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Insurance Coverage Decisions: Issued Today - Impact Tomorrow
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Insurer Caught With Its Pants On The Ground

Vermont Supreme Court Hits Insurer For Not Addressing Allocation Between Covered and Uncovered Claims

Binding Authority considered running a commercial during this year's Super Bowl. But it just didn't work out. First, there was some clause in Danica Patrick's contract with Go Daddy that prevented her from also serving as the Binding Authority Girl. It was unfortunate. She loved the script and was very disappointed. Plan B didn't fare any better. Man those Clydesdales don't work for cheap.

My favorite Super Bowl ads are the ones from small and unknown companies that have decided to use the game as a vehicle for attempting to break out nationally. There is high drama knowing that a company has taken a large portion of its budget, placed it on the pass line and is about to throw the dice. With so much hinging on 30 seconds, the message had better be important and memorable.

Last Thursday the Supreme Court of Vermont issued a decision that is analogous to such a situation (ok work with me here). Vermont's high court isn't known for issuing decisions in insurance coverage cases that garner a lot of attention or have wide-reaching implications. Whether maple syrup is a "pollutant" is an issue that just doesn't arise in many states. [Vermonters – you can send hate mail to the address above.] But last week the Supreme Court of Vermont issued an opinion addressing a significant coverage issue, that had not before been the subject of many decisions (especially at the supreme court level), and the court did so in clear and unmistakable terms. These are the ingredients for a decision that makes a statement and gets peoples' attention. This was the Supreme Court of Vermont's Super Bowl commercial moment.

At issue in *Pharmacists Mut. Ins. Co. v. Myer* was allocation between covered and uncovered claims. Consider this everyday scenario – an insurer is defending a case under a reservation of rights and has asserted various coverage defenses. When all is said and done, some of the damages or claims are very likely covered and others are very likely not covered. But what happens if the case proceeds to trial and there is a general verdict.

How can the insurer determine which portion of that general verdict is covered and which is not covered?

In other words, no matter how beautifully written your reservation of rights letter may be – explaining in the Queen's English that some damages or claims may be covered, while others are not -- the insurer may still need to take action to achieve that outcome. Reservation of rights letters are a first step toward allocation between covered and uncovered claims and damages. But in some states they are not the last. The Supreme Court of Vermont expressed this loud and clear in last week's decision in *Pharmacists Mut. Ins. Co. v. Myer*.

Myer involved coverage for defamation. While the facts and issues of the case were fairly detailed, it is not necessary to address the ins and outs to make the point here. Rather, consider that a jury rendered a $150,000 award against an insured for defamation, but, as the court put it, such award was "undifferentiated" and "did not distinguish between covered and uncovered conduct." *Myer* at 7. In general, coverage was owed for defamatory statements made negligently, but not for statements made with malice or intent.

Again, without getting into the details, the court concluded that the insurer, on remand, was entitled to attempt to prove that all of the statements made by the insured were of the excluded type. But the court then went one step further – asking "how – if at all -- to allocate the damage award in the event of a finding on remand that some of the defamatory statements were merely negligent and therefore within the policy coverage." *Id*.

The court posed this question because "[i]t is settled law in Vermont … that once an insured has demonstrated coverage under a policy, the burden falls on the insurer to show that a third party's claim against the insured is *entirely excluded* from coverage. Thus, it was, and remains, Pharmacists' burden to demonstrate that the award was based upon conduct entirely excluded from coverage, or to show how the jury allocated damages as between covered and uncovered conduct." *Id.* at 7-8 (citation and internal quotes omitted) (emphasis in original).

But the court concluded that such allocation could not be accomplished:

> In the absence of special interrogatories it is impossible, of course, to reliably allocate the defamation damages, <u>but the problem could—and should—have been avoided</u>. While Pharmacists did not control the litigation—having perceived a conflict and deferred to independent counsel—it nevertheless continued to monitor the *Cooper* trial through its "litigation specialist" and remained in regular contact with defense counsel. Indeed, Pharmacists remained the most informed party concerning coverage issues and the potential difficulties of parsing a general verdict as between covered and uncovered claims. Therefore, to protect its interests and meet its burden it was

> incumbent upon Pharmacists to notify the trial court and the parties of the potential apportionment issue and of the need for special interrogatories allocating damages, to seek permission if necessary to attend the charge conference to propose such interrogatories, or even to intervene in the litigation if all else failed.

Id. at 8. (emphasis added).

The court held that, because Pharmacists failed to seek an allocated verdict on the defamation award, it could not meet its burden to demonstrate that the award was for defamatory statements entirely excluded from coverage. Therefore, the court held that Pharmacists would remain responsible for the defamation award in its entirety in the event that **any** of the statements were ultimately found to fall within the policy coverage. *Id.* at 9.

In reaching this decision, the *Myer* court relied on, among others, the Pennsylvania Superior Court's decision in *Butterfield v. Giuntoli*, 670 A.2d 646 (Pa. Super. Ct. 1995). I was not surprised to see *Myer* rely on the Pennsylvania court's decision in *Butterfield*. It goes right to the heart of this issue and it is a decision that I discuss with clients regularly.

Butterfield involved coverage for punitive damages awarded in a medical malpractice action. Plaintiffs tried both direct and vicarious liability punitive damage claims against a hospital. The jury returned a punitive damages verdict against the hospital without specifying whether its finding was based on direct or vicarious liability theories. Under Pennsylvania law, public policy precludes insurance coverage for directly assessed punitive damage awards but permits it for policyholders who are found vicariously liable for a third party's punitive damages.

Noting that a representative of the insurer was present in the courtroom every day at trial, the *Burtterfield* Court held that the insurer was barred from litigating, in a subsequent coverage action, the question whether the punitive damages were direct or vicarious in origin:

> While in court, in chambers or through the defense attorneys handling the case, Lexington had the opportunity to request specific instructions on the question, specific interrogatories, or special verdict forms. Moreover, if necessary, Lexington had the option to intervene. Yet, Lexington did not pursue any means available to them at the outset of the trial, during the trial, or immediately following the verdict in order to definitively determine its duty to indemnify the [hospital].

Butterfield at 658. As a result, because the insurer could not meet its burden of proving that the claim was excluded, it was obligated to provide coverage for the punitive

damages (even though they may have been awarded on a "direct" basis – for which public policy would ordinarily preclude coverage).

As *Myer* makes clear, sending a reservation of rights letter, explaining that some damages or claims may be covered, while others are not, is, in some states, only a step toward achieving allocation between covered and uncovered claims and damages. Sometimes more must be done by an insurer to avoid being characterized, as in *Butterfield*, as one that sat on the sidelines and watched, aware of the covered vs. uncovered issue, but took no affirmative step to address it.

Allocation between covered and uncovered claims is an issue that our group handles often for clients, including through the use of Intervention. Intervention and covered vs. uncovered claims has been a topic at the Coverage College, Gale presented on it not long ago at an industry seminar, I addressed it at a client seminar a couple of weeks back and it was also the subject of one of the decisions in the 2009 Top 10 Cases article. We've been talking about this issue a lot. *Pharmacists Mut. Ins. Co. v. Myer* is certainly not going to change that.

A copy of the Supreme Court of Vermont's February 4, 2010 decision in *Pharmacists Mut. Ins. Co. v. Myer* can be accessed here:

http://info.libraries.vermont.gov/supct/current/op2008-405.html

Please let me know if you have any questions.

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