

Sanctions Petition Seeking Other Relief Is Within Definition of “Damages” Despite Sanctions Carve Out

October 2012

Applying Pennsylvania law, the United States Court of Appeals for the Third Circuit has held that an insurer had a duty to defend an insured attorney against a petition for sanctions, notwithstanding the policy's carve out for sanctions in its definition of “damages,” because the claimant also sought costs, attorneys' fees, expenses and other relief. *Post v. St. Paul Travelers Ins. Co.*, 2012 WL 3095352 (3d Cir. July 31, 2012). The court also held that the insurer had not acted in bad faith because it had a reasonable, though mistaken, basis for denying coverage.

The insured attorney represented a client as a defendant in a medical malpractice action in which the insured attorney allegedly had engaged in misconduct during discovery. The client fired the insured attorney and retained new counsel. The client's new counsel sent the insured attorney letters advising him that he had been terminated and, on October 12, 2005, sent another letter stating that the attorney's misconduct had caused the client substantial exposure in the medical malpractice action. The client's new counsel later sent another letter advising the insured attorney to put his lawyers professional liability insurer on notice. On November 21, 2005, the plaintiffs in the medical malpractice action filed a petition for sanctions against the insured attorney and the former client, alleging that the discovery misconduct forced the parties to settle rather than present the case to the jury.

The attorney tendered the petition for sanctions to the insurer. The policy's definition of “damages” exempted “civil or criminal fines, forfeitures, penalties, or sanctions” from coverage. The insurer denied coverage on the grounds that the petition did not seek “damages” as defined in the policy, but rather only sought uncovered sanctions. On February 8, 2006, the former client filed an answer in the sanctions proceeding admitting that the insured attorney had committed discovery violations and joining in the request for sanctions against his former attorney. The former client also sought costs, attorneys' fees, expenses and any other relief the court deemed just and equitable.

When the insurer continued to deny that it had an obligation to defend against the sanctions petition, the insured attorney filed a coverage action alleging breach of contract and bad faith. The court held first that the insurer's duty to defend was triggered as of October 12, 2005, when the former client's counsel made clear to

the insured attorney that it should expect a legal malpractice claim. The court also held, however, that the scope of the duty to defend the sanctions petition was limited to defense costs incurred by the insured attorney following the former client's answer to the sanctions petition on February 8, 2006. The court found that, although the original sanctions petition did not assert a claim for "damages" against the insured attorney, the former client's answer to the petition included a prayer for relief seeking costs, attorneys' fees, expenses and other relief. As such, the court held, the client's answer sought covered "damages."

The court also held that the insurer had not committed bad faith in failing to defend the insured attorney. Bad faith in Pennsylvania, the court stated, requires evidence of "a dishonest purpose" on the part of the insurer, rather than mere negligence; a reasonable, though mistaken, belief in non-coverage is a defense to bad faith. The court found that the insurer's claims handling was benign and that its reliance on the sanctions carve out from the definition of "damages" was reasonable, though ultimately incorrect. As such, the court held that the insurer was not liable for bad faith.