

ALERT

Punitive Damages Award Fails To Implicate Dishonesty Exclusion

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The United States District Court for the Southern District of West Virginia has held that the dishonesty exclusion in a directors, officers and trustees liability policy was not triggered by a jury's award of punitive damages based on a finding of "fraudulent" conduct because the causes of action that gave rise to the jury's verdict against the insured did not involve fraudulent or dishonest conduct. *Executive Risk Indem., Inc. v. Charleston Area Med. Ctr.*, 2011 WL 1833194 (S.D. W.Va. May 12, 2011).

The insured, a medical center, was sued by a doctor after the center determined that his plan for self-funding professional liability insurance was inadequate and, as a result, revoked his clinical privileges. The doctor asserted claims for defamation and false light invasion of privacy, arguing that the insured breached a duty by communicating to others that he did not have adequate insurance, had not demonstrated the actuarial soundness of his self-insurance plan, and was not qualified for clinical privileges. He also sought punitive damages. The jury returned a verdict against the insured. The first section of the verdict form indicated the jury's finding in favor the doctor; in the second section, the jury awarded \$5 million in compensatory damages; in the third section, the jury awarded \$20 million in punitive damages based on a finding of "fraudulent, malicious, oppressive, wanton, willful, or reckless conduct"; and the fourth section indicated the jury's finding that the insured had acted in "bad faith, vexatiously, wantonly, or for oppressive reasons." The parties ultimately settled for \$11.5 million.

In subsequent coverage litigation, the court addressed whether the insured's policy covered amounts paid in the settlement. The policy covered an aggregate of \$10 million of "Loss" that the insured was

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obligated to pay as a result of a "Claim" based on, *inter alia*, a "Wrongful Act," defined as "any actual or alleged error, omission, misstatement, misleading statement or breach of duty." An endorsement added punitive damages to the definition of "Loss," capping such coverage at \$5 million. The policy also contained an exclusion for losses associated with claims brought about "by any dishonest or fraudulent act or omission." The court rejected the argument by the insurer that the jury's findings in the third and fourth sections of the verdict form triggered the dishonest or fraudulent acts exclusion and required allocation of the settlement to account for covered and excluded losses. The court noted that only the first section addressed the insured's liability, and that liability was based on defamation and invasion of privacy—not fraud. The court explained that the doctor never asserted any claims predicated on fraudulent or dishonest conduct, so the jury could not have imposed liability based on such conduct. According to the court, the wrongful conduct the doctor alleged—communicating to others about his lack of insurance, finding his self-insurance plan inadequate, and revoking his clinical privileges—did not involve fraudulent or dishonest conduct. The court further pointed out that the third and fourth sections of the verdict form related only to the punitive damages and the attorneys' fees awards and did not alter the nature of the conduct underlying the insured's liability. The court also concluded that an allocation was not required because the damages awarded did not involve distinct sets of covered and uncovered claims. According to the court, both of the doctor's claims—defamation and invasion of privacy based on an alleged "breach of duty"—were covered, precluding any need for allocation.