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NEWSLETTER

Tenth Circuit Concludes Securities Suits Not Related to Prior Litigation

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In a ruling dated June 24, 1999, the Tenth Circuit found that securities class actions filed in 1996 were not "causally connected" to a prior lawsuit filed in 1993 during a previous D&O policy period, and that the undepleted limits of 1996 policies therefore applied to the class actions. *Stauth v. Federal Ins. Co.*, No. 97-6437, 1999 U.S. App. LEXIS 14006 (10th Cir. June 24, 1999). It also reversed the district court's application of the "larger settlement" rule, reasoning that the allocation issues presented by the claim could not be resolved in advance of a settlement or judgment in the underlying litigation.

Fleming Companies, Inc. ("Fleming") and one of its officers were sued in 1993 by a customer who alleged that Fleming had overcharged it for food and related products under a "cost plus" contract between the customer and Fleming. The case went to trial in 1996 and resulted in a $207 million verdict against Fleming. It later settled for $19.9 million. Following the 1996 verdict, shareholders and noteholders filed securities suits against Fleming and several directors and officers. Ultimately consolidated into two actions, the suits alleged that the defendants failed to disclose the prior customer lawsuit and the exposure it presented. *Id.* at 7-11.

Federal Insurance Company, which was on the risk in both 1993 (and paid part of the settlement in the first suit) and in 1996, argued that the 1993 policy applied based on the definition of "Interrelated Wrongful Acts," which included "causally connected" wrongful acts. According to Federal, because the alleged wrongful acts in the various suits were interrelated, all loss should be deemed to have originated in the earliest policy year in which any wrongful act was first reported to the insurer. *Id.* at 11-12.

The Tenth Circuit found that the suits were not "causally connected" for a variety of reasons. The customer suit named only one officer, and that officer was not named in the class actions. Looking beyond the allegations in the operative complaints, the court also noted that the record did not reveal to what extent the officer named in the customer suit was involved in the facts relating to the class actions or to what extent the class action defendants were involved in the circumstances giving rise to the customer lawsuit. The court further indicated that the class actions themselves allege "different facts and press different claims of fraud," and the noteholders' class action included underwriters as defendants. *Id.* at 19-20. In reaching its conclusion, the court stressed the specific language in the policy before it and implied that other language might result in a more expansive application of the "Interrelated Wrongful Acts" provision. *Id.* at 26 n.8.

The court further rejected Federal's argument for application of the exclusion in the 1996 policy for claims arising out of circumstances that were the subject of notice under a prior policy and that would be covered under such prior policy. The court found the exclusion inapplicable because of its determination that the 1993 policy did not cover the class actions.

Finally, the Tenth Circuit reversed the district court's ruling that the "larger settlement" rule should be used to allocate between covered and noncovered loss. Noting that the Private Securities Litigation Reform Act of 1995 applied to the class actions, the court explained that, if the cases went to trial, exact percentages of fault would be attributed by the factfinder to each defendant pursuant to that statute. *Id.* at 40-41. Because the cases had not proceeded to judgment or settlement, the court concluded that any determination of the appropriate allocation would amount to an impermissible advisory opinion. *Id.*

In summary, the decision is notable for the court's desire in resolving the "Interrelated Wrongful Acts" issue to flesh out in detail the facts underlying each of the lawsuits. The court implicitly criticized a reliance on the allegations of the operative complaints alone for purposes of a coverage analysis. *Id*. at 18-19. With respect to the allocation issue, the opinion contains a helpful acknowledgment that cases to which the PSLRA applies may require an allocation analysis that differs from that employed in suits that predate the statute, such as *Caterpillar, Inc. v. Great American Insurance Co.,* 62 F.3d 955, 961 (7th Cir. 1995). Further, the court refused to foreclose the possibility that the corporate entity should bear some share of the exposure even applying the larger settlement rule. *Stauth,* at 40 n.10 ("[I]t is certainly conceivable that Fleming itself could be found liable on some of the securities claims, even if the directors and officers are not, due to differing standards of liability and the availability of certain defenses to the directors and officers.”). Thus, the opinion may prove useful in cases involving policies without entity coverage or preset allocations. top