

Legal Fees for Pursuit of Cross-Claim Are "Defense Costs" under Policy

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The United States District Court for the District of South Dakota, applying South Dakota law, has held that legal fees and expenses incurred in pursuing a cross-claim constituted "defense costs" under a D&O policy because the cross-claim could be viewed as the policyholder's answer to a complaint filed against it in a different forum. *IBP, Inc. v. Nat'l Union Fire Ins. Co. of Pittsburgh, Pa.*, 2003 WL 23175427 (D.S.D. Dec. 3, 2003).

The insurer issued a D&O policy to a company. The policy defined "defense costs" as "[r]easonable and necessary fees, costs and expenses consented to by the Insurer...resulting solely from the investigation, adjustment, defense and appeal of a Claim against the Insured, but excluding salaries of Officers or employees of the Company." The policy defined "claim" to include "a civil, criminal or administrative proceeding for monetary or non-monetary relief which is commenced by...service of a complaint or similar pleading."

The company entered into a merger agreement with a purchasing company. Shortly thereafter, the purchasing company sued the policyholder in the Arkansas court for rescission of the agreement on the grounds that the policyholder had fraudulently induced the purchaser's acceptance. Rather than responding in the Arkansas court, however, the policyholder filed a cross-claim against the purchasing company in a pending securities action in Delaware court where both companies had been named as defendants. In the cross-claim, the policyholder sought, among other things, specific performance of the merger agreement.

The company sought coverage from the insurer for the legal costs it incurred in both the Arkansas and Delaware actions. Although the insurer acknowledged that it was required to pay the costs in connection with the Arkansas litigation, it took the position that the legal fees and expenses incurred in the Delaware action were not "defense costs" because the company had sought affirmative relief by requesting specific performance rather than merely defending itself.

The district court granted summary judgment for the company, holding that the fees and expenses it incurred in connection with the Delaware litigation were "defense costs" resulting from a "claim." The court opined that it was "clear" from the Delaware court's opinion in the underlying litigation "that neither [the policyholder nor the purchasing company] believed the issue of specific performance was a significant issue in the Delaware litigation." In the court's opinion, the parties were "nearly exclusively litigating" the fraudulent inducement issue

first raised in Arkansas, and the company's attorneys "would have spent a limited amount of time" on specific performance. The court asserted that other district courts have held that an insured's initiation of a lawsuit "does not automatically preclude coverage for defense-type legal fees and expenses where the insured is resisting a contention of liability for damages." The court reasoned that the allegations in the purchasing company's counterclaim in Delaware court were "nearly identical" to the allegations in its Arkansas complaint. Accordingly, the court concluded that the company's cross-claim in Delaware was "in essence" an answer to the complaint filed in Arkansas and, as a result, the legal fees and expenses were covered "defense costs."

The court also held that the insurer was entitled to a jury trial on the question of whether the fees and expenses paid by the policyholder were "reasonable and necessary" because the inadequate descriptions of work performed by the policyholder's lawyers prevented the court from ruling on the reasonableness of the charges as a matter of law.

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