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## Trends in Professional Liability Insurance Litigation - 2005

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This article briefly touches upon some of the important professional liability insurance issues that were adjudicated in 2005. In reviewing these cases and anticipating their relevance to similar factual situations, it is important to keep in mind the critical importance of the specific policy language at issue. Minor variances in such language can result in vastly differently but equally valid outcomes.

In 2005, insurers became even more willing to litigate rescission of D&O and E&O policies for misrepresentations made in the application for insurance. Typically these misrepresentations were either made in response to application questions about the applicant's knowledge of past or potential future claims, or contained within the corporate financial statements required to be submitted as part of the application. Rescission looms particularly large in cases where the financials statements in question are later restated by the insured entity. In rescission cases, an important sub-issue is severability - that is, whether the misrepresentations of one director or officer may be imputed to "innocent" insureds. Recent decisions by federal appeals courts indicate a trend which concludes that severability may not be implied into the policy, either by finding ambiguity or as a matter of public policy.<sup>1</sup> Rather, the courts will only rely upon express language providing protection for innocent insureds.<sup>2</sup> Without such language, the misrepresentations and the knowledge of the person who signed the application can provide grounds to rescind the policy as to all insureds no matter their culpability.

Coverage disputes that are about "all or nothing" issues, such as rescission, are often accompanied by a demand for advancement of defense costs. The trend is for courts to hold that until there is a final judicial finding of rescission, an insurer must treat the policy as though it were in full effect. This has been found to mean that insurers must advance defense costs, subject to the right to be reimbursed by the insureds if rescission is eventually upheld. A federal district court in New York recently ordered advancement in the *WorldCom* case despite the insurers' efforts to rescind their respective policies. Shortly thereafter, a New York state court reached the same result in the *Tyco* case.<sup>3</sup> This trend is not universal, however: a federal court in California found that an insurer's unilateral rescission "renders the policy totally unenforceable from the outset" and, therefore, the insurer could not be said to have any obligations until the court determined whether the rescission was justified.<sup>4</sup>

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<sup>1</sup> *Cutter & Buck, Inc. v. Genesis Insurance Co.*, 144 Fed. Appx. 600 (9th Cir. 2005); and *Fed. Ins. Co. v. Homestore, Inc.*, 144 Fed. Appx. 641 (9th Cir. 2005).

<sup>2</sup> *Am. Guarantee & Liab. Ins. Co. v. The Jaques Admiralty Law Firm*, 121 Fed. Appx. 573 (6th Cir. 2005).

<sup>3</sup> *In re WorldCom, Inc., Sec. Litig.*, 354 F. Supp. 2d 455 (S.D.N.Y. 2005); *Fed. Ins. Co. v. Kozłowski*, 18 A.D.3d 33 (N.Y. App. Div. 2005). See also *Great Am. Ins. Co. v. Gross*, 2005 U.S. Dist. LEXIS 8003 (E.D. Va. 2005).

<sup>4</sup> *Amel Corp. v. St. Paul Fire & Marine Ins. Co.*, 2005 U.S. Dist. LEXIS 27277 (N.D. Cal. 2005).

Courts sometimes conflate the duty to advance defense costs with the duty to defend. An Ohio court recently held that even though the policy expressly disclaimed any duty to defend, if any aspect of a claim against an insured is potentially covered, then the insurer must advance defense costs for the entire claim.<sup>5</sup> A different result was properly reached by a federal court in Illinois construing a policy that contained an express allocation clause requiring the advancement of only that portion of the total defense costs that the insurer, in its sole discretion, believed to be covered.<sup>6</sup>

Disputes frequently arise over the policy definition of "loss." The past year saw a continuation of the holdings that judgments or settlements constituting disgorgement or restitution of ill-gotten gains are not insurable loss.<sup>7</sup> These cases can influence an insurer's position with regard to actions that seek the disgorgement of director and officer compensation or of profits from insider trading. Another aspect of "loss" that was analyzed in 2005 is whether the Insured incurs a financial detriment when a settlement amount is paid through the issuance of stock. A federal court in New Hampshire held that a company's issuance of stock to settle a shareholder class action lawsuit was not "loss" because although the issuance of additional stock dilutes the value of each share, that dilution is a loss experienced by the shareholders, not the insured company, and the shareholders are not insureds.<sup>8</sup> A Utah case reached a similar conclusion.<sup>9</sup>

A perennial hot topic is the interpretation of policy exclusions. One coverage issue that arises in the bankruptcy context is the "Insured versus Insured" exclusion and its application to claims against individual insured persons by entities asserting claims belonging to the debtor. With few exceptions, courts are finding that the exclusion does not apply in that context.<sup>10</sup>

The nature of a claims-made policy means that the interrelationship of claims is a crucial determination, especially when different lawsuits are brought against the insureds by different plaintiffs in different jurisdictions alleging different legal theories of recovery. In that context, a number of recent cases address the application of the "claim first made" and "interrelated wrongful acts" provisions, as well as the "pending or prior litigation" exclusion.<sup>11</sup> In general, courts are finding these provisions to be unambiguous and, therefore, apply them as written. As a result, the outcome of each case turns on the specific policy language at issue.

Finally, because notice triggers coverage under a claims-made policy, the issues of timely reporting and the prejudice rule continue to be litigated. The general trend, with very few and narrow exceptions, is for courts to enforce notice requirements strictly, even when it leads to harsh results, and to adopt the rule that imposing a prejudice requirement would be inconsistent with the nature of a claims-made and reported policy.<sup>12</sup>

5 *The Am. Chem. Soc'y v. Leadscope, Inc.*, 2005 Ohio App. LEXIS 2428 (Ohio Ct. App. 2005).

6 *Seeger et al., v. Gulf Underwriters Ins. Co.*, 04cv7176 (N.D. Ill. March 17, 2005)

7 *Serio v. Nat'l Union Fire Ins. Co. of Pittsburgh, Pa.*, 18 A.D.3d 319 (N.Y. App. Div. 2005).

8 *Enterasys Networks, Inc. v. Gulf Ins. Co.*, 2005 U.S. Dist. LEXIS 5033 (D.N.H. 2005).

9 *ClearOne Comm, Inc. v. Lumbermens Mutual Cas. Co.*, 2005 U.S. Dist. LEXIS 26187 (D. Utah 2005).

10 *Rigby v. Underwriters at Lloyd's, London*, 2005 Fla. App. LEXIS 7909 (2005).

11 *Highwoods Properties, Inc. v. Exec. Risk Indem. Inc.*, 407 F.3d 917 (8th Cir. 2005); *Seneca Ins. Co. v. Kemper Ins. Co.*, 2005 U.S. App. LEXIS 9841 (SDNY 2005); 12 *American Gen. Life Ins. Co. v. Franklin Life Ins. Co.*, 131 Fed. Appx. 217 (11th Cir. 2005).

12 *First Professionals Ins. Co., Inc. v. Heart & Vascular Inst. of Tex.*, 2005 Tex. App. LEXIS 8192 (2005); *Or. Sch. Activities Ass'n v. Nat'l Union Fire Ins. Co. of Pittsburgh, Pa.*, 05cv214 (D. Or. Oct. 13, 2005); *Argent Fin. Group, Inc. v. Fid. & Deposit Co. of Md.*, 04cv2323 (W.D. La. Sept. 21, 2005); *Precis, Inc. v. Fed. Ins. Co.*, 2005 U.S. Dist. LEXIS 13985 (N.D. Tex. 2005); *Catholic Med. Cir. v. Exec. Risk Indem.*, 867 A.2d 453 (N.H. 2005); *but see Root v. Am. Equity Spec. Ins. Co.*, 130 Cal. App. 4th 926 (2005).



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