

Court Dismisses Breach of Contract Claim But Allows Bad Faith Claims to Go Forward Against D&O Insurer

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The United States District Court for the District of Nevada has denied an insurer's motion to dismiss claims for statutory and common law "bad faith" in connection with coverage positions under a bond and D&O policy issued to a bank despite finding that no coverage existed under the D&O policy and that the insured failed to state a claim for breach of the D&O policy. *First Nat'l Bank of Ely v. Progressive Cas. Ins. Co.*, 2012 WL 5944847 (D. Nev. Nov. 27, 2012).

The insured bank sought coverage under a fidelity bond and a directors and officers liability insurance policy in connection with an employee's embezzlement of several million dollars belonging to depositors. The insurer, which issued both the bond and the D&O policy, determined that limited coverage was available under the bond and that no coverage was available under the D&O policy in the absence of any lawsuit against the insured bank or its directors or officers.

The insured bank filed coverage litigation alleging breach of contract and of the duty of good faith and fair dealing under both the bond and the D&O policy, as well as violations of the Nevada Fair Claims Settlement Practices Act, fraud and concealment and negligence. According to the insured, the insurer wrongly denied coverage under the D&O policy, unreasonably delayed issuing its coverage decisions and misrepresented the terms of the D&O policy. The insurer moved to dismiss.

The court concluded that the insured bank stated a valid claim for breach of the bond. But as to the D&O policy, the court found no claim for breach of contract because the D&O policy afforded coverage only with respect to loss resulting from claims for wrongful acts that the bank is permitted to indemnify insured persons or that the bank was legally obligated to pay. The underlying claim consisted of losses the bank suffered due to embezzlement, not indemnification or company liability. Accordingly, the bank failed sufficiently to allege breach of the D&O policy. Moreover, the court found, that coverage would be barred by an exclusion for claims arising out of fraudulent, dishonest or criminal acts.

Nevertheless, the court determined that the insured had alleged a breach of the covenant with respect to the D&O policy (as well as the bond) even though the insurer had no obligation to pay under the D&O policy. The court stated that the insurer “did have a responsibility to conduct a prompt evaluation of the claim and to not misrepresent the terms of the policy.” Because the insurer took nearly a year and half to issue its coverage positions and because it initially represented to the insured that the D&O policy required the filing of a lawsuit—despite coverage under the policy for certain written or oral demands—the court denied the insurer’s motion to dismiss the bank’s claims for breach of the covenant of good faith. The court opined that these allegations also supported valid claims for violations of the Nevada Fair Claims Settlement Practice Act. The same allegations did not, however, state a valid claim for fraud or negligence, the court found, because the insured did not allege reliance on any such misrepresentations or damages based on its reliance.