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DOES YOUR INSURANCE POLICY COVER YOU FOR PUNITIVE DAMAGES? PART II

In our previous edition of The Bassett Bulletin, we discussed the Texas Supreme Court's ruling on whether insurance should cover a finding for punitive damages against an insured.

In *Fairfield*, the Texas Supreme Court considered whether an insurance company had to insure a company that was being sued for only punitive damages based on a wrongful death case. *Fairfield Ins. Co. v. Stephens Martin Paving, LP*, 246 S.W.3d 653 (Tex. 2008). The Court held that it did in cases with workers' compensation insurance.

In this article, we will discuss the United States Fifth Circuit Court of Appeals' different view on whether insurance should cover a finding of punitive damages against an insured. The Fifth Circuit also looked to the actions of the insured when determining whether there should be such coverage.

THE 5TH CIRCUIT COURT OF APPEALS' OPINION *AMERICAN INTERNATIONAL SPECIALTY LINES INSURANCE CO. V. RES-CARE, INC.*

In *Res-Care, Inc.*, the Fifth Circuit Court of Appeals took an entirely different stance than the Texas Supreme Court and held that Texas public policy bars coverage for punitive damages. *Am. Int'l Specialty Lines Ins. Co. v. Res-Care, Inc.*, 529 F.3d 649 (5th Cir. Tex. 2008).

Res-Care operated a group home healthcare in Houston, Texas, called Appleridge, that provided services for mentally disabled individuals. From July 1, 1997, through July 1, 1998, American International insured Res-Care. Both the primary and umbrella policies for Res-Care excluded from coverage damages arising from intentional acts. The umbrella policy also excluded from coverage damages payable by the insured as punitive or exemplary damages.

Trenia Wright, a 37-year old woman with cerebral palsy and mental disabilities, lived at Appleridge from June 1, 1992, until her death on April 16, 1998. On April 12, 1998, Wright fell in the hallway and defecated on the floor. An employee at Appleridge poured a mixture of undiluted bleach and another cleaner onto the floor and escorted other residents outside, while leaving Wright inside the home where she stayed for several hours.

Eventually, other staff members put Vaseline on Wright, but they did not attempt to wash the bleach off of her. Although she had chemical burns on her legs, arms, stomach, and back, Wright received little medical care in the following days. She was not taken to the facility's doctor until approximately 17 hours after the incident where she was diagnosed with superficial burns. The doctor prescribed pain medication and recommended whirlpool treatments, which were not provided.

On April 15, 1998, Wright fell out of bed and was found unresponsive. She was taken to the emergency room and diagnosed with extensive chemical burns. On the morning of April 16, 1998, Wright died from complications due to the severe burns, which covered over 40% of her body.

In June of 1998, Wright's family filed a wrongful death and survival suit for compensatory and punitive damages against Res-Care and others. American assumed the defense of the case against Res-Care. In February 2000, the Wright Plaintiffs demanded \$16 million to settle the suit, and on February 25, 2000, American issued its first reservation of rights letter.

Over the next few months, Res-Care urged American to settle the claims against it, while American urged Res-Care to bear part of any settlement because it believed a settlement would necessarily include claims for uncovered punitive damages. In April 2000, the Wright Plaintiffs filed their Fourth Amended Complaint in which they asserted an additional allegation that Wright had suffered "ongoing neglect and abuse and sustained repeated personal injuries" since she first arrived at Appleridge in 1992, which prompted another reservation of rights letter from American.

On July 19, 2000, the Wright Plaintiffs filed their Ninth Amended Complaint against Res-Care in which they alleged a total of 75 claims for injuries that Wright allegedly suffered from 1993 to 1998. The additional injuries allegedly occurred on different specified dates and were distinct from the April 12, 1998, incident.

On August 1, 2000, American and Res-Care executed a separate non-waiver agreement that authorized American to seek a settlement of the Wright suit. Prior to the execution of the agreement, American believed that coverage under its policies would be limited to Wright's actual damages, which it estimated would be no more than \$ 2.5 million. It refused to make a settlement offer above that amount. The parties acknowledged in the non-waiver agreement that the Wright Plaintiffs were seeking both compensatory and punitive damages and that American believed it was responsible under the policies for only actual damages, but that Res-Care believed American had an opportunity to settle all claims within the available coverage limits.

The parties agreed that if American was able to negotiate a settlement with the Wright Plaintiffs, American "shall then have a right to proceed with a claim for recoupment from the Res-Care Defendants of all sums paid by [American] attributable to any claims not covered under the applicable policies." Thereafter, American settled the Wright suit for \$9 million and paid that sum to the Wright Plaintiffs.

American then sought recovery in the district court for breach of contract under the non-waiver agreement. American contended that Res-Care breached the agreement by refusing to reimburse it for uncovered claims paid as part of the Wright settlement.

The Federal District Court determined that the portion of the settlement for the Wright Plaintiffs' actual damages was \$4 million and that the punitive damages portion totaled \$5 million. The District Court determined that the entire \$9 million represented the settlement of the claim for the April 12, 1998, bleach incident. The court held that the additional 74 claims first alleged on the eve of trial in the Wright Plaintiffs' Ninth Amended Complaint did not substantially factor into the settlement. As punitive damages were not covered under the umbrella policy, the District Court entered judgment for American for \$5 million and Res-Care appealed the District Court's judgment.

Faced with these facts, the Fifth Circuit Court of Appeals held that the documented and systematic problems that this health care provider had with Wright were to such a degree that public policy required that Res-Care pay its punitive damages. The Court agreed with the District Court and made Res-Care pay the jury's award of punitive damages. Also, the Court held that the insurance policy did NOT cover punitive damages.

THE DIFFERENCE BETWEEN *RES-CARE, INC.* AND *FAIRFIELD*

What is the apparent difference between this case and *Fairfield* (the case in our last Newsletter)? It seems to come down to whether the Defendant should be "punished" for the wrongs that it has committed. In *Fairfield*, it did not appear that the Defendant acted in such a way that it should be punished for the death of its employee. In other words, the employer's acts were not intentional and repetitive wrongs against its employee.

However, in *Res-Care, Inc.*, the mistreatment of the Plaintiff seemed to go on and on and the Court agreed that the Defendant should be punished for its actions. Ultimately, it seems that the Court is looking at the severity and repetitiveness of the actions of the Defendant in order to determine whether they should be monetarily punished for their actions.

TIPS WHEN DEALING WITH THIS SITUATION

1. If in doubt, hire a coverage attorney. The attorney that you hire to handle your litigation should not be the attorney who helps you with coverage issues. Due to ethical considerations between the insurance carrier, attorney, and client, your trial attorney should not handle anything in regard to insurance coverage. Therefore, if in doubt, get an attorney who specializes in these types of cases to help you.

2. Document. Document. Document. You should be getting letters from your attorney advising you of all offers of settlement. Are the demands within your policy? If so, would it be best to settle? Open lines of communication between the insurance adjuster, the client, and the attorney are critical to keep the litigation team on track. As an insured, you should be responsive and open with the insurance adjuster to make sure that everyone is on the same track.

3. What evidence does the opposing counsel have against you? Have you or your employees blatantly disregarded applicable rules or codes repeatedly? Is there documentation to support such violations? Although the *Res-Care, Inc.* case is an extreme situation, this case clearly shows that the Court may indeed examine the actions of an insured to see if they should pay out of pocket for their wrongs.

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