ISSUE THIRTEEN – JUNE 2015

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Rhode Island: Insurers Must Pay $29,605,582.93 Judgment Against Insured Despite Multiple Exclusions

In November 2014, the United States District Court for the District of Rhode Island analyzed five specific exclusions in an insurance policy and determined that none of them barred an insured's claim for coverage of a $29,605,282.93 judgment rendered against it.

In *Lifespan Corporation v. National Union Fire Insurance Company of Pittsburgh, PA.*, 59 F. Supp.3d 427 (D.R.I. 2014) Lifespan Corporation ("Lifespan") filed suit seeking coverage under its insurance policies with the defendants for a $29,605,282.93 amended judgment against it following litigation between Lifespan, New England Medical Center, Inc. ("NEMC") and the Massachusetts Attorney General. The issue before the court was whether any of several exclusions in the policies applied to exclude the judgment from coverage. The court examined five exclusions: the unlawful advantage exclusion; the deliberate fraudulent act exclusion; the contractual liability exclusion; the securities exclusion; and the professional services exclusion.

The underlying action involved an affiliation agreement with NEMC, in which Lifespan had become NEMC's corporate partner. The Lifespan judgment resulted from breaches of fiduciary duties and gross negligence in connection with the negotiation of NEMC's health insurer contracts, an interest rate swap transaction, and NEMC's overall financial performance. Lifespan had a directors and officers policy from National Union and an excess policy with RLI Insurance Company. Lifespan sought coverage under these policies. The insurers denied coverage for the judgement rendered against Lifespan. Lifespan filed suit against the insurers.

In analyzing the coverage issues, the court focused on whether the defendant insurers met the burden imposed by Rhode Island law of proving the applicability of the policy exclusions on which they relied to deny coverage. The first exclusion invoked by the insurers was the "unlawful advantage exclusion". That provision excludes from coverage claims involving the unlawful "gaining of any profit or advantage" by the insured. The insurers asserted that the exclusion applied because Lifespan's chief financial officer was motivated by the hope that by entering into an interest swap with NEMC he would be invited to join an exclusive wine club. The court expressed doubt that membership in a wine club was the type of profit or advantage that the exclusion was intended to cover. In any case, said the court, the exclusion required the actual gaining of a profit or advantage. The chief financial officer's hope that he would be invited to join the wine club was insufficient to trigger the exclusion.

The insurers also claimed that the "deliberate fraudulent act exclusion" applied to bar coverage. The court disagreed, noting that the policy language expressly required that there be a "judgment" or "final adjudication" that the insured had committed a "deliberate fraudulent act". Since the judgment against Lifespan was for breach of fiduciary duty and indemnification, neither of which required fraud as an element, the judgment requirement was not satisfied.

In addition, the court reasoned that even if the chief financial officer had committed a deliberate fraudulent act, it could not be imputed to Lifespan. Specifically, an exception to the exclusion stated that "The Wrongful Act of an Insured shall not be imputed to any other Insured for the purpose of determining the applicability of exclusions." Ordinarily, the insured has the burden of establishing that such an exception to an exclusion applies. However, another endorsement created an ambiguity as to the application of the exception. Again following Rhode Island law, the court construed the ambiguous language against the insurers and ruled in favor of coverage.

Next, the court considered whether the "contractual liability exclusion" applied to bar coverage. The question was whether the judgment sustaining the Massachusetts Attorney General's claim for breach of fiduciary duty by Lifespan arose out of "contractual liability". The court determined that any and all contractual liability between NEMC and Lifespan was released in the restructuring agreement that was signed by

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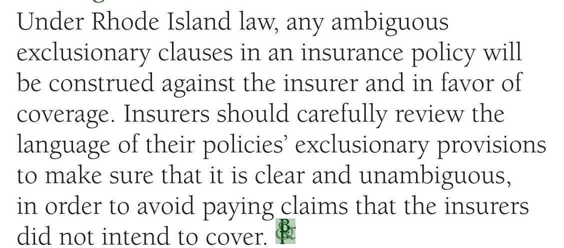
the parties prior to the underlying action, and since the Attorney General was not a party to the affiliation agreement, her claim for breach of fiduciary duty was not barred. Moreover, the Attorney General's claim arose from the special relationship of "faith, confidence and trust" that NEMC had with Lifespan, not from any contractual obligation

The insurers also argued that the claim was excluded by a "securities exclusion", which provided that the insurer was not liable for payment on any claims arising out of or relating to the purchase and sale of securities by the insured. Looking to the law of New York, which expressly controlled the rate swap agreement, the court found that the swap was not a security and the exclusion did not apply.

Lastly, the court examined the "professional services exclusion". That exclusion relieves the insurer of any obligation to pay a claim arising out of the insured's performance or failure to perform medical or other professional services. Lifespan argued that the exclusion had to be read in the context of the "Not-For-Profit Health Care Organization Amendatory Endorsement" in which it was contained, and interpreted to exclude only professional services involved in the actual provision of healthcare to others. The insurers, stressing the word "or" in the phrase, "medical or other professional services", argued that claims arising from all professional services were excluded. The court agreed with Lifespan that the exclusion had to be read in the context of the endorsement and the policy as a whole, and only excluded claims arising from Lifespan's health-care related professional services. In addition, the court found that the exclusion was ambiguous and therefore had to be construed against the insurers.

Looking Forward



Under Rhode Island law, any ambiguous exclusionary clauses in an insurance policy will be construed against the insurer and in favor of coverage. Insurers should carefully review the language of their policies' exclusionary provisions to make sure that it is clear and unambiguous, in order to avoid paying claims that the insurers did not intend to cover.

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Rhode Island: Insurer not Liable under Owner-Liability Statute for Injuries Sustained Outside of Motor Vehicle

The Rhode Island Supreme Court has determined that an auto insurance company can not be held liable under the automobile owner-liability statute, R.I.G.L. §31-33-6, for injuries sustained by a plaintiff when the driver exited his vehicle and punched the plaintiff, a pedestrian.

In *Hough v. McKiernan*, 108 A.3d 1030 (R.I. 2015), the plaintiff brought a negligence claim against defendants including Quincy Mutual Fire Insurance Co., the company that had insured the vehicle that was driven by defendant, McKiernan, at the time of the incident. The plaintiff alleged that he was walking along the road, and as McKiernan approached in his vehicle, McKiernan began yelling obscenities at him. McKiernan later stopped his vehicle at least two car lengths away from the plaintiff, jumped out of his vehicle, and punched the plaintiff, who fell backwards and hit his head on the pavement, sustaining severe injuries.

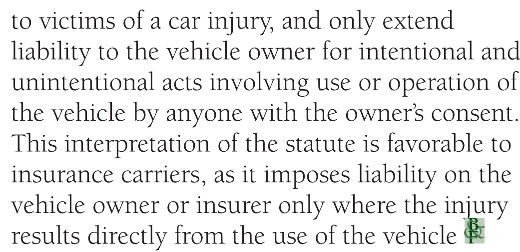
The plaintiff argued that there was a sufficient connection between his injuries and the insured vehicle to warrant the application of G.L. §31-33-6, the "Owner-Liability Statute" and to impose liability on the insurance carrier. The statute imposes vicarious liability on the owner of a vehicle for the acts of anyone who uses the vehicle with his permission. Here, the owner's automobile insurer, Quincy Mutual, was substituted as a defendant after his death.

Examining G.L. §31-33-6, the court indicated that the statute allows recovery only by someone who was the "victim of a car injury". In order to recover, the plaintiff had to show a causal relationship between the use of the vehicle and the injuries he sustained. The court found that he failed to do so. The plaintiff's injuries resulted directly from McKiernan's punch. He was not struck by the insured's vehicle, and neither he nor McKiernan was in the vehicle at the time of the

incident. Thus, the court concluded, there was no causal relationship between McKiernan's use of the vehicle and the injuries sustained by the plaintiff, even though McKiernan had circled the plaintiff in his vehicle, and had used the vehicle to drive to and from the scene of the incident.

Looking Forward

The Rhode Island courts will likely continue to interpret G.L. §31-33-6 to apply exclusively to victims of a car injury, and only extend liability to the vehicle owner for intentional and unintentional acts involving use or operation of the vehicle by anyone with the owner's consent. This interpretation of the statute is favorable to insurance carriers, as it imposes liability on the vehicle owner or insurer only where the injury results directly from the use of the vehicle



Maine states exception to "death knell" rule for appeals

Maine generally recognizes an exception to the final judgment rule, permitting immediate appeals of interlocutory orders regarding claims premised on an insurer's refusal to defend a lawsuit against its insured. A decision that an insurer does not have a duty to defend its insured is ordinarily immediately appealable under the "death knell" exception to the final judgment rule, on the theory that losing an insurer-provided defense during litigation may sound a "death knell" for the insured's defense. Courts recognize that a substantial right of a party will be irreparably lost if review of such a ruling is delayed until final judgment.

However, in *Irving Oil Limited v. ACE INA Insurance*, 91 A.3d 594 (Me. 2014), the Supreme Judicial Court of Maine dismissed interlocutory cross-appeals filed by the insured and its insurer, reasoning that the death knell exception does not apply where the underlying lawsuits against the insured have been settled.

In 2009, Irving Oil Limited filed a complaint asking for a declaration that its insurer had a duty to defend and a duty to indemnify Irving against dozens of environmental lawsuits. Both parties filed motions for summary judgment; ACE claimed that other insurance should cover the claim, while Irving asserted that it was entitled to judgment on the duty-to-defend count as a matter of law. The court denied both motions. Irving filed an interlocutory appeal. ACE argued that the appeal should be dismissed as taken from a non-final judgment, and cross-appealed.

The Supreme Judicial Court dismissed the interlocutory appeals, citing the final judgment rule. The court recognized the death knell exception, but noted that since all of the underlying environmental lawsuits against Irving had been settled, there was no longer anything for ACE to defend Irving against. That being the case, dismissal of the duty-to defend claim would

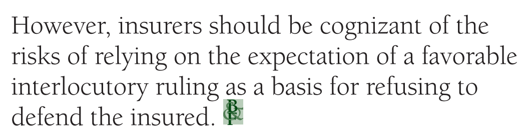
not deprive Irving of its right to a defense, and the death knell exception did not apply.

The court specifically cautioned insurers not to delay providing a defense in the hope that the underlying suit would settle. The court pointed out that ACE would remain liable for all costs incurred by the insured in reaching a settlement if it was later determined that a duty to defend existed. Furthermore, insurers are vulnerable to an action for breach of contract and an appropriate award of damages in the case of an unjustified denial of coverage.

Looking forward

Where the underlying lawsuits against an insured have been settled or dismissed, neither the insured nor the insurer can avail itself of the death knell exception to the final judgment rule, to obtain immediate review of an interlocutory ruling on a duty to defend claim.

However, insurers should be cognizant of the risks of relying on the expectation of a favorable interlocutory ruling as a basis for refusing to defend the insured.



In Maine, the death knell exception to the final judgment rule does not afford review of an interlocutory ruling that no coverage exists, where the underlying claims against the insured have been settled. However, insurers who rely on the expectation of a favorable interlocutory ruling as a basis for refusing to defend an insured run the risk of an action for breach of contract and possible award of damages.

Massachusetts: Federal Court Strictly Enforces Basement Exclusion in a Standard Flood Insurance Policy

A 2014 decision by the United States District Court for the District of Massachusetts reiterated that exclusions to FEMA's Standard Flood Insurance Policy ("SFIP"), must be strictly construed and enforced by the private insurers that issue the policies. In *Matusevich v. Middlesex Mutual Assurance Company*, 2014 WL 952985 (D. Mass. March 12, 2014), the court construed the SFIP's standard "basement exclusion" to deny coverage for damage to the ground level of a home.

The case involved damage resulting from a 2011 flood at the plaintiff's home in which approximately fifty inches of water entered the lower level of the home. The plaintiff's home was subgrade on three sides, and the fourth side was open to a same level in-ground swimming pool. There was a concrete apron surrounding the pool that extended from the edge of the pool to the rear of the home. The usable surface of the floor, including the subfloor and floor coverings, was .76 inches below the surface of the concrete pool apron, but 2.49 inches higher than the ground beneath the pool apron.

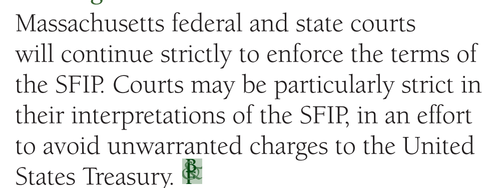
The insurer rejected the claim, based on its determination that the lower level was a "basement" as defined in the SFIP, that is, "any area of the building, including any sunken room or sunken portion of a room, having its floors below ground level (subgrade) on all sides." The plaintiff argued that "ground level" should be interpreted as the level of the soil underneath the pool apron, while the insurer asserted that the top of the apron was the appropriate measuring point.

Noting that any claim paid under the National Flood Insurance Program is a direct charge to the U.S. Treasury, the court stated that all conditions precedent to the payment of a claim must strictly enforced. The court then cited to a Third Circuit decision and stated, "Coverage under a flood insurance policy is predicated upon the occurrence of a flood. There cannot be a flood unless water rises above and flows over the existing ground level. It only makes sense, therefore, to equate 'ground level' in the flood insurance policy as the ground level that was actually flooded, i.e. as the ground level at the time of the flood."

The court concluded that "ground level", as used in the SFIP, meant the ground level at the time of the flood, not the natural grade when the building was constructed. Based on that interpretation, the lower level of the plaintiff's home was a "basement" and the claim was excluded from coverage.

Looking Forward

Massachusetts federal and state courts will continue strictly to enforce the terms of the SFIP. Courts may be particularly strict in their interpretations of the SFIP, in an effort to avoid unwarranted charges to the United States Treasury.



FROM THE NEWSROOM

Margaret Suuberg of our Worcester office obtained a judgment in favor of the insurer in a declaratory judgment action arising out a denial of coverage. The insured had been sued by a plaintiff who was rendered paraplegic when he fell off a roof at the insured's work site. The court granted summary judgment for the insurer, ruling that the claim was excluded from coverage based on an "Independent Contractors Employees" exclusion.

Burns & Farrey is pleased to announce that **Thomas B. Farrey, III** has been recognized as a leading attorney in Rhode Island within the 2016 edition of *Chambers USA: America's Leading Lawyers for Business.*

Chambers & Partners surveys and interviews industry-leading companies and organizations throughout the US and worldwide, basing their rankings on technical legal ability, client service and commercial astuteness.

Burns & Farrey has been named a First Tier firm for both Personal Injury Litigation – Defendants and Product Liability Litigation - Defendants in Worcester by U.S. News Best Lawyers "Best law Firms" in 2015.

Burns and Farrey is pleased to welcome **Emily LaCroix** back to the firm's Boston office. A graduate of Wellesley College and the University of Michigan Law School, Attorney LaCroix has experience representing multinational corporations in tort, products liability, and employment litigation.

This newsletter reports developments in the law. It is not intended to provide legal advice. It is circulated to our clients and others in the insurance industry and may be considered advertising.