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EXECUTIVE SUMMARY

Developments Affecting Professional Liability Insurers | March 2014

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New York High Court Holds That Insurer's Breach of Duty to Defend Does Not Mean Automatic Indemnity Coverage

The New York Court of Appeals, applying New York law, has held on reargument that an insurer's breach of its duty to defend does not bar it from later relying on policy exclusions. *K2 Investment Group, LLC v. Am. Guarantee & Liability Ins. Co.*, 2014 WL 590662 (N.Y. Feb. 18, 2014). In so holding, the court vacated its previous decision. *K2 Investment Group v. Am. Guarantee & Liability Ins. Co.*, 21 N.Y.3d 387 (2013).

The plaintiffs in the underlying action made loans to a real estate investment company. A lawyer associated with the insured law firm was also a member of the real estate investment company. The plaintiffs alleged that the lawyer, acting as their attorney, failed to record mortgages in the plaintiffs' favor to secure their loans. The real estate investment company subsequently became insolvent and never made payments on the unsecured loans. The plaintiffs sued the lawyer and made a settlement demand within policy limits.

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Third Circuit Holds That Insurer Bears Burden of Showing That Claims Are Related

Applying Pennsylvania law, the United States Court of Appeals for the Third Circuit has held that, where an insurer seeks to deny coverage for a claim on the grounds that it is related to a claim made prior to the inception of a professional liability policy, the insurer bears the burden of showing that the claims are related. *Borough of Moosic v. Darwin Nat'l Assurance Co.*, 2014 WL 407477 (3d Cir. Feb. 4, 2014). The district court opinion was reported in the August 2012 edition of the *Executive Summary*.

In the underlying dispute, two property owners attempted to challenge a nearby tire company's plans to begin manufacturing operations, but were allegedly thwarted by their town's public officials, who allegedly refused to allow them to speak at public meetings and attempted to intimidate them by sending surveyors to their property. The property owners filed suit against the town, alleging violations of 28 U.S.C. § 1983. The town sought coverage for the property owners' suit under

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Bad Faith Count Survives Motion to Dismiss, Even Though District Court Initially Agreed That Policy Afforded No Coverage

The United States District Court for the Central District of Illinois has held that a bad faith claim could not be dismissed as a matter of law at the motion to dismiss stage where a district court initially agreed that a policy afforded no coverage but was later reversed by an appellate court. *Strategic Capital Bancorp Inc. v. St. Paul Mercury Ins. Co.*, 2014 WL 562970 (C.D. Ill. Feb. 13, 2014).

A bank requested coverage from its D&O insurer for a suit filed against the bank and two of its directors and officers alleging claims for fraud, civil conspiracy, and violation of the Illinois Consumer Fraud and Deceptive Business Practices Act. Three of the five plaintiffs in the suit were former directors of the insured bank. In the ensuing coverage litigation, the court agreed with the insurer that the policy's insured v. insured exclusion barred coverage. The Seventh Circuit reversed in part, holding that the insured v. insured exclusion barred coverage only in part, and that the insurer had a duty to defend and indemnify the bank against the portion of the suit brought by the non-insured plaintiffs.

On remand, the district court considered the remaining arguments of the insurer's motion to dismiss the insured bank's complaint, which contained claims for breach of contract and for bad faith refusal to provide coverage. The insurer argued that the bad faith claim could be dismissed at the motion to dismiss stage because the district court had initially concluded that the policy afforded no coverage, and thus the carriers' denial was *per se* reasonable. Rejecting this argument, the district court held that a resolution of the bad faith claim was premature because the court did not have "the benefit of all the evidence in order to consider the totality of the circumstances, as required by the law regarding" Illinois's bad faith statute. Accordingly, the court denied the insurer's motion to dismiss. ■

Invasion of Privacy Exclusion in D&O Policy Bars Coverage for Alleged TCPA Violations

The United States District Court for the Central District of California has held that an invasion of privacy exclusion in a D&O policy barred coverage for a claim alleging violations of the Telephone Consumer Protection Act (TCPA). *LAC Basketball Club v. Fed. Ins. Co.*, No. 2:14-cv-001113-FAF-FFM (C.D. Cal. Feb. 14, 2014).

The policyholder, a professional basketball organization, was sued for negligent and willful violations of the TCPA after it allegedly sent "spam" advertisements via text message to numerous individuals. The policyholder tendered the suit under its D&O policy, but its insurer denied coverage on the basis that the policy barred coverage for any claim "based upon, arising from, or in consequence of . . . invasion of privacy." After disputing the denial, the policyholder filed a coverage action against its insurer.

Ruling on the insurer's motion to dismiss, the court held that the invasion of privacy exclusion barred coverage for the underlying suit. First, the court analyzed TCPA case law from the Ninth Circuit, which discussed the relationship between the statute and the privacy interests it was enacted to protect. Then, in light of that case law, the court ruled that the privacy exclusion in the D&O policy "plainly" applied because the broad phrase "invasion of privacy" in turn "encompass[ed] TCPA claims." The court rejected the argument that the exclusion did not apply given that "invasion of privacy" is not an element of a TCPA claim, observing that "'invasion of privacy' need not be included as an element because Congress has already determined that the prohibited behavior, if proved, ***constitutes*** an invasion of privacy." (Emphasis in original.) As a result, the court held that there was no coverage under the policy and dismissed the coverage action. ■

Notice-Prejudice Statutes Apply to Claims-Made-and-Reported Policies

Applying Wisconsin law, the Court of Appeals of Wisconsin has held that the state's late notice-prejudice statutes apply to claims-made-and-reported liability policies and require the insurer to prove prejudice when denying coverage based on late notice, even when the claim is not reported until after the expiration of the claims-made-and-reported policy period. *Anderson v. Aul*, 2014 WL 625676 (Wis. Ct. App. Feb. 19, 2014).

The buyers in a real estate transaction signed a form waiving their right to independent counsel and agreeing to be represented by the seller, who was an attorney. Following closing, the buyers became dissatisfied with the seller's representation and, on December 23, 2009, sent the seller a letter setting forth the reasons for their dissatisfaction. At the time, the seller was insured under a professional liability policy issued for the policy period of April 1, 2009 to April 1, 2010, which afforded coverage for claims both first made and reported during that policy period. The seller did not inform his insurer of the buyer's letter until March 9, 2011, nearly a year after the expiration of the 2009-2010 policy. On March 22, 2012, the buyers filed suit against the seller. The insurer intervened and moved for summary judgment, contending, among other things, that the policy did not afford coverage for the buyers' claim because the claim was not reported during the policy period in which it was made and because the insured made a material false misrepresentation on his renewal application for the 2010-2011 policy by failing to disclose the buyer's letter in connection with that application. The trial court entered summary judgment for the insurer based on the insured's untimely notice and the insured's failure to disclose the claim on his renewal application. The trial court declined to address whether the insurer had been prejudiced by the untimely notice, observing that "that's not the standard."

On appeal, the Court of Appeals reversed and remanded for further proceedings. Although the court acknowledged that the insured did not

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Claim Based on Accountants' Investment Advice Barred by Securities Practices Exclusion

Applying Massachusetts law, the United States District Court for the District of Massachusetts has held that an exclusion for claims made in connection with the alleged violation of state blue sky laws bars coverage for securities law and common law counts asserted against accountants in a complaint alleging they gave poor investment advice. *Salomon v. Philadelphia Ins. Co*., 2014 WL 294320 (D. Mass. Jan. 23, 2014).

An accounting firm and one of its principal accountants were named as defendants in an action by a former client who alleged that, acting on the advice of his accountants, he invested in what turned out to be a Ponzi scheme. The client's complaint asserted counts for negligent misrepresentation for the accountants' alleged failure to exercise reasonable care in learning about the investment opportunity before recommending it, breach of fiduciary duty for similar conduct, and numerous counts for violation of the Massachusetts Uniform Securities Act.

The accountants sought coverage under their professional liability policy, but the insurer denied coverage based on three separate policy exclusions for claims arising out of (1) professional services performed for a client for whom any insured promoted, sold, or solicited securities or other investments; (2) the sale or solicitation of securities or other investments by any insured; and (3) the actual or alleged violation of state blue sky laws and claims "based upon common law principles of liability if made in connection with an actual or alleged violation of" the state blue sky laws. According to the insurer, the counts for Massachusetts Uniform Securities Act violations were barred by the blue sky law exclusion, a proposition which the insured did not dispute, and the other counts were common law claims "made in connection with" the same alleged wrongful conduct and thus were barred by the exclusion. In addition, the insurer asserted that the other two exclusions for the solicitation and sale of investments independently operated

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Sixth Circuit Finds No Bankruptcy Exception to Prohibition Against Direct Actions In Tennessee

The United States Court of Appeals for the Sixth Circuit has held that no exception exists to Tennessee's general prohibition on direct actions against an insurer, even in cases where the insured has declared bankruptcy triggering an automatic stay before a judgment in the underlying action. *Mauriello v. Great Am. E&S Ins. Co.*, 2014 WL 321921 (6th Cir. Jan. 30, 2014). In so holding, the Sixth Circuit reasoned that an adequate remedy remains notwithstanding the automatic stay for a claimant to obtain a judgment against a bankrupt insured.

The insurer issued various professional liability insurance policies to two real estate management companies. The claimant filed an action alleging fraud against the insureds in relation to certain real estate purchases. The insureds filed for bankruptcy protection, triggering an automatic stay of the fraud action. The claimant sought relief from the automatic stay to continue the action, and the bankruptcy court granted such relief "only if there is available insurance" and directed that the claimant "shall not obtain in personam relief against the [insureds] but rather shall only obtain in rem relief against [the insureds] to the extent of available insurance." The claimant voluntarily dismissed the fraud action prior to obtaining a judgment against the insureds, and instead filed a direct action against the insurer seeking a declaration that the claimant was the intended third party beneficiary of the insurance policies and that the insurer had defense and indemnity obligations under the policies for the fraud action. The insurer filed a motion for summary judgment, arguing that the direct action was barred under Tennessee law.

The Sixth Circuit concluded that Tennessee law does not permit direct actions by third party claimants against an insurer, even in the event that an insured files for pre-judgment bankruptcy protection. According to the appellate court, "[the claimant's] circumstances are not unique, and parties in [the claimant's] situation typically request relief from the automatic stay to the extent of available insurance and proceed against the debtor as a nominal defendant for the purpose of establishing the debtor's liability." The Sixth Circuit also noted that it is well-settled that a claimant may sue the insured debtor once the bankruptcy proceedings conclude as long as the suit is purposed solely to establish the debtor's liability. In this case, the bankruptcy court granted the claimant relief from the automatic stay to the extent of available insurance. According to the Sixth Circuit, "[the claimant] now attempts to circumvent [the bankruptcy court's order] collaterally by asking this court to rewrite Tennessee state law." ■

Dishonesty Exclusion Bars Coverage for False Claims Act Lawsuit

The United States District Court for the Northern District of Illinois, applying Illinois law, has held that a dishonesty exclusion barred coverage for a lawsuit alleging violations of the False Claims Act because the lawsuit alleged that the insureds made knowingly false statements to the federal government. *Gen. Star Nat'l Ins. Co. v. Adams Valuation Corp.*, 2014 WL 479759 (N.D. Ill. Feb. 6, 2014). Also, the court held that no coverage was available because the lawsuit did not allege an act or omission in the performance of professional services and held that non-insured co-defendants were not necessary parties to the coverage litigation because they had no interest in the policy.

The former employee of a bank filed a False Claims Act lawsuit against a bank and the insured real estate appraisal firm as well as one of the insured's officers. The lawsuit alleged that the insureds engaged in a scheme with the bank and the bank's officers to defraud the Federal Deposit Insurance Corporation (FDIC) by overstating the value of properties secured by bank loans, which decreased the bank's liability for deposit insurance assessments. The real estate appraisal firm tendered the lawsuit to its E&O insurer, and the insurer filed a declaratory judgment action seeking a determination that it had no duty to defend or indemnify the insureds.

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Under New York Law, Claimant Has No Direct Action Against Insurer Prior to Obtaining Judgment Against Insured

Applying New York law, the United States District Court for the Eastern District of New York has held that a claimant has no direct cause of action against an insurer prior to obtaining a judgment against the insured. *Commonwealth Land Title Ins. Co. v. Am. Signature Servs., Inc.,* 2014 WL 672926 (E.D.N.Y. Feb. 20, 2014).

Two title insurance companies filed a lawsuit against their insurance agent for alleged failure to perform properly certain tasks under the parties' agency agreements. The agent was insured under a title agent's professional liability policy, and the professional liability insurer denied coverage for the claim by the title insurers. Thereafter, the title insurers named the agent's insurer as a defendant in their claim against the agent. The title insurers contended that they were third-party beneficiaries of the insurance policy issued to the title agent, and thus they sought indemnification directly from the agent's insurer. Alternatively, the title insurers sought a declaratory judgment that the agent's insurer is required to defend and indemnify the agent in the title insurers' claim.

The court granted the liability insurer's motion to dismiss the claim against it, holding that New York law does not permit claimants to file a direct action against an insurer prior to the claimants obtaining a judgment against the insured. The title insurers had argued that New York Insurance Law Section 3420, which provides a mechanism for a claimant to pursue an action against an insurer in certain circumstances, does not apply to them because it governs only claims for personal injury or property damage and not claims for professional liability. The court disagreed, finding that Section 3420 is not a limitation on direct actions but rather is an expansion of the right of a claimant to file a direct action in certain circumstances. Because the title insurers admittedly did not meet the statutory requirements of Section 3420, the court held that the provision does not apply here and instead common law controls. According to the court, under New York common law, a claimant cannot pursue a claim against an insurer until the claimant has obtained a judgment against its insured. ■

Securities Exclusion May Not Negate Duty to Defend Where ERISA Action Alleges Conduct Outside Exclusion's Scope

The United States District Court for the District of Nevada, applying Nevada law, granted in part and denied in part an insurer's motion to dismiss, finding that a company adequately pled that claimants in an underlying ERISA action alleged conduct outside the scope of a Securities Exclusion. *Int'l Game Tech., Inc. v. Fed. Ins. Co.*, 2014 WL 580876 (D. Nev. Feb. 13, 2014).

Participants in the insured company's retirement plan brought an ERISA action against the technology company and its directors for breach of their fiduciary duties alleging various failures with respect to the plan's investments in the company's own stock. The company sought coverage under an Executive Protection Portfolio insurance policy, which contained a Fiduciary Liability Coverage Section that imposed a duty to defend. The insurer disclaimed coverage under the policy's Securities Exclusion, which precluded coverage for Loss arising from "[a]ny offering, issuance, distribution, sale or purchase of securities" and "[a]ny Organization's past, present, or future financial or operational performance, condition, or prospects."

The court rejected the insurer's argument that the ERISA action fell "squarely and entirely within the Securities Exclusion." Instead, it found that the insurer, in disclaiming its duty to defend, "merely assumed" that none of the claims gave rise to a duty to defend or indemnify. Applying Nevada pleading standards and construing the Securities Exclusion narrowly, the court found that the company had "adequately pled that the ERISA Plaintiffs alleged conduct outside the scope of the Securities Exclusion." Specifically, the ERISA plaintiffs' allegation of a failure "to adequately review the performance" of the retirement plan's other fiduciaries did not clearly fall within the

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No Coverage for Contractual Liability for Independent Agent's Misconduct

The United States Court of Appeals for the Sixth Circuit, applying Ohio law, held that a title insurer's professional liability policy did not cover the title insurer's contractual obligation to reimburse escrow funds stolen from its clients by an independent issuing agent. *Entitle Ins. Co. v. Darwin Select Ins. Co.*, 2014 WL 304497 (6th Cir. Jan. 29, 2014).

The title insurer used an independent issuing agent to offer title insurance to its clients. The independent agent also performed closing and escrow agent services on its own behalf. For some clients, the title insurer offered a closing protection letter, agreeing to reimburse the client if the issuing agent engaged in fraud, dishonesty or negligence in handling the clients' closing or escrow funds. When the issuing agent misappropriated $3.9 million in client escrow funds, the title insurer reimbursed the 14 clients to whom it had issued such letters. The title insurer disclaimed responsibility to the others on the grounds that the issuing agent was not its agent with respect to escrow and closing funds.

The title insurer's professional liability policy covered wrongful acts of entities for whom the title insurer was "legally responsible." The title insurer argued it was "legally responsible" for the issuing agent's misappropriation from those customers it had agreed to reimburse, which therefore should have been covered under the professional liability policy.

The court held that no coverage was available because the issuing agent was not an entity for whom the title insurer was legally responsible. The fact that the title insurer acquired contractual liability to certain clients did not change the analysis of coverage. The court therefore refused to interpret the policy to "allow [the title insurer] to secure business by making contractual guarantees to its clients regarding the performance of third-party business partners that are not its agents and then force its insurer to foot the bill when that third-party fails to perform according to [the title insurer]'s guarantee, despite [the title insurer]'s disavowal of all noncontractual responsibility, legal or otherwise." ■

Professional Services Exclusion Does Not Bar Coverage for Deceptive Advertising Claim

Applying Rhode Island law, the United States District Court for the District of Rhode Island has held that a professional services exclusion does not bar coverage for a law firm's allegedly deceptive advertising practices. *Rob Levine & Assocs., Ltd. v. Travelers Cas. & Sur. Co. of Am.*, 2014 WL 406509 (D.R.I. Feb. 3, 2014).

In the underlying action, several clients alleged that the insured law firm and two of its attorneys violated Rhode Island's deceptive trade practices statute by engaging in false advertising. Specifically, the clients asserted that the law firm's television and Internet advertisements gave the false impression that the insureds had special expertise in personal injury cases and had a superior ability to recover money, as compared to other Rhode Island attorneys. The law firm's insurer denied coverage under its D&O liability policy based on an exclusion stating that the insurer "will not be liable for Loss for any Claim based upon or arising out of any Wrongful Act related to the rendering of, or failure to render, professional services."

In the coverage litigation that followed, the court held that the professional services exclusion did not preclude coverage for the underlying suit, which "is about advertising, not the provision of legal services." The court reasoned that the insureds advertised to the general public—including both current and future clients—before performing any legal services. According to the court, the insurer's proposed interpretation of the professional services exclusion would render the policy "meaningless," as there would be no coverage for any conduct by the insureds. ■

Insured May Recover Damages for "Aggravation and Inconvenience" Caused by Insurer's Breach, but Not Prejudgment Interest on Attorneys' Fees

Applying West Virginia law, the United States Court of Appeals for the Fourth Circuit has held that where an insurer violates its duty to defend or indemnify its insured, the insured may recover consequential damages for aggravation and inconvenience, but not prejudgment interest on unliquidated attorneys' fees incurred as a result of the insurer's breach. *Graham v. Nat'l Union Fire Ins. Co. of Pittsburgh, PA*, 2014 WL 350147 (4th Cir. Feb. 3, 2014).

A director of a nonprofit organization was sued by the state of West Virginia based on allegations of misuse of public funds. He tendered the claim to his commercial general liability insurer for a defense. The insurer denied coverage, concluding it had no duty to defend or indemnify the director. After prevailing in the underlying liability proceedings, the director brought a declaratory judgment action against his insurer, claiming the insurer breached its duty to defend him. Although judgment was initially entered for the insurer on the coverage issues, the Fourth Circuit reversed, and judgment was entered in favor of the director. The director then sought prejudgment interest on the portion of his fee award associated with the underlying liability proceedings. He also sought to recover damages for the "aggravation and inconvenience" caused by the insurer's denial of coverage.

Noting that West Virginia law allows recovery of consequential damages, the court concluded that "there is no logical reason to authorize an award for one item of consequential damages—attorney fees in the enforcement litigation—while simultaneously denying recovery for aggravation and inconvenience." Thus, the court held that consequential damages consisting of aggravation and inconvenience are recoverable in coverage litigation, regardless of whether the insurer violated its duty to defend or its duty to indemnify.

However, the court rejected the director's claim for prejudgment interest on the attorneys' fees expended in the underlying liability proceedings. Relying on West Virginia law, which only allows prejudgment interest for "special or liquidated damages," the court concluded that the director's attorneys' fees, although already paid, were not liquidated until the insurer stipulated to the precise amount of those fees on remand after the first appeal. Accordingly, the court concluded that "the absence of liquidation is enough to exclude attorney fees . . . from the reach of the West Virginia prejudgment interest statute." ■

Notice-Prejudice Statutes Apply to Claims-Made-and-Reported Policies *continued from page 3*

report the claim until 11 months after the policy expired and that the express language of the policy required any claim to be both first made and first reported during the policy period, the court also held that the policy was subject to Wisconsin's two statutes governing "how the timeliness of notice of a claim affects coverage," Wis. Stat. §§ 631.81 and 632.26(2). According to the Court of Appeals, both statutory provisions require an insurer—including an insurer that has issued a claims-made-and-reported policy—to show that it has been prejudiced by an insurer's untimely notice of a claim before denying coverage based on late notice. Thus, the Court of Appeals held that the trial court erred by not considering prejudice. Because the insurer here argued only that it would be prejudiced if it had to cover a claim for which it did not bargain and did not contend "that its ability to investigate, evaluate and defend this claim was impaired by [the insured's] late notice," the Court of Appeals held, as a matter of law, that the insurer had not been prejudiced. The Court of Appeals declined to address any of the other coverage defenses raised by the insurer. ■

New York High Court Holds That Insurer's Breach of Duty to Defend Does Not Mean Automatic Indemnity Coverage *continued from page 1*

The law firm's insurer denied coverage for the underlying litigation and settlement demand based on policy exclusions for claims arising out of the policyholder's capacity or status as a director or officer of a business enterprise, and for claims arising out of alleged acts or omissions of the insured for any business enterprise in which the policyholder had a controlling interest. The lawyer failed to appear in the litigation, resulting in a default judgment in excess of the policy limits. The lawyer then assigned his claims against the carrier, including bad faith claims, to the plaintiffs.

In the resulting declaratory judgment action, the trial court found that the insurer had breached its duty to defend, and the intermediate appellate court affirmed, holding that the exclusions relied upon by the insurer were inapplicable. By its previous order, the New York highest court had affirmed, determining that, where an insurer breaches its duty to defend, it loses the right to rely on policy exclusions in litigation over its indemnity obligation.

On reargument, the New York Court of Appeals held that its prior decision erroneously failed to take account of a controlling precedent, *Servidone Construction Corp. v. Security Insurance Co. of Hartford*, 64 N.Y.2d 419 (1985), which held that an insurer that breaches its duty to defend is not automatically liable to indemnify the policyholder where coverage is disputed. The court rejected the plaintiffs' contention that *Servidone* was distinguishable from this case because it involved an underlying settlement rather than a judgment against the insured. The court also declined to make a distinction between cases where the breaching insurer raises defenses based on "noncoverage" (*i.e.*, claims that do not fall within the insuring agreement) rather than policy exclusions. Refusing to limit *Servidone* in this way, the court concluded that both policyholders and insurers should be able to rely on the court's decisions unless the state legislature decides otherwise.

The court then concluded that the applicability of the business enterprise and insured's status policy exclusions presented an issue of fact sufficient to defeat summary judgment because it was a factual question whether the malpractice claim against the lawyer arose partly out of his status or activity with the real estate investment company. The court remanded the case to the trial court to deny the plaintiffs' motion for summary judgment. ■

Securities Exclusion May Not Negate Duty to Defend Where ERISA Action Alleges Conduct Outside Exclusion's Scope *continued from page 5*

exclusion. As a result, the court found that the company stated a "plausible claim for breach of the duty to defend."

The court then dismissed with prejudice the company's claim that the insurer was estopped from raising any defenses to coverage due to its refusal to defend without conducting a reasonable coverage analysis. The court found this claim "false and obviously misleading" because the insurer's coverage letter, which was incorporated by reference into the complaint, reflected the insurer's careful coverage analysis and reservation of rights. ■

Claim Based on Accountants' Investment Advice Barred by Securities Practices Exclusion *continued from page 3*

to bar coverage for the negligent misrepresentation and breach of fiduciary duty counts. In response, the accountants contended that the insurer's interpretation of the exclusions would render meaningless an endorsement in the policy that provided coverage for "personal financial planning," which, the accountants contend, was precisely what was alleged in the client's complaint.

The court ruled for the insurer, finding first that, although there was some overlap between the policy's two exclusions for the solicitation and sale of investments on the one hand and the coverage extension for personal financial planning on the other, the extension did not read the exclusions out of the policy. Moreover, the court concluded, even in the absence of those two exclusions, the claim would still be barred by the blue sky law exclusion because the counts for negligent misrepresentation and breach of fiduciary duty were based on the same allegations as the excluded securities law violations, and thus all of the counts were "made in connection with an . . . alleged violation of" state blue sky laws. Accordingly, the court held that the insurer had no duty to defend or indemnify the accountants. ■

Dishonesty Exclusion Bars Coverage for False Claims Act Lawsuit *continued from page 4*

As an initial matter, the court rejected the insureds' argument that the co-defendants in the underlying lawsuit were necessary parties to the coverage litigation. The insureds contended that 14 non-insured co-defendants were necessary parties to the coverage litigation because they could have a potential claim for contribution against the insureds. The court held that the co-defendants were not necessary parties because they were not parties to the insurance policy and had no legal interest in the policy as potential indemnitors.

The court held that the policy's dishonesty exclusion barred coverage for the lawsuit. The exclusion provided that "[t]his Insurance Policy does not apply to Claims: [a]rising out of a dishonest, fraudulent, criminal or malicious act or omission, or intentional misrepresentation . . . committed by, at the direction of, or with the knowledge of any Insured." The exclusion applied because, to establish civil liability under the False Claims Act, the claimant must prove that the insureds knowingly made a false statement to the government.

Although the court reasoned that it need not reach the issue, it also held that no coverage was available for the suit because it did not allege an act or omission in the performance of professional services, which included services performed as a real estate appraiser for a fee. The insured's liability, if any, would be based on its false submissions to the FDIC and not the performance of real estate appraisals. ■

Third Circuit Holds That Insurer Bears Burden of Showing That Claims Are Related
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its public officials' professional liability policy. The insurer denied coverage on the basis that certain matters it deemed to be related to the suit, including a mandamus complaint by the property owners to compel the town to comply with its own zoning laws, predated the inception of the policy.

In the coverage litigation that followed, a federal district court granted the insurer's motion to dismiss the insured's demand for declaratory relief, finding that the mandamus complaint was related to the § 1983 suit and that, consequently, the § 1983 suit should be treated as a claim first made before the inception of the policy. The policy defined "Related Claim[s]" as: "all claims for Wrongful Acts based upon, arising out of, resulting from, or in any way involving the same or related facts, circumstances, situations, transactions or events or the same or related series of facts, circumstances, situations, transactions or events, whether related logically, causally or in any other way." The policy required that "[a]ll Related Claims … be treated as a single Claim made when the earliest of such Related Claims was first made, or when the earliest of such Related Claims is treated as having been made in accordance with CONDITION F(2), whichever is earlier."

On appeal, the court remanded the case to the district court, finding that it incorrectly assigned to the insured the burden of proving that the mandamus complaint and § 1983 suit were not related claims. The court noted that, if the related claims provision was a condition precedent to coverage, the insured would bear the initial burden of demonstrating that the mandamus complaint and the § 1983 suit were unrelated. The court noted that, if, alternatively, the related claims provision was an exclusion, the insurer would bear the burden of proving that the claimed loss fell within the scope of the related claims provision. The court defined a "condition precedent" as "either an act of a party that must be performed or certain event that must happen before a contractual right accrues or contractual duty arises" and an exclusion as a "limitation of liability or carving out of certain types of loss to which the coverage or protection of the policy does not apply." The court found that the related claims provision did not fit within the definition of a condition precedent because there was no act the insured had to perform or event that had to occur for there to be no related claim first made before the policy's inception. According to the court, in contrast, the related claims provision did limit coverage under the policy and was, hence, an exclusion. Finally, the court held that the related claims provision's placement in the policy's "Conditions" section rather than its "Exclusions" section was not determinative. ■

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