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Claim for Violation of California Securities Statute Is Uninsurable under D&O Policy

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The California Court of Appeal has held that there is no coverage under a D&O policy for a suit charging violations of the California securities laws based on Section 533 of the California Insurance Code, which bars coverage "for a loss caused by the willful act of the insured." *California Amplifier, Inc. v. RLI Ins. Co.*, 2d Civil No. B146315 (Cal. App. Dec. 3, 2001).

The plaintiffs in the underlying suit alleged false and misleading statements by the insureds in order to inflate the price of the company's stock in violation of California Corporations Code sections 25400 and 25500. Section 25400 prohibits companies from making "false and misleading statements designed to manipulate the securities market." Section 25500 provides a private remedy for violations of Section 25400. The insureds settled the case and sought coverage from their D&O insurers. RLI denied coverage on the grounds that the suit was not insurable under Section 533 because the underlying suit was premised on willful acts.

The Court of Appeal endorsed the insurer's position. The court reasoned that while the level of scienter for a violation of Section 25400 may only be negligence or recklessness, the requisite level of scienter for a remedy under Section 25500 is willful conduct. The court opined that the legislature intended to make the scienter requirement higher so that only persons who willfully, and not merely recklessly, violate Section 25400 can be held liable for damages. Second, the court found that the willful conduct required for relief under Section 25500 constituted a "willful act" within the meaning of Section 533. Because a plaintiff must demonstrate "knowing and deliberate" conduct to recover under Section 25500, the court concluded that Section 533's purpose-discouraging willful wrongdoing-was directly implicated. At the same time, the opinion suggests that liability for reckless behavior does not necessarily fall within the ambit of Section 533.