

ALERT

Delaware Court: Settlement For Statutory Damages, Calculated Without Reference to Actual Damages Incurred, Is For Penalty, Not Covered Loss

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A Delaware trial court has held that a settlement for statutory damages paid by a health care organization represents uncovered penalties rather than covered Loss. *Executive Risk Specialty Ins. Co. v. First Health Group Corp.*, No. 09C-09-027 (Del. Super. Ct. May 7, 2013). The court further held that the portion of the settlement attributable to attorney fees was also not covered.

The policyholder, which issued and underwrote medical service plans, allegedly violated a Louisiana statute regulating reimbursement of health care providers by preferred provider organizations. The statute provides that failure to comply will subject the offender to “damages payable to the provider of double the fair market value of the medical services provided, but in no event less than the greater of fifty dollars per day of noncompliance or two thousand dollars, together with attorney fees to be determined by the court.” The underlying claimants alleged that the policyholder violated the statute a total of 130,931 times, which under the statute yielded a minimum damages number of \$261,862,000. After the claimants obtained a judgment for that amount in a Louisiana trial court and prevailed in an intermediate appeal of that judgment, the policyholder settled with the claimants for \$150,500,000 and an assignment of rights against the policyholder’s E&O carriers. Coverage litigation ensued.

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The governing policy's definition of Loss provided, in relevant part, that "Loss shall not include . . . fines, penalties, taxes, and punitive, exemplary and multiplied damages." The carrier argued that the settlement represented payment of a penalty. The court agreed.

The court looked to Black's Law Dictionary's definitions of "penalty," "civil penalty," and "statutory penalty." It further quoted an Illinois case for the proposition that a statutory penalty must "(1) impose automatic liability for a violation of its terms; (2) set forth a predetermined amount of damages; and (3) impose damages without regard to the actual damages suffered by the plaintiff." The court found that the Louisiana statute at issue satisfied that definition because it automatically imposed a remedy without reference to damages actually suffered. The court additionally noted record evidence that the claimants suffered damages of approximately \$20 million, rather than the \$261 million judgment rendered.

The court also addressed the claimants' argument that the \$52.5 million of the settlement that they allocated to attorney fees should constitute covered Loss. The court observed that the underlying settlement agreement did not specifically allocate any portion of the policyholder's payment to attorney fees. In addition, the court reasoned that under Louisiana law, an award of attorney fees is punitive in nature, and therefore not within the policy's definition of Loss.