

No Coverage for Section 11 Claims Because Not a "Loss"

February 2003

An Indiana state trial court has held that no coverage is available under an excess D&O policy for claims against a company alleging violations of Section 11 of the Securities Act of 1933. The court reasoned that damages paid to settle Section 11 claims are restitutionary in nature and that, as a result, there was no "Loss" under the policy. *Conseco, Inc. v. Nat'l Union Fire Ins. Co. of Pittsburgh, Pa., et. al.*, No. 49D130202CP000348 (Ind. Cir. Ct. Dec. 31, 2002).

Conseco had a \$100 million D&O insurance program in which the primary policy provided that the insurers would "pay the Loss of the Company arising from a (i) Securities Claim first made against the Company, or (ii) Claim first made against the Directors or Officers, during the Policy Period...for any actual or alleged Wrongful Act..." "Loss" was defined to include "damages, judgments, settlements and Defense Costs." Conseco and 15 of its directors and officers were sued in both securities and derivative lawsuits arising out of alleged material misstatements and/or omissions. After several of its D&O insurers denied coverage for these claims, Conseco filed coverage litigation against the insurers. Thereafter, Conseco settled the securities litigation for \$120 million, of which \$81.84 million was attributed to the Section 11 claims and \$38.16 million was attributed to the Section 10(b) claims asserted in the securities litigation. Certain underwriters at Lloyd's, which had provided \$25 million in coverage in excess of \$75 million in underlying limits, refused to contribute to the settlement, arguing that the \$81.84 million payment in connection with the Section 11 violations was not a "Loss" under the policy, and thus, its coverage layer was not implicated.

The court agreed with Lloyd's that there was no coverage for violations of Section 11 because payment to settle such claims did not constitute a "Loss." The court reasoned that, in settling the Section 11 claims, Conseco was simply returning funds "it wrongfully took from the investing public" because the alleged misrepresentations resulted in the public paying more money to Conseco for the shares than it would have absent the misrepresentations. Thus, according to the court, "[t]he \$81.84 million portion of the Securities Litigation settlement was in character payments representing the disgorgement of profits to which Conseco was never entitled." The court rejected Conseco's argument that the Section 11 portion of settlement represented compensatory damages, concluding that the Section 11 was restitutionary in character because the damages represented ill-gotten gains.

The court also rejected Consecos contention that the insurance coverage for securities claims afforded under the D&O policies would be illusory if the damages sought for Section 11 violations do not constitute "Loss." The opinion reasoned that Consecos could still benefit from the coverage for securities claims that do not allege violations of Section 11, including claims for violations of Section 10(b). The court also rejected Consecos argument that it had a reasonable expectation of coverage, opining that, under Indiana law, the court will only consider such expectations if a policy is ambiguous or illusory, which the policy language in this case was not. The court further rejected Consecos argument that it was entitled to coverage because the individual directors and officers could have been found personally liable under Section 11 and those individuals had not benefited from the "ill-gotten" gain, reasoning that the individuals had not, in fact, been obligated to pay any portion of the settlement.

Finally, the court rejected an argument by Consecos that the insurers had fraudulently induced it to purchase the excess policies by representing that the policies would provide coverage for Section 11 violations. The court found that the insureds had failed to plead fraud with the appropriate particularity since its claim was based only on the policy language. The court explained that a "coverage grant in an insurance policy that is limited by another provision does not provide the basis for a claim for fraud."

For more information, please contact one of WRF's Professional Liability Attorneys at 202.719.7130.