

D&O Policy's Fraud Exclusion Did Not Bar Coverage for Securities Class Action Settlement Because There Was No Finding of Fraud in the Underlying Action

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A Delaware Superior Court, applying New York law, has held that coverage for a securities class action settlement was not barred by a fraud exclusion in a D&O policy issued to AT&T because there was no "finding" or "adjudication" of fraud in the underlying action. *AT&T v. Clarendon Am. Ins. Co.* (Del. Super. Ct. June 25, 2008).

In this coverage action, AT&T sought, among other things, coverage for a \$100 million securities class action settlement. As a result of the settlement, and a prior partial summary judgment ruling in AT&T's favor, no jury ever found that AT&T engaged in any deliberate dishonest, fraudulent or criminal act or omission. Throughout the underlying litigation, and in the settlement documentation, AT&T denied any wrongdoing.

The insurer denied coverage for the settlement and the defense costs incurred by AT&T in connection with the securities litigation based on the policy's fraud exclusion. The exclusion at issue barred coverage for claims "brought about or contributed to in fact by any deliberate dishonest, fraudulent, or criminal act or omission . . . and providing any such finding is material to the cause of action so adjudicated."

Applying New York law, the court held that the exclusion was not ambiguous and did not apply to bar coverage. According to the court, the exclusion at issue does not apply to bar coverage for dishonest, fraudulent or criminal acts unless (1) there is a "finding" that such acts occurred, and (2) such a finding is "material" to the cause of the action being "adjudicated." The court determined that there was no finding of any dishonest, fraudulent or criminal acts in the underlying litigation and there was no "adjudication" of the claims not dismissed. The court further held that the relevant "finding" and "adjudication" must be in the underlying action and not in subsequent coverage litigation. As such, the court concluded that there could no longer be an "adjudication" implicating the exclusion because the underlying action was resolved.

The insurer also argued that under New York law "when the only pending causes of action require a finding of

fraud or of a not knowingly wrongful act, courts will apply the fraud exclusion to a settlement where there has been no actual finding of fraud even if the exclusion requires a final adjudication." The court rejected this argument and, citing *Alstrin v. St. Paul Mercury Ins. Co.*, 179 F. Supp.2d 376 (D. Del. 2002), held that to apply the fraud exclusion to bar coverage under the circumstances here "would effectively eviscerate the purpose of the policy," which "expressly provides coverage for securities claims."