

Allegations of Misleading Statements Regarding Scope of Coverage Not Sufficient to Support Insureds' Fraud Claim

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Applying California law, the United States District Court for the Eastern District of California has dismissed a claim by insured directors and officers alleging insurer fraud, ruling that the complaint failed to allege with sufficient particularity that the insurer had misled the insureds regarding the scope of the policy's coverage. *Hawker v. Bancinsurance, Inc.*, 2013 WL 1281573 (E.D. Cal. Mar. 26, 2013). The court also held that the insureds' bad faith claims failed to allege malice, oppression or fraud on the part of the insurer necessary to support a claim for punitive damages.

A bank purchased a directors and officers insurance policy with a coverage term from January 2006 to January 2009. The policy's insured vs. insured exclusion precluded coverage for "a Claim by, or on behalf of, the Company, or any successor, trustee, assignee or receiver of the Company." The policy also contained a regulatory exclusion precluding coverage for actions or proceedings brought by or on behalf of any regulatory agency, but that exclusion was deleted by endorsement. In 2007, while the policy was in effect, the bank requested additional directors and officers coverage, and the insurer advised that the bank substitute its current policy with a new policy. The new policy had a similar insured vs. insured exclusion, but it did not include a regulatory exclusion like that included in (and deleted from) the original policy. According to the bank, the insurer indicated that the new policy provided broader coverage than the original policy, and thus the bank agreed to purchase the new policy.

Subsequently, the bank failed and the Federal Deposit Insurance Corporation (FDIC) was appointed as receiver. The FDIC then filed suit against the bank's directors and officers for negligence and breach of fiduciary duty. The insurer denied coverage for the claim pursuant to the new policy's insured vs. insured exclusion. The directors and officers filed suit against the insurer alleging fraud and seeking reformation of the new policy. The complaint alleged that, based on the insurer's suggestion that the new policy afforded broader coverage than the original policy, and in light of the new policy's omission of a regulatory exclusion like that in the original policy, the insureds believed that the new policy would provide coverage for regulatory actions by the FDIC. The insurer moved to dismiss the directors' and officers' complaint.

The court held that the complaint adequately alleged that the insurer had advised the bank that the new policy would afford broader coverage than the original policy, and that the bank had reasonably relied on this assurance in agreeing to purchase the replacement policy. Nevertheless, the court stated, a fraud claim requires pleading with particularity as to the names of persons who allegedly made fraudulent misrepresentations and the details of those statements. Finding that the directors and officers had failed to plead such details, the court dismissed the fraud claim with leave to amend.

The directors and officers also asserted a claim against the insurer for punitive damages based on the insurer's denial of coverage without reasonable basis and without conducting a reasonable investigation. The insurer sought dismissal of this claim based on the failure of the insureds to plead malice, oppression or fraud. The court agreed with the insurer, finding that the directors and officers had not alleged misconduct on the part of the insurer to support a claim for punitive damages, and thus the court dismissed the claim.