

Second Circuit Affirms Ruling for D&O Carrier Based on Prior and Pending Litigation Exclusion

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The United States Court of Appeals for the Second Circuit, in *Zunenshine v. Executive Risk Indemnity, Inc.*, No. 98-9251, 1999 U.S.App. LEXIS 14629 (2d Cir. June 29, 1999), affirmed the grant of summary judgment to Executive Risk Indemnity, Inc. ("Executive Risk") based on the "prior and pending litigation" and "prior notice" exclusions in a D&O policy issued to SLM International, Inc. ("SLM"). The Second Circuit concluded that a prior claim that was made and reported during the policy period of an earlier insurer was "sufficiently similar" to a subsequent lawsuit brought during the Executive Risk policy period to invoke the exclusions.

In *Zunenshine*, several SLM directors and officers were named as defendants in two separate lawsuits. The first, a federal securities suit, was brought by shareholders prior to the inception of the policy at issue, which was issued by Executive Risk. SLM provided its prior D&O insurer, Chubb Insurance Company of Canada, with notice of the shareholder litigation. The second suit, brought by a group of institutional investors holding \$71 million in unsecured notes from SLM ("Noteholders"), was filed after the inception of the Executive Risk policy. Each lawsuit contained several similar allegations of wrongdoing, including allegations that the directors and officers had made false statements concerning SLM's net income for the first three quarters of 1993, the percentage of sales spent on television advertising and the effect on the company's financial position of a trademark infringement action.

The Executive Risk policy barred coverage for claims arising out of "any fact, circumstances, situation, transaction, event or Wrongful Act underlying or alleged in any prior and/or pending litigation or administrative or regulatory proceeding" as of the policy inception date. The policy also excluded coverage for claims arising out of any "fact, circumstance, situation, transaction, event or Wrongful Act which, before [the policy inception date], was the subject of any notice given under any policy of directors and officers liability or other similar insurance." In granting Executive Risk's motion for summary judgment based upon these two exclusions, the United States District Court for the Southern District of New York determined that the two lawsuits had a strong factual nexus and need not be identical in order for the exclusions to apply.

On appeal, the Second Circuit agreed that the dispositive issue was whether the two lawsuits were "sufficiently similar." The Court also agreed that the suits were sufficiently similar to apply the exclusions, stating that it was "immaterial" that the two lawsuits involved different parties and somewhat different legal theories (negligent misrepresentation v. securities fraud), "because the [policy terms] clearly focus on the existence of common facts." *Id.* at 4. The Court also deemed it immaterial that the two suits alleged a different manner of conveying the misrepresentations (private communications v. public disclosure), because the misrepresentations themselves underlied both lawsuits. *Id.* at 4-5.

The Second Circuit arguably carried its analysis of the policy terms a step further than the trial court, however, by adopting a broad test for when two lawsuits will be deemed sufficiently similar to trigger application of either the "pending and prior litigation" or the "prior notice" exclusion. SLM argued that the two suits were not sufficiently similar because the shareholder action contained several allegations of misrepresentations that were not alleged in the Noteholders' action. The Court rejected SLM's argument, stating that the "exclusions apply if the Noteholders' claims were based on any fact underlying the Shareholder litigation." *Id.* at 5 (emphasis added).

Lastly, the Court rejected SLM's argument that its interpretation was inconsistent with the purpose of claims-made insurance policies. Declining to consider SLM's argument that the exclusions were overly broad as interpreted by the Court, the Second Circuit noted that SLM was on notice of potential claims by the Noteholders as early as the Shareholder litigation, because one of the allegations contained in the shareholder litigation was a claim that the directors and officers had intentionally made the misrepresentations in order to complete the sale of the \$71 million in notes to the Noteholders.