

Professional Liability Coverage for Knowing, Intentional and Criminal Acts

By Mark Garbowski



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Professional liability policies (also commonly known as “errors and omission” or “E&O” policies), typically cover claims arising out of any “wrongful act” or “any negligent act, error or omission” in connection with the policyholder’s performing a professional service. They also often include an exclusion for some combination of knowing, dishonest, fraudulent, intentional or criminal acts. Insurance companies typically seize upon any allegation of intent or knowledge on the part of their policyholders to avoid coverage.

This issue often arises where a claimant sues the policyholder for a number of tortious acts, ranging from negligence to recklessness to intentional misconduct. Most cases hold that the claim is covered based upon the presence of the negligence claims. The issue can then become one of allocation: to what extent is coverage afforded for the cost of defending or settling the entire action? There is a split among the states. The majority view is that if any claims are potentially covered, a policyholder is entitled to reimbursement of defense costs for the entire action. A minority of courts hold that the policyholder is only entitled to reimbursement of those defense costs associated with potentially covered claims.

Another issue arises as to whether mere allegations of dishonest, fraudulent, intentional or criminal conduct trigger the exclusion. Often, the exclusion states that it only applies where the dishonest, fraudulent or criminal conduct has been finally adjudged in a court of competent jurisdiction. Under

such circumstances, “final adjudication” should mean the exhaustion of all appellate rights. Further, there may be an issue as to whether “final adjudication” can be avoided by settlement before any adjudication reaches the stage of “final.” Arguably, claims of criminal or fraudulent acts which are never established through “final adjudication” because of a settlement should require the insurance company to indemnify.

Should The Exclusion Even Potentially Apply?

As a preliminary matter, however, policyholders should not casually accept an insurance company assertion that any reference to knowledge, intent or a crime means that at least some portion of the claim is potentially not covered. It is important to distinguish between an intent to commit an act on one hand, and an intent to cause the harm caused by the act on the other hand. In many states, only claims where both forms of intent are present can be excluded from coverage.

“It is important to distinguish between an **intent to commit an act** ... and an **intent to cause harm caused by the act.**”

As recently decided by the Eighth Circuit in *American Home Assurance Co. v. Kelly Pope*, an insurance company that sold professional liability insurance to a psychologist sought to avoid coverage for claims that the psychologist had failed to warn an underage victim of sexual

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abuse that her abuser continued to pose a threat after treatment.

The insurance company argued that it had no obligation to defend or indemnify the psychologist because the underlying action was based upon a knowingly wrongful act — the failure to warn the minor — and won a summary judgment motion on this point. On appeal, the Eighth Circuit ruled that the relevant exclusion was ambiguous. The provision at issue excluded coverage for "any wrongful act committed with knowledge that it was a wrongful act." The appellate court ruled that this exclusion was ambiguous, especially given the interplay between it and the insuring agreement. As the court noted:

The ambiguous nature of the contract becomes apparent when the conduct expressly covered by the policy is compared and contrasted with the conduct expressly excluded. First, the contract states it will insure damages resulting from a "wrongful act," defined, in relevant part, as "any actual or alleged negligent act, error, or omission." (Emphasis added). Then, the contract excludes coverage for liabilities resulting from a knowingly wrongful act.

The court reasoned that the policy could not exclude the knowing breach of a professional duty, because that is the nature of negligence in the professional context:

The American Home policy is a professional liability insurance policy which insures negligent conduct, but American Home now attempts to exclude the knowing breach of a duty, which breach is by its nature negligence. A negligence claim

necessarily requires a duty to act, that is, a duty known or presumptively known by the defendant.

Accordingly, the exclusion was ambiguous and could not be applied.

Policyholders should carefully review their claims and their policies when dealing with such exclusions. In addition to the analysis provided by the Eighth Circuit, policyholders should review their claims to determine whether, in fact, actions styled as fraudulent or intentional torts are actually based upon negligence. In most jurisdictions, a determination of insurance coverage is not predicated on an injured party's choice of remedy or the form of action. Rather, the nature of the damage and the risk involved, in light of particular policy provisions, controls the issue of insurance coverage. If, as in the *Kelly Pope* case, a knowing failure to perform a known duty can nonetheless be characterized as a negligent act, then coverage should be afforded.

Coverage for Arguably Criminal Acts

In the same *Kelly Pope* case, the court also rejected the insurance company's attempt to negate coverage under a criminal acts exclusion. While many E&O policies, as noted earlier, contain a single exclusion for intentional and criminal acts, in the *Kelly Pope* case the exclusions for knowing acts and criminal acts were separate. One of the claims in that case was based upon the psychologist's failure to report the sexual abuse to the appropriate state authorities. The district court found that such failure was criminal, and therefore granted summary judgment to the insurance company due to the criminal act exclusion.

As part of an earlier appeal, the Eighth Circuit also overturned the lower court on this point and



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also restored coverage to the policyholder. The court ruled that the criminal failure was not the source of the liability to the victim. First it determined that the criminal failure to report did not give rise to a private cause of action on behalf of the victim. More importantly, the Eight Circuit also ruled that the failure to warn duty — the duty to warn the victim and her caregivers — was separate from the criminal duty. In doing so, the court read the criminal acts exclusion, which by its terms applied to “any dishonest, criminal, fraudulent or malicious act or omission,” narrowly. Rather than find that the failure to warn was inextricably linked to the criminal failure to report, it read the exclusion narrowly and interpreted the policy in favor of coverage.

Conclusion

Professional liability policyholders cannot afford to take a checklist approach to reviewing the potential for coverage for difficult claims. Just because a claim alleges a criminal act, or a knowing violation of a known duty, does not mean that seemingly applicable exclusions will defeat coverage. It is necessary to look behind the labels used by the claimants who seek to put you, your firm or your company in the worst possible light. Just because terms such as “knowing,” “intentional” or even “criminal” appear in the claim against you does not mean that the claim is excluded.▲

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Recovery of Attorney’s Fees and Arbitral Clauses: Ask to Opt In!

By John G. Nevius and Peter A. Halprin*

The inclusion of arbitration provisions in insurance policies is on the rise. When buying or renewing liability coverage, it is important for risk managers to determine what aspects need revision or where additional risk protection is necessary. One clause to focus on is the arbitration clause — which all too frequently, if it is read at all, is unscrutinized. Specifically, policyholder’s need to check whether the arbitration provision allows the awarding of attorney’s fees to prevailing policyholders.

Arbitration was designed to provide an alternative forum for dispute resolution that would be faster and cheaper than traditional litigation. In recent years, however, arbitration has been under attack because it can be just as slow and costly as the traditional litigation it sought to help parties avoid.

In the field of insurance, the presence of an arbitration clause in an insurance policy has become commonplace as insurance companies attempt to escape what they perceive to be a more hostile judicial environment for the relative comfort of an arbitral forum. An arbitral forum provides insurance companies with an arena in which precedent may be less rigorously applied, discovery is more restricted and there can be a disincentive for arbitrators to lose business by siding too often with policyholders. The latter is a well-documented phenomenon in finance. For example, a 2007 Public Citizen study found that consumers lost nearly 94% of credit card disputes administered by the National Arbitration Forum. All too often, the party that more frequently makes repeated use of an arbitral forum will generally prevail.

Another reason that arbitration is beneficial to insurance companies is that the terms set forth in arbitration clauses can operate to take away some common law protections for policyholders. For example, most jurisdictions follow the rule of *contra proferentum*, where ambiguous contractual terms are construed against the drafter of the contract language at issue. Insurance companies frequently attempt to contract around the rule by

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drafting arbitration clauses rendering that doctrine inapplicable.

Perhaps the most inequitable provision in an arbitration clause, however, is one that denies prevailing policyholders any award of attorney's fees. In many jurisdictions, a policyholder's best offense against improper conduct or bad faith on the part of the insurance company is the sword of attorney's fees (as well as punitive damages). Arbitration clauses that shield the insurance company and disarm the policyholder often make the pursuit of an arbitration award an unaffordable proposition, as the inability to recover attorney's fees may nullify the advantage of obtaining coverage when costly proceedings are drawn out or delayed.

In a recent Illinois decision, *Amerisure Mutual Ins. Co. v. Global Reins. Corp. of America*, the First District Appellate Court encountered a case in which an insurance company and a reinsurance company were in a dispute over coverage regarding attorney fees to be awarded in the underlying action. The insurance company prevailed in the lower courts, which affirmed an arbitration award, including attorney's fees, in its favor.

The case is notable for several reasons. First, and this is quite rare, the Appellate Court found that the arbitration panel had "exceeded its authority." Second, the section of Illinois' Uniform Arbitration Act relied upon specifically provides that "unless otherwise provided in the agreement to arbitrate, the arbitrators' expenses and fees, together with other expenses, *not including attorney's fees*, incurred in the conduct of the arbitration, shall be provided in the

award." See 710 ILCS 5/10 (West 2006). Although this section of the Act was interpreted to allow for fees where provided for in an arbitration agreement, the failure to address the recovery of attorney's fees in the arbitration clause at issue, ultimately proved fatal to the insurance company's recovery.

Given the ruling in *Global Reinsurance*, risk managers and other purchasers of insurance need to be even more careful in scrutinizing all aspects of an arbitration clause. Risk managers should attempt, where possible, to remove disadvantageous arbitration clauses or at least negotiate the express inclusion of an award of prevailing party attorney's fees. Ensuring that attorney's fees may be recovered by the policyholder in any coverage dispute with an insurance company may serve to dissuade insurance companies from improperly denying a claim. Ironically, "a stitch in time may save nine." In other words, leveling the arbitration playing field when purchasing or renewing coverage may be the best way to avoid disputes and thereby obviate the need for paying the costly fees potentially associated with them. ▲

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