster*, 480 N.E.2d at 277 (citing *Travelers Indemn. Co. v. Armstrong*, 442 N.E.2d 349, 364 (Ind. 1982)).

<sup>24</sup>*Id.*

<sup>25</sup>*Id.*

<sup>26</sup>*Id.* at 278.

<sup>27</sup>*Id.* at 279.

<sup>28</sup>*Id.*

## V. SOLIDIFICATION OF METHODOLOGY FOR ESTABLISHING PUNITIVE DAMAGES CLAIM

As such, these three cases have reaffirmed *Travelers* and have solidified the methodology which should be used to establish a punitive damage claim in first party insurance contract actions. This methodology entails that (1) the insured must present clear and convincing evidence that the breach of insurance contract is accompanied by an independent common law tort such as fraud or misrepresentation, or establish by clear and convincing evidence that elements of fraud, gross negligence, or oppression have mingled with the insurance company's breach of contract; (2) present evidence that is inconsistent with a hypothesis that the improper conduct was the result of a mistake of law or fact, honest error of judgment, over-zealousness, negligence, or other noniniquitous human failing; and (3) establish that punitive damages will further a social end of punishing the wrongdoer and that their imposition will deter future misconduct by the insurer or the insurance industry.<sup>29</sup>

Conduct which will not be held to constitute bad faith sufficient to support an award of punitive damages includes an insurer's denial of a claim based on the insurer's good faith belief that no coverage is owed to the insured,<sup>30</sup> incompetence or negligence by an insurer's employees or agents in processing and evaluating an insured's claim,<sup>31</sup> negligent investigation of an insured's claims,<sup>32</sup> or settlement practices which fall below insurance industry standards.<sup>33</sup>

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<sup>29</sup>An insured has no right to punitive damages. These damages are considered a windfall to the insured and are not compensatory in nature, but are awarded only to punish the wrongdoer or to deter similar misconduct by others. *Travelers Indemn. Co. v. Armstrong*, 442 N.E.2d 349, 358-63 (Ind. 1982); *see also* *Bymaster v. Bankers Nat. Life Ins. Co.*, 480 N.E.2d 273, 278 (Ind. Ct. App. 1985); *Farm Bureau Mut. Ins. Co. v. Dercach*, 450 N.E.2d 537, 541 (Ind. Ct. App. 1983).

<sup>30</sup>*See, e.g.*, *Travelers Indemn. Co. v. Armstrong*, 442 N.E.2d 349, 364 (Ind. 1982); *Town & Country Mut. Ins. Co. v. Hunter*, 472 N.E.2d 1265, 1269 (Ind. Ct. App. 1984); *American Family Ins. Group v. Blake*, 439 N.E.2d 1170, 1175 (Ind. Ct. App. 1982); *Nationwide Mut. Ins. Co. v. Neville*, 434 N.E.2d 585, 595 (Ind. Ct. App. 1982); *Hoosier Ins. Co. v. Mangino*, 419 N.E.2d 978, 987-88 (Ind. Ct. App. 1981).

<sup>31</sup>*See, e.g.*, *Town & Country Mut. Ins. Co. v. Hunter*, 472 N.E.2d 1265 (Ind. Ct. App. 1984); *D & T Sanitation, Inc. v. State Farm Mut. Auto. Ins. Co.*, 443 N.E.2d 1207, 1209 (Ind. Ct. App. 1983).

<sup>32</sup>*See, e.g.*, *Town & Country Mut. Ins. Co. v. Hunter*, 472 N.E.2d 1265, 1269 (Ind. Ct. App. 1984); *Continental Casualty Corp. v. Novy*, 437 N.E.2d 1338, 1356 (Ind. Ct. App. 1982); *Nationwide Mut. Ins. Co. v. Neville*, 434 N.E.2d 585, 596 (Ind. Ct. App. 1982).

<sup>33</sup>*See, e.g.*, *Nationwide Mut. Ins. Co. v. Neville*, 434 N.E.2d 585, 596 (Ind. Ct. App. 1982). *But see* *Indiana Unfair Claims Settlement Practices Act*, IND. CODE § 27-4-1-4.5 (Supp. 1985). The effect of this Act upon the substantive and evidentiary requirements of *Travelers* has yet to be addressed by the Indiana courts. The Act enumerates numerous unauthorized practices and empowers the Insurance Commissioner to impose cease and

As a matter of trial strategy, the insurance company should tender an instruction which requires the jury to find clear and convincing evidence of tortious conduct and evidence which is inconsistent with the hypothesis of a good faith mistake or negligence. The tendered instruction also should identify exceptions to bad faith claims, *e.g.*, negligent investigation or incompetence, to the extent that such exceptions are supported by the evidence, and instruct the jury that punitive damages cannot be awarded if the evidence supports these exceptions. Finally, the instruction should require the jury to determine that punitive damages will punish the insurer or deter future misconduct by that insurer or the insurance industry, and that imposition of punitive damages for this reason will result in a non-prohibitive social cost to the insurance premium paying public.

## VI. CONCLUSION

Indiana courts have demonstrated a clear preference for disallowing punitive damages except in the most egregious instances of misconduct by the insurer. However, there are numerous unsettled questions which will necessarily be addressed as the plaintiff's bar and the insurance industry square off in a continued effort to establish the limits and requirements for maintaining a civil action for punitive damages for an insurer's breach of insurance contract.

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desist orders and monetary penalties against an insurance company for violating the Act. Unsettled is the question of whether an adverse or unfavorable determination by the Insurance Commissioner after an administrative hearing against an insurer will be admissible in a first party action where punitive damages are sought. Also unsettled is the question of whether a violation under the Act is relevant and admissible to prove an insurer's bad faith conduct. See Arthur, *Insurance, 1983 Survey of Recent Developments in Indiana Law*, 17 IND. L. REV. 223, 241-42 (1984).