

BAD FAITH BLOG

Accounting Malpractice Insurer Defeats Bad Faith Claim and is Reimbursed Fees Spent on Defense

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Summary: Professional liability insurer brought a declaratory judgment action against its insured, an accounting firm, seeking a declaration that it owed the insured no defense or obligation beyond its \$100,000 sub-limit and seeking recovery of overpayments of defense costs above the sub-limit. The insured accounting firm filed counterclaims seeking a declaration that the insurer's duty to defend and indemnify was not limited by the sub-limit and for bad faith. The United States District Court for Eastern District of Pennsylvania granted the insurer's summary judgment motion for declaratory judgment and for recovery for over-payment. The insured appealed to the Third Circuit United States Court of Appeals and the Court of Appeals affirmed.

CAMICO Mutual Insurance Company v. Heffler, Radetich & Saitta, LLP

The accounting malpractice insurer and the accounting firm entered into a Claims Made Accountant's Professional Liability insurance policy. The policy provided insurance for claims brought against the accounting firm that, among other tasks, distributed settlement funds to claimants in class action suits. The policy insured both the accounting firms and others, including the accounting firm's former employees.

The accounting firm was tasked with distributing a \$490 million settlement of a class action against Bank of America. A senior claims analyst was assigned to help administrate the settlement. However, the senior claims analyst, while employed at the accounting firm and after his employment ended, defrauded three separate class actions of tens of millions of dollars by working with co-conspirators to file false claims. The claims analyst subsequently pleaded guilty to these charges. Thereafter, a member of the Bank of America class brought a class action suit against the accounting firm seeking damages resulting from its former claims analyst's crimes. The class action suit alleged, among other claims, a breach of fiduciary duty, accountant malpractice, and negligent supervision.

The accounting firm notified its accounting malpractice insurer of this potential liability associated with its former claims analyst's actions. The accounting malpractice insurer funded the accounting firm's defense, but subsequently advised the accounting firm that it reserved its right to recover costs and expenses relating to the defense that exceeded the \$100,000 sub-limit in the policy concerning misappropriation, misuse, theft, or embezzlement.

The Third Circuit found the \$100,000 sub-limit applied based upon the plain language of the policy. The Third Circuit also found that based upon the allegations and the underlying lawsuit, the former claims analyst, at the very least, misappropriated funds which triggered the \$100,000 sub-limit.

Next, the Third Circuit determined the former claims analyst was performing professional services for the benefit of the accounting firm. The Third Circuit found that because the claims analyst was engaged in the professional service of claims administration at the time he was employed by the accounting firm and the benefits of the claim administration inured to the accounting firm, then the former claims analyst performed professional services as defined by the insurance policy. Finally, the Third Circuit also found that the former claims analyst, based upon the plain language of the policy, was qualified as an insured under the policy even though he was a former employee.

Once the Third Circuit determined that the \$100,000 sub-limit applied, it next turned to the issue of whether the accounting malpractice insurer was entitled to be reimbursed for amounts it paid in defense over the \$100,000 sub-limit. Like, many states, Pennsylvania law states that an insurer is not entitled to be reimbursed for defense costs absent an express provision in the written insurance contract. The Third Circuit found that the policy at issue did include an express provision in the policy. Therefore, the Third Circuit affirmed reimbursement to the accounting malpractice insurer of all funds paid in excess of the sub-limit and the summary judgment against the accounting firm on its bad faith claim against the insurer.

Insurers must be mindful of the law of the jurisdiction as to whether reimbursement of defense costs is allowed. Moreover, insurers must know and understand the interpretation of their policy in regard to reimbursement of defense costs before making any demand for defense costs whether it be after a limit has been exhausted or whether facts are developed after the defense is provided that triggers no coverage. Demands for reimbursement should be made with caution as they could trigger claims for bad faith – like in this case.

By Aaron D. French

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