

"Claim" Refers to Individual Claims Within an Action, Not Entire Action

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The California Court of Appeal has held that the term "claim" refers to individual claims within an action, not to the "entire action" itself, such that a policy's dishonest acts exclusion did not relieve the insurers of their duty to reimburse defense fees where the underlying suit sought relief for both acts that were barred by the exclusion and acts that were not. *Health Net, Inc. v. RLI Ins. Co.*, 2012 WL 1850929 (Cal. Ct. App. May 22, 2012). The court also ruled that claims seeking unpaid policy benefits from the health insurer policyholder are not covered because, irrespective of the health insurer's alleged wrongful acts, the company still would have been legally obligated to pay the benefits to its subscribers.

This case arose out of a consolidated pair of class actions brought against a health insurer. The suits sought relief on a number of grounds, alleging that the health insurer calculated reimbursements to subscribers and beneficiaries using systematically flawed databases and outdated databases and that it improperly adjusted certain reimbursements in other ways. The suits also asserted a number of claims under ERISA, including claims that the health insurer had failed to disclose plan participants' rights and obligations. Following discovery disputes, the federal trial court ultimately sanctioned the health insurer by treating as established the fact that the health insurer had knowingly and willfully used outdated databases in adjusting claims. The health insurer later settled the class actions for a total of \$215 million.

Prior to settlement, the health insurer brought a coverage action against its primary insurer and three excess insurers for failure to reimburse defense costs (provided for by a policy endorsement) and failure to indemnify in the underlying actions. On review from the trial court's grant of summary judgment, the court of appeal concluded that "the bulk of damages sought" in the underlying actions were unpaid benefits under the health plans and therefore were not covered by the policies. Noting that the policies covered only damages that the health insurer became legally obligated to pay as a result of a claim for a wrongful act, the court underscored that the unpaid health benefits would have been owed regardless of the health insurer's wrongful acts. "[A]n insured's alleged or actual refusal to make a payment under a contract does not give rise to a loss caused by a wrongful act," the court concluded. Nonetheless, the court acknowledged that some claims were potentially covered, including claims for damages for failure to comply with certain state regulations, damages for failing to comply with ERISA's disclosure duties, and the attorneys' fees arising from the defense of those claims.

Because the court determined that the underlying actions contained some potentially covered claims, it next turned to the dishonest acts exclusion. As an initial matter, the court rejected the notion that the term "claim" referred to the entire underlying action. The court emphasized long-standing California precedent to the effect that the duty to defend embraces an underlying suit "to the extent that it seeks . . . damages [for a covered claim]." That the policies here defined "claim" to include a "judicial . . . proceeding" did not alter the analysis, the court continued, because that definition simply served to identify the time at which a policy is triggered.

Finally, applying its interpretation of "claim" to the dishonest acts exclusion, the court held that the exclusion barred those remaining claims arising out of the health insurer's use of outdated databases since the federal court had deemed that misconduct "knowing and willful." This conclusion did not dispose of those claims arising out of other alleged wrongdoing, however, including the claims based on the health insurer's use of systematically flawed databases and its miscellaneous adjustment-related misconduct. Thus, the court concluded, the dishonest acts exclusion did not bar coverage for the entirety of the potentially covered claims.