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NEWSLETTER

Lawsuit Implicates Health Care Professional Liability Policy and Falls Within D&O Policy's Medical Malpractice Exclusion

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Applying Illinois law, an Illinois appellate court has held that a suit brought against a hospital by participants of a discontinued vaccine trial arises out of professional services, meaning that it implicates the hospital's professional liability policy but falls within the medical malpractice exclusion of the hospital's D&O policy. *Rosalind Franklin Univ. of Med. & Sci. v. Lexington Ins. Co.*, 2014 WL 905547 (Ill. App. Ct. Mar. 7, 2014). The court also held that the hospital's professional liability insurer was not estopped from asserting coverage defenses because, even though its appointed counsel defended the suit for several months before the insurer notified the hospital of any coverage issues, the hospital could not show resulting prejudice.

For nearly two decades, the insured hospital administered a study to evaluate the efficacy of a vaccine, which was funded with money donated by the physician who developed the vaccine. When the hospital ended the study in 2004, 50 study participants filed suit against the hospital, alleging that the discontinuation of the study put their lives at risk. The lawsuit sought injunctive relief and also asserted a variety of common law and statutory claims. Early in the litigation, the parties agreed to settle for $3 million, including a $2.5 million payment to a trust to resume the study and a $500,000 payment directly to the plaintiffs for pain and suffering.

At the time the suit was filed, the hospital was insured under primary and excess "Healthcare Professional Services Liability" policies issued by the same insurer. The hospital also had a D&O liability policy issued by another insurer. The D&O insurer denied coverage for the suit based on its policy's medical malpractice exclusion. The professional liability insurer did not confirm its position until after the execution of the settlement agreement, at which point it denied coverage. The hospital filed suit against both insurers. The trial court held that both insurers had a duty to indemnify the hospital, but rejected the insured's "bad faith" claim against the professional liability carrier.

The appellate court affirmed in part and reversed in part. As a threshold matter, the court rejected the hospital's argument that its professional liability insurer was estopped from asserting any coverage defenses. Although the evidence showed that the insurer appointed the attorney who defended the hospital in the underlying action, the court concluded that the hospital did not surrender control of its defense to the insurer-appointed counsel. Instead, its general counsel remained involved. Accordingly, the court concluded that the

hospital could not show that it had been prejudiced because there was nothing indicating that the defense would have been conducted differently with independent counsel.

Next, the court turned to the coverage defenses raised by the carriers. First, the court held that the settlement did not constitute uncovered disgorgement. The insurers argued that the money donated to fund the study was earmarked solely for the vaccine program, meaning that the hospital forfeited its right to the funds when it ended the study. As a result, the insurers argued that the settlement represented a disgorgement of wrongfully retained funds rather than covered "damages" or "loss." The court disagreed. Although the court did not dispute that "there is no insurable loss where an insured is compelled to turn over money that it had never had a right to possess," it concluded as a factual matter that (1) the terms of the donation required only that the funds be used for cancer research generally; and (2) the settlement represented a compromise of *all* the plaintiffs' claims, "including the nondisgorgement claims," as shown by the hospital's use of its general operating fund to pay the settlement.

Second, the court considered the professional liability carrier's argument that the underlying lawsuit did not arise out of "professional services." The court held that the gravamen of the underlying complaint alleged activity that involved "specialized medical knowledge" rather than "wrongful administrative acts." The court reasoned that the plaintiffs' claims were all based on the decision to shut down the study—a decision that constituted "an exercise of medical judgment" given that it was made based on safety concerns and the vaccine's unproven efficacy. According to the court, therefore, the complaint implicated the professional liability policies' insuring agreements, which covered damages "resulting from a medical incident arising out of professional services."

The court also rejected the professional liability carrier's argument that it never consented to the settlement, noting that the carrier knew of the settlement negotiations and failed to raise any objections before the settlement was consummated. Similarly, the court determined that the carrier's contention that it had no duty to defend because it was never informed that its policy's retention had been satisfied was without merit because the carrier had voluntarily undertaken the hospital's defense by appointing counsel to defend the underlying action.

The court then considered the D&O carrier's arguments and agreed that the underlying complaint fell within the D&O policy's exclusion barring coverage for claims "based upon or attributable to any medical or professional malpractice[.]" It also held that the portion of the settlement representing a $500,000 payment for "pain and suffering" fell within the D&O policy's bodily injury exclusion, even if it was actually intended to compensate the plaintiffs for their attorneys' fees. In any event, the court concluded that the $500,000 payment would fall within the D&O policy's medical malpractice exclusion.

Finally, the court held that the trial court did not abuse its discretion in concluding that the professional liability insurer's actions did not constitute either statutory or common law "bad faith" under Illinois law.