

Insurance

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Commentary

Global Warning: Virginia Trial Lawyers Association Predicts The End Of Liability Insurance Following *AES v. Steadfast Insurance Company*

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[Editor's Note: © 2012 by the Author. Randy J. Maniloff is a Partner in the Business Insurance Practice Group at White and Williams, LLP in Philadelphia. He concentrates his practice in the representation of insurers in coverage disputes over various types of claims. Maniloff writes frequently on insurance coverage topics for a variety of industry publications (including, for the past eleven years, a review for Mealey's Litigation Report: Insurance of the year's ten most significant insurance coverage decisions). Maniloff's views on coverage issues have been quoted by numerous media including The Wall Street Journal, The New York Times, USA Today, Associated Press and Dow Jones Newswires. This month Maniloff published the 2nd Edition of "General Liability Insurance Coverage: Key Issues In Every State," a book that addresses the law in all 50 states, and the District of Columbia, on twenty-one key liability insurance coverage issues (Oxford University Press) (co-authored with Professor Jeffrey Stempel of the University of Nevada Las Vegas Boyd School of Law). The views expressed herein are solely those of the author and not necessarily those of White and Williams or its clients. Responses are welcome.]

In the debate surrounding global warming, positions are often expressed in all-or-nothing terms. For some, global warming is Manhattan under 20 feet of water, as portrayed in Al Gore's movie on the subject. And then there is Oklahoma Senator James Inhofe, who has described global warming as "the greatest hoax ever perpetrated on the American people." Global

warming is not known for bringing out peoples' ambivalent sides.

So it should come as no surprise that, in the debate over the availability of insurance coverage for damages allegedly caused by global warming, an extremist view has likewise emerged – that of a plaintiffs' bar interest group. In September 2011, in *The AES Corporation v. Steadfast Insurance Company*, the Supreme Court of Virginia held that The AES Corporation, a power company, was not entitled to a defense, under general liability policies, for property damage allegedly caused by its release of greenhouse gases. In response, the Virginia Trial Lawyers Association characterized the court's decision as one that, if allowed to stand, "likely wipes out liability coverage for most negligence-based claims."

The Supreme Court of Virginia recently granted AES's petition for rehearing. The VTLA supported AES's effort to secure rehearing by filing an *amicus curiae* brief. Riding shotgun, the VTLA wrote that the Supreme Court's decision will render liability insurance "largely useless." Ironically, the VTLA responded to a decision about the emission of carbon dioxide by, well, hyperventilating. While the issue before the Virginia top court during February's rehearing will be AES's specific claim for coverage from Steadfast, it seems conceivable that the VTLA's doomsday scenario may also be on some of the justices' minds.

Despite the VTLA's warnings, the *AES* Court reached its decision in a manner that is entirely consistent with how many states address the duty to defend. And in such states, liability insurance is alive and well — having been neither *wiped out* nor rendered *largely useless*. The inconvenient truth for the VTLA is that the *AES* Court determined an insurer's duty to defend by properly rejecting an approach that plaintiffs and policyholders would prefer to exploit, namely, one that minimizes the court's role in the process. Instead, the court concluded that plaintiffs and policyholders need adult supervision. The opinion also reaffirmed the judiciary's role when determining insurance coverage.

Simply put, while there is a lot of debate in scientific circles over what happens when greenhouse gases are released into the atmosphere, the impact of the Supreme Court of Virginia's decision in *AES* is not uncertain — the atmosphere is not falling on insureds. Although Virginia's Justices have agreed to rehear *AES v. Steadfast*, the Supreme Court should reach the same conclusion.

Background: The AES Corporation v. Steadfast Insurance Company

In *AES Corp. v. Steadfast Ins. Co.*, 715 S.E.2d 28 (Va. 2011), the Supreme Court of Virginia held that a lawsuit against an insured, for property damage allegedly caused by its release of greenhouse gases, did not allege an "occurrence" to implicate general liability coverage. The issue arose as follows.

The Native Village of Kivalina and City of Kivalina ("Kivalina"), a native community located approximately seventy miles north of the Arctic Circle on the tip of a small Alaskan barrier reef, commenced a lawsuit against the insured, AES Corporation, and numerous other defendants, for damages allegedly caused by global warming stemming from emissions of greenhouse gases. *AES* at 30. In the lawsuit, Kivalina alleged that AES engaged in energy-generating activities through the use of fossil fuels that emit carbon dioxide and other greenhouse gases, and that such emissions contributed to global warming, "causing land-fast sea ice protecting the village's shoreline to form later or melt earlier in the annual cycle." *Id.* The melting ice allegedly exposed the shoreline to storm surges, resulting in erosion of the shoreline and rendering the village uninhabitable. *Id.*

Kivalina's complaint alleged that AES acted intentionally and "knew or should have known" the

consequences of its greenhouse gas-emitting actions. The complaint specifically alleged that AES "*intentionally* emits millions of tons of carbon dioxide and other greenhouse gases into the atmosphere annually." *Id.* (emphasis in original). The complaint further alleged that AES "*knew or should have known* of the impacts of [its] emissions' of carbon dioxide, but that '[d]espite this knowledge' of the 'impacts of [its] emissions on global warming and on particularly vulnerable communities such as coastal Alaskan villages,' AES 'continued [its] substantial contributions to global warming.'" *Id.* (emphasis in original).

Kivalina dedicated sixteen pages and sixty-six paragraphs to explain global warming, including the claim that there is "a clear scientific consensus that global warming is caused by emissions of greenhouse gases, primarily carbon dioxide from fossil fuel combustion and methane releases from fossil fuel harvesting." *Id.* at 30-31. The complaint stated three causes of action: two for nuisance and one for concert of action. *Id.* at 31.

AES sought defense and indemnity coverage from Steadfast Insurance Company under certain general liability policies. *Id.* at 30. Steadfast provided AES with a defense under a reservation of rights and filed a declaratory judgment action. *Id.* In the coverage action, Steadfast argued that, for three reasons, it did not owe defense or indemnity to AES for damages allegedly caused by AES's contribution to global warming: (1) the complaint did not allege "property damage" caused by an "occurrence"; (2) any alleged injury arose prior to the inception of the Steadfast policy; and (3) the claims alleged in the complaint fell within the scope of the pollution exclusion. *Id.* at 30. AES and Steadfast cross-moved for summary judgment. The Virginia Circuit Court ruled in favor of Steadfast, holding that the complaint did not allege an "occurrence," as required by the insuring policies' agreements. *Id.* The Supreme Court of Virginia affirmed.

The Supreme Court of Virginia commenced its analysis by laying out the ground rule that would govern its decision: "only the allegations in the complaint and the provisions of the insurance policy are to be considered in deciding whether there is a duty on the part of the insurer to defend and indemnify the insured." *Id.* at 31-32 (citations omitted). This is known as the "eight corners" rule. *Id.*

The court observed that the terms “occurrence” and “accident” are “synonymous and . . . refer to an incident that was unexpected from the viewpoint of the insured.” *Id.* at 32 (quoting *Utica Mut. Ins. Co. v. Travelers Indem. Co.*, 286 S.E.2d 225, 225 (Va. 1982)). “We have held that an ‘accident’ is commonly understood to mean ‘an event which creates an effect which is not the natural or probable consequence of the means employed and is not intended, designed, or reasonably anticipated.’” *Id.* (quoting *Lynchburg Foundry Co. v. Irvin*, 16 S.E.2d 646, 648 (Va. 1941)).

Here, the court noted that Kivalina alleged that AES intentionally released carbon dioxide and greenhouse gases as part of its electricity-generating operations. *Id.* An intentional act cannot be deemed an accident or “occurrence”; nor can “the natural and probable consequences of an insured’s intentional act.” *Id.*

AES argued it was entitled to a defense because the complaint alleged negligence, namely, that because “AES ‘knew or should know’ that its activities in generating electricity would result in the environmental harm suffered by Kivalina, Kivalina alleges, at least in the alternative, that the consequences of AES’s intentional carbon dioxide and greenhouse gas emissions were unintended.” *Id.* at 33 (emphasis in original).

The Supreme Court of Virginia rejected the argument:

In the Complaint, Kivalina plainly alleges that AES intentionally released carbon dioxide into the atmosphere as a regular part of its energy-producing activities. Kivalina also alleges that there is a clear scientific consensus that the natural and probable consequence of such emissions is global warming and damages such as Kivalina suffered. Whether or not AES’s intentional act constitutes negligence, the natural and probable consequence of that intentional act is not an accident under Virginia law.

Id. “Even if AES were actually ignorant of the effect of its actions and/or did not intend for such damages to occur, Kivalina alleges its damages were the natural and probable consequence of AES’s intentional actions. Therefore, Kivalina does not allege that its property damage was the result of a fortuitous event or accident,

and such loss is not covered under the relevant CGL policies.” *Id.* at 34.

The AES Corporation v. Steadfast Insurance Company: The Petition For Rehearing

In October 2011 AES filed a petition for rehearing. The crux of its argument was that the court erred by holding that there is no “occurrence” or “accident,” and, thus, no duty to defend, under a commercial general liability policy, when “a complaint alleges that a defendant ‘should have known’ its conduct would cause the alleged harm – *i.e.*, when it knows that the harm was reasonably foreseeable.” The AES Corp.’s Petition for Rehearing at 1, *The AES Corp. v. Steadfast Ins. Co.*, No. 10-0764 (Va. Oct. 17, 2011). AES argued that none of the authorities relied upon by the court supported excusing an insurer’s duty to defend based solely on an allegation that the insured “should have known” its conduct would cause the alleged harm. *Id.* Instead, according to AES, all of the authorities hold “that the duty to defend is excused only when the complaint alleges a defendant ‘should have known to a substantial probability’ that its conduct would cause the alleged harm.” *Id.* (emphasis in original).

AES described the consequences of the Supreme Court’s decision as follows:

This Court’s opinion departs from precedent and basic principles of insurance law by treating allegations that a defendant “should have known” (*i.e.*, foreseen) a particular harm as equivalent to allegations that the insured should have known to a substantial probability that the insured’s acts would cause the harm. The opinion thus collapses the ordinary negligence standard into the intentional act standard. If allowed to stand, it will eliminate insurance coverage in most cases. Insureds and plaintiffs alike will suffer, because they will be unable to depend on insurers to provide a defense or coverage in most tort cases.

Id. at 9-10.

The Virginia Trial Lawyers Association filed an *amicus curiae* brief in support of AES’s petition for rehearing. The VTLA’s brief took direct aim at the Supreme Court’s statement: “When the insured knows or *should have known* of the consequences of his actions, there is

no occurrence [or accident] and therefore no coverage.” Virginia Trial Lawyers Ass’n as *Amicus Curiae* Supporting The AES Corp.’s Petition for Rehearing at 3, *The AES Corp. v. Steadfast Ins. Co.*, No. 10-0764, (Va. Oct. 17, 2011), quoting *The AES Corporation v. Steadfast Insurance Company*, 715 S.E.2d at 33 (italics in opinion; alteration in motion).

The VTLA went on to provide examples of the use of “should have known” foreseeability in various types of tort scenarios, such as premises liability, product liability, entrustment and negligence cases generally. *Id.* at 4-5. Following this discussion, the VTLA concluded:

Precisely because the “should have known” allegation in its various forms is an essential element of tort liability in Virginia, it currently appears in thousands of complaints pending throughout the state and federal courts in the Commonwealth. VTLA asks that the Court reaffirm in explicit terms that the “should have known” allegation of foreseeability has not abruptly ousted all of those defendants of the benefit of their insurance policies. VTLA respectfully requests that the Court eliminate from its opinion any suggestion that all of the defendants in all of those cases are suddenly and completely exposed.

Id. at 6.

The VTLA warned that, unless the Virginia Supreme Court so acts, its current opinion “risks foreclosing coverage for many if not all negligence-based torts in Virginia, rendering liability insurance largely useless.” *Id.* at 1. Indeed, the VTLA went so far as to say that “[t]he court’s opinion as currently written likely wipes out liability coverage for most negligence-based claims.” *Id.* at 3 (capitalization altered).

The Role Of The “Eight Corners” Rule In AES v. Steadfast

The logical place to begin addressing the Virginia Supreme Court’s decision in *AES v. Steadfast* is the point on which both AES and Steadfast agreed:

[I]t is a well-established principle, consistently applied in this Commonwealth, that only the allegations in the complaint and

the provisions of the insurance policy are to be considered in deciding whether there is a duty on the part of the insurer to defend and indemnify the insured. This principle is commonly known as the ‘eight corners rule’ because the determination is made by comparing the ‘four corners’ of the underlying complaint with the ‘four corners’ of the policy, to determine whether the allegations in the underlying complaint come within the coverage provided by the policy.

AES v. Steadfast at 31-32 (numerous citations omitted).

Relying on the “eight corners rule,” AES argued that, because the complaint alleged that it “knew or should know” that its activities in generating electricity would result in the environmental harm suffered by Kivalina, the complaint therefore alleged, at least in the alternative, that the consequences of AES’s intentional carbon dioxide and greenhouse gas emissions were unintended, and, therefore, accidental, *i.e.*, within the definition of an “occurrence.” *Id.* at 33.

This is the ageless duty to defend argument, routinely put forth by insureds in “eight corners” states (or “four corners” states, as the same rule is more commonly named). So the argument goes, for purposes of determining if a defense is owed, the allegations in the complaint are all that matter. And such allegations must be examined by the insurer wearing blinders, oblivious to anything but the written words in the complaint, and without ascribing any meaning to them. In doing so, as long as the allegations state a claim that, if proved, is within the coverage of the policy, a defense is owed. The process as described is so rote that there could be an app for it.

The urging of such a straight-jacketed rule can have dramatic consequences. In drafting its complaint, the plaintiff’s attorney likely wants the defendant to be covered under a liability policy. The reasons are obvious. The path of least resistance for a plaintiff to collect money from a defendant is usually the defendant’s insurance company and not the defendant itself. In addition, a plaintiff, especially one with a weak case, may be able to use the fact that the defendant’s insurer is anxious to turn off defense counsel’s meter as a rationale for reaching a settlement.

Thus, the incentive for a plaintiff, to draft a complaint that will trigger a duty to defend on the part of the defendant's insurer, is significant. And even if the plaintiff's counsel does not have a copy of the defendant's liability policy at the time he is drafting the complaint, he surely knows enough that it very likely provides coverage for an "accident." Thus, the plaintiff is likely to allege that the defendant, whatever it did to cause the plaintiff's injury, *should have known* of the consequence of his actions. The plaintiff's attorney's arithmetic is simple: a "should have known" allegation in the complaint, plus an "eight corners" rule, that strictly limits review to the allegations in such complaint, equals a duty to defend – and its concomitant benefits.

Since the plaintiff alone controls the allegations in his complaint, he can plead that the defendant "should have known" of the consequence of his actions — no matter what those actions are alleged to be. Take a defendant that commits an execution style murder — it can be plead that he *should have known* what that would do to the plaintiff. A defendant coldcocks the plaintiff in the face — he should have known the problems that would cause. Defendant is an arsonist — he should have known of the dangers of fire.

That plaintiff's attorneys plead complaints, with the goal in mind of triggering a duty to defend, is hardly a secret buried deep in the bowels of Langley. See *L.C.S., Inc. v. Lexington Ins. Co.*, 853 A.2d 974, 980 (N.J. Super. Ct. App. Div. 2004) (recognizing that plaintiff's plead "bogus" allegations in complaints that are "designed only to reach the pot of gold at the end of the rainbow" — a general liability policy). What's more, any argument by an insurer that, say, a negligently committed execution style murder is nonsensical, will undoubtedly be met with the long-standing maxim that an insurer has a duty to defend a complaint even if it is groundless, false or fraudulent.

Thus, barring application of another policy defense, such as an exclusion, the "eight corners" test, applied in this strict manner, gives plaintiff's counsel an ability to essentially trigger a duty to defend in every tort action. But the *AES* Court didn't seem to get that memo. The court did not spot the words "should have known" in the complaint and then mechanically ring the duty to defend bell — the Pavlovian response that plaintiffs and policyholders believe to be appropriate.

This consequence of the decision was not lost on *AES*'s counsel. Writing in his blog, "Virginia Appellate News & Analysis," L. Steven Emmert described the affect of *AES* like this:

Make no mistake — this ruling will work a fundamental change in the way tort claims are pleaded in Virginia. In the past, plaintiff's lawyers, careful to avoid jeopardizing insurance coverage by pleading intentional torts, have included at least one negligence-based claim, so the insurer can't strand the tort defendant. Such claims typically included the very same [as in *AES*] "or should have known" language, in order to state that negligence claim.

As of today, that won't be good enough to keep an insurer in the case, and a good many tort defendants are going to find themselves going into court without coverage. Inevitably, some defendants may seek bankruptcy protection from at least the negligence-based claims (liability for intentional torts can't be discharged in bankruptcy). Most likely, it will sharply curtail allegations of intentional torts, even as alternative counts, in tort suits; smart plaintiff's lawyers just won't take the chance of jeopardizing coverage and leaving their plaintiffs with no meaningful way to collect on a judgment.

http://www.virginia-appeals.com/scv_opinion.aspx?id=396.

But notwithstanding the "should have known" allegations that were contained within the confines of the pages of the underlying *Kivalina* complaint, and the *AES* Court's admitted obligation to follow the "eight corners" rule, the court did not err by concluding that the complaint did not allege an "occurrence," thereby relieving Steadfast of a duty to defend.

The "Eight Corners" Rule And Judicial Response To The "Artfully Drafted" Complaint

It is likely that the rehearing before the Supreme Court of Virginia in *AES* will center around the question "what is an 'accident,'" which is the term at the heart of the question "what is an 'occurrence'" under a general liability policy. Such a discussion can get very technical

and even esoteric. Consider that AES is arguing the distinction between allegations that the insured "should have known" its conduct would cause the alleged harm versus "should have known to a substantial probability" that its conduct would cause the alleged harm.

Notwithstanding such complexities, the Virginia Supreme Court's approach to the duty to defend was clear. Moreover, such approach is followed in several states. And, most importantly, those states have not seen liability insurance "wiped out" nor rendered "largely useless." Yes, Virginia, there really will be liability insurance, even after *AES v. Steadfast* remains unchanged. But while the VTLA need not worry about an apocalypse, its ability to be both player and referee suffered a setback.

As discussed above, applied strictly, the "eight corners" test gives plaintiff's counsel, as the sole drafter of the complaint, tremendous control over whether an insurer will owe the defendant a duty to defend. And with the plaintiff having so much to gain by triggering a duty to defend, it is the proverbial fox guarding the hen house situation. Courts in "four corners" and "eight corners" states are keenly aware of this potential for abuse by plaintiffs. They resolve it by looking beyond the "labels" that are attached to the complaint allegations and focus on the nature of the defendant's actions. See *Erie Ins. Exchange v. Muff*, 851 A.2d 919, 931 (Pa. Super. Ct. 2004) ("We are mindful of the danger that an artfully-drafted pleading may attempt to circumvent the 'expected or intended' personal injury limitation on a homeowner's insurance policy by 'liberally sprinkling' the word negligence throughout the complaint. Consequently, the courts of this Commonwealth have put an emphasis on the actual factual averments contained in the underlying complaint.") (citations omitted). Applied robotically, the "four corners" or "eight corners" test allows plaintiffs to game the duty to defend system. Many courts have refused to countenance such conduct.

For example, in *Erie Insurance Exchange v. Fidler*, 808 A.2d 587 (Pa. Super. Ct. 2002), the Pennsylvania Superior Court addressed coverage for Matthew Fidler against allegations in a complaint that he "threw the minor Plaintiff, Merrill Tracy Denslow, IV, with such great force that the Plaintiff's head struck the wall and a desk causing him to fall unconscious to the floor." *Fidler* at 589. The complaint further alleged that Fidler "failed to act with due and reasonable care and in an appropriate manner under the circumstances and acted

negligently and without consideration of and/or knowledge of the consequences of his actions without desiring and knowing that such consequences were substantially certain to result from his actions." *Id.*

Erie Insurance denied that it owed either defense or indemnity to the Fidlers, under their homeowners policy, based on an exclusion for bodily injury "expected or intended by anyone we protect." *Id.*

The Pennsylvania Superior Court acknowledged that the obligation of an insurer to defend an action against the insured is fixed solely by the allegations in the underlying complaint. *Id.* at 590. In other words, Erie's obligation to defend would be determined based on a "four corners" standard.

The *Fidler* Court noted that the amended complaint in the underlying lawsuit did not expressly state that Fidler "expected or intended" the resulting injuries, and, in fact, it referred to the incident as "negligence." *Id.* However, despite the fact that the complaint, based solely on the allegations contained therein, surely triggered a defense, the court held otherwise:

However, the particular cause of action that a complainant pleads is not determinative of whether coverage has been triggered. Instead it is necessary to look at the factual allegations contained in the complaint. *Mutual Benefit Ins. Co. v. Haver*, 555 Pa. 534, 725 A.2d 743, 745 (1999). If we were to allow the manner in which the complainant frames the request for damages to control the coverage question, we would permit insureds to circumvent exclusions that are clearly part of the policy of insurance. See *id.* (allowing the language of the complaint alone to control coverage questions would "encourage litigation through the use of artful pleadings designed to avoid exclusions"). The insured would receive coverage neither party intended and for which the insured was not charged. The fact that the Denslows couched their claims in terms of negligence does not control the question of coverage.

Id. See also *Prudential Prop. & Cas. Ins. v. Bryan*, No. 0621 May Term 2004, 2005 Phila. Ct. Com. Pl.

LEXIS 23 (Phila. Ct. Com. Pl. Mar. 4, 2005), *aff'd* 889 A.2d 124 (Pa. Super. Ct. 2005) (Table) (“If the factual allegations of the complaint sound in intentional tort, arbitrary use of the word negligence will not trigger an insurer’s duty to defend.”) (holding no duty to defend a complaint that alleged a pattern of harassment consisting of physical assault, verbal and physical threats and shooting and pointing of a BB gun, despite the inclusion in the complaint of negligence allegations).

Another example of a court concluding that “negligence” does not always mean “negligence” is *Collins Holding Corporation v. Wausau Underwriters Insurance Company*, 666 S.E.2d 897 (S.C. 2008). Here the Supreme Court of South Carolina addressed coverage for Collins Holding, an owner, operator and distributor of amusement devices and gambling machines, for an underlying action alleging that the company systematically violated South Carolina laws specifically enacted to protect the public from excessive gambling losses. *Collins Holding* at 898.

The Supreme Court held that the insurer did not breach its duty to defend Collins Holding in the underlying action because the plaintiffs’ complaint did not allege the possibility of an “occurrence” under a general liability policy. *Id.* at 899.

The court reached its decision, that there had been no breach of the duty to defend, on the basis that the underlying plaintiffs asserted that Collins Holding exceeded the maximum daily payout limit of \$125 and engaged in advertising schemes which fraudulently induced the plaintiffs to believe that they could win jackpots in excess of the \$125 limit. *Id.* The court also looked to the fact that the plaintiffs employed words and phrases such as: “unlawfully and fraudulently seek to induce and entice;” “engaged in advertising about and offering inducements . . . that are clearly and expressly prohibited by South Carolina law;” “racketeering activity;” “conspiring;” “knowingly engaging;” and “knowingly conducting.” *Id.* The court concluded that “[t]hese allegations constitute intentional, deliberate, and illegal acts executed with the purpose of addicting patrons to gambling machines, and in our view, such alleged conduct cannot be construed as accidental in nature.” *Id.*

Most notable, however, was this aspect of the *Collins Holding* Court’s decision: while the South Carolina

high court acknowledged that it was bound by a duty to defend test that was based solely on the allegations in the complaint, *i.e.*, four or eight corners, it rejected the lower court’s decision that a defense was owed on the basis of a “negligent misrepresentation” cause of action. *Id.* at 900. Notwithstanding that the underlying action included a cause of action for negligent misrepresentation, the court concluded that it “must look beyond the label of negligence to determine if Insurance Company had a duty to defend Collins.” *Id.* (citing *Manufacturers and Merchants Mut. Ins. Co. v. Harvey*, 498 S.E.2d 222, 228 (S.C. Ct. App. 1998) and characterizing it as holding “where a complaint mischaracterizes intentional conduct as negligent conduct, a court may find no duty to defend despite the label of negligence in the complaint”).

Examining the allegations in the complaint against the insured – that it “sold, leased, and distributed machines that were equipped in a manner ‘as to permit manipulation’ and that were configured to be used in a manner that violated laws expressly designed to protect the public from the lure of excessive gambling” – the *Collins Holding* Court held that “these allegations do not support a claim for negligent conduct.” *Id.*

In *Heim v. City of West Allis*, 522 N.W.2d 37 (Wis. Ct. App. 1994), the Court of Appeals of Wisconsin addressed coverage for an action filed against an employee of a city’s housing and rental assistance program who directed sexually inappropriate comments and exposed himself to a citizen seeking to use the program’s services. *Heim* at *1. The liability insurer for the Housing Authority declined to defend Williams, the employee. *Id.* While Williams acknowledged that the policy did not provide coverage for intentional acts, he argued that the complaint did not allege that his actions had been intentional. *Id.*

Addressing whether the insurer breached its duty to defend, the Wisconsin appeals court first noted that the test for determining an insurer’s defense obligation is “four corners.” *Id.* at *2. The court then rejected Williams’s argument that the complaint alleged negligent conduct. While noting that the complaint used words that sounded in negligence, the *Heim* Court concluded that “the acts alleged are without question intentional and the damages were therefore ‘expected or intended from the standpoint of the insured.’” *Id.* at *3, n.1. Notwithstanding that its decision was controlled

by the “four corners” rule, the court agreed with the insurer that “courts are not bound by the terms used in the complaint, but must look at the actual allegations to determine the nature of the claims asserted.” *Id.*

In *W. Va. Fire & Cas. Co. v. Stanley*, 602 S.E.2d 483 (W. Va. 2004), West Virginia’s highest court upheld a decision that an insurer had no duty to defend its insured under the following circumstances. Cass-Sandra Stanley filed a complaint alleging that she was sexually abused and exploited by her uncle, Jesse Stanley, for several years. She also alleged that such abuse took place with the full knowledge of her grandparents, Glen and Helen Stanley, who intentionally failed to disclose the acts to Cass-Sandra’s parents or law enforcement authorities. *Stanley* at 487. West Virginia Fire & Casualty Company filed a declaratory judgment action seeking a determination that it had no duty to defend or indemnify Jesse, Glen or Helen under a homeowner’s policy issued to Glen and Helen Stanley. *Id.* at 488.

At issue was the applicability of the policy’s intentional acts exclusion. The court noted that its consideration of the insurer’s duty to defend was limited to the allegations in the complaint. *Id.* at 490. “[I]n order to determine whether there is coverage under the policy at issue, we look to the claims set forth in the underlying complaint to see if they, without amendment, may impose liability for risks not precluded by the intentional acts exclusion.” *Id.* at 494.

Notwithstanding that the court concluded that intent to injure was inferred to Jesse Stanley, it also concluded that, based on the nature of the allegations, the intentional acts exclusion applied. Notably, it reached this decision notwithstanding the existence of negligence allegations:

We believe that the complaint against Jesse Stanley is at its essence a sexual abuse claim in which intentional and intentionally harmful conduct are the primary allegations. In the “General Allegations” portion of the complaint, it is alleged that Jesse Stanley “sexually abused and sexually exploited” Cass-Sandra Stanley against her will for a period of approximately nine years. In her deposition, Cass-Sandra Stanley describes forced and painful vaginal and anal sexual intercourse

perpetrated against her by Jesse Stanley during which she screamed, kicked, and cried. Further, as discussed above, the complaint, in several separate counts, alleges intentional torts against Jesse Stanley, almost all of which aver that Jesse Stanley’s conduct was “malicious.” In light of these facts, we believe it is clear that the gravamen of Cass-Sandra and Sandra Stanley’s complaint is that Jesse Stanley intentionally sexually abused and sexually exploited Cass-Sandra Stanley, and that he intended, or at least expected, bodily injury to result. Accordingly, we conclude that any alleged negligent acts against Jesse Stanley are precluded by the intentional acts exclusion.

Id. at 496.

The *Stanley* Court even went so far as to conclude that the “negligent supervision” claims against Glen and Helen Stanley in fact alleged intentional conduct:

Although the word “negligent” is used in their allegations against Glen and Helen Stanley, intentional conduct is actually described. For example, the complaint alleges that Glen and Helen Stanley had *actual* knowledge that Jesse possessed deviant sexual propensities and was a continuing danger to Cass-Sandra, but that they *permitted* him to continually sexually abuse and sexually exploit Cass-Sandra throughout her childhood years. Further, the conduct of Glen and Helen Stanley is characterized as willful, wanton, reckless, outrageous, intentional, and malicious.

Id. at 497 (emphasis in original).

And Virginia is no stranger to following this approach when determining an insurer’s duty to defend a faux-negligence complaint. In *Markel American Ins. Co. v. Staples*, No. 3:09-cv-435, 2010 U.S. Dist. LEXIS 7148 (E.D. Va. Jan. 28, 2010), a Virginia federal court addressed an insurer’s duty to defend a complaint filed against an insured for injuries he allegedly caused in a physical struggle. The insurers argued that no coverage was owed because, among other reasons, the injuries alleged in the complaint were the result of intentional

acts. *Staples* at *3-4. The court was clear that Virginia applies the “eight corners” rule for purposes of determining an insurer’s duty to defend. *Id.* at *6. Seizing on this, the underlying plaintiff and insureds pointed to the frequent use in the complaint of the adverb “negligently” to establish the existence of an “occurrence” and defeat the intentional acts exclusion. *Id.* at *8.

The *Staples* Court looked nationally at courts that have been required to address whether a mere allegation of negligence in a complaint is sufficient to overcome an intentional acts exclusion. Following this survey of the issue, the court held:

Of the courts that have confronted this issue, the most persuasive authority leads to the conclusion that the mere presence of a negligence claim is insufficient to end-run an intentional acts exclusion. Instead, a reviewing court should examine the facts of the underlying complaint and the nature of the claim. The Netherland complaint alleges various causes of action, but they all stem from a singular series of intentional and illegal acts by Staples. The factual allegations in the Netherland complaint recount a malicious and unprovoked attack that can only be characterized as intentional and purposeful. Netherland’s conclusory allegations of negligent threats, negligent false imprisonment, and negligent infliction of emotional distress have no transformative effect. The Court finds that all claims in the Netherland complaint are excluded from insurance coverage under both the Markel and USAA policies based on the policies’ intentional acts exclusions.

Id. at *12-13. “Simply attaching a negligence claim to a suit will not automatically bring an otherwise intentional act within the scope of coverage. Coverage decisions turn on a careful review of all factual allegations, not simply the scrivener’s characterizations.” *Id.* at *15 (citation omitted).

The Virginia Supreme Court’s Decision In *AES v. Steadfast* Was Correct And Reached In A Manner Consistent With Many States’ Duty To Defend Principles

As the aforementioned decisions, from a host of jurisdictions, including Virginia, clearly demonstrate, while

the “four corners” or “eight corners” test, for determining an insurer’s duty to defend, does not allow consideration of certain things, judicial common sense is not one of them. In each of these cases, the courts could have cited the “four corners” or “eight corners” rule, pointed to the allegation of negligent conduct, and concluded, *viola*, that the complaint alleged an “accident” or that an intentional-based exclusion did not apply. But they didn’t. Instead they looked beyond the labels and at the nature or gravamen of the allegations to determine if a defense were owed.

This was the approach followed by the Supreme Court of Virginia in *AES v. Steadfast*, even if the court did not specifically describe it as such, and even if the facts differ from the more typical case involving an intentional assault of some type that is pleaded as “negligent.”

The *AES* Court described the “dispositive issue” in determining whether an accidental injury occurred as “whether *the resulting harm* is alleged to have been a reasonably anticipated consequence of the insured’s intentional act.” *AES* at 32-33 (emphasis in original). “Thus, resolution of the issue of whether Kivalina’s Complaint alleges an occurrence covered by the policies turns on whether the Complaint can be construed as alleging that Kivalina’s injuries, at least in the alternative, resulted from unforeseen consequences that a reasonable person would not have expected to result from AES’s deliberate act of emitting carbon dioxide and greenhouse gases.” *Id.* at 33.

This was AES’s “eight corners” opportunity. It argued that, because the complaint alleged that it “knew *or should know*” that its activities in generating electricity would result in the environmental harm suffered by Kivalina, then the complaint contained an allegation that the consequences of AES’s intentional carbon dioxide and greenhouse gas emissions were unintended, and, therefore, accidental, *i.e.*, within the definition of an “occurrence.” *Id.* at 33.

While AES served up this “eight corners” pitch, which it no doubt considered to be a beach ball right over the plate, the Virginia Supreme Court did not swing:

[A]llegations of negligence are not synonymous with allegations of an accident, and, in this instance, the allegations of negligence do not support a claim of an accident. Even if AES were negligent and did not intend to

cause the damage that occurred, the *gravamen* of Kivalina's nuisance claim is that the damages it sustained were the natural and probable consequences of AES's intentional emissions.

Id. (emphasis added). As noted above, Kivalina alleged that there was a "clear scientific consensus that the natural and probable consequence of such emissions [carbon dioxide] is global warming and damages such as Kivalina suffered." *Id.*

AES v. Steadfast Did Not "Wipe Out" Liability Insurance In Virginia

While AES did not prevail, and should not on the reprise, the good news for plaintiffs and policyholders is that, despite the VTLA's dire warning, *AES v. Steadfast* is not the end of liability insurance in Virginia. It has not been *wiped out* nor rendered *largely useless*, just as it has not been in any state that has excused an insurer from being obligated to defend an action involving intentional conduct that was labeled as negligent.

Under a strict application of the "eight corners" rule, such as the one that AES's counsel advocates for in his blog, insurers would have an obligation to defend just about every tort action. Under the *AES* Court's approach, as far as the VTLA sees it, insurers will not have an obligation to defend any tort action. Surely these extreme positions can't be right. And that's because determining the duty to defend is not a mechanical process.

The Virginia high court should seize the opportunity to explain that, when it comes to determining the duty to defend, while plaintiff's counsel gets to write the story, courts are the ones that get to tell it. As a result, there are no automatic winners or losers when it comes to the duty to defend. When the Virginia Supreme Court adopted the "eight corners" rule for purposes of determining an insurer's duty to defend, it did not abdicate the role of courts in that process. They still serve the critical role of determining if a defense is owed, based not on the literal words of the complaint, but, rather, what they mean.

Lastly, while there has been much debate between AES and Steadfast over the "occurrence" issue, the pollution exclusion waits in the wings even if the Supreme Court of Virginia concludes that AES has cleared the hurdle of the policies' insuring agreements. While the applicability of the pollution exclusion was made moot by the Supreme Court's holding of no "occurrence," this is no small issue. Virginia law will unquestionably present challenges to AES to overcome the applicability of the pollution exclusion to the claims at issue in the *Kivalina* suit. With policyholders currently having a difficult time convincing Virginia courts that the pollution exclusion does not apply to claims for damages allegedly caused by Chinese drywall, a rough road surely lies ahead for a policyholder that allegedly "emits millions of tons of carbon dioxide and other greenhouse gases into the atmosphere annually." *AES*, 715 S.E.2d at 30. ■

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