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Professional Liability Coverage For Knowing, Intentional And Criminal Acts

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.

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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.

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 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 Eight Circuit also overturned the lower court on this point and 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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Mark Garbowski is a senior shareholder in Anderson Kill's New York office. Mr. Garbowski's practice concentrates on insurance recovery, exclusively on behalf of policyholders, with particular emphasis on professional liability insurance, directors and officers insurance, fidelity and crime-loss policies, internet and high-tech liability insurance issues.

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