wiley

NEWSLETTER

Excess D&O Insurers Must Advance Defense Costs Pending "Final Disposition of a Claim," Despite Guilty Plea by President

August 2007

A trial court in Delaware, relying on "general legal principles," has held that several excess D&O insurers must advance defense costs to an insured corporation and its outside directors for a securities class action pending "final disposition" of the claim, despite the fact that the company's president had pled guilty to a fraudulent conspiracy. *Sun-Times Media Group, Inc. v. Royal & SunAlliance Ins. Co. of Canada*, 2007 WL 1811265 (Del. Super. Ct. June 20, 2007).

The primary policy provided that "the insurer must advance defence [sic] costs, excess of the applicable retnetion [sic], pursuant to the terms herein prior to the final disposition of a claim." The policy also contained two "personal conduct" exclusions. The first exclusion barred coverage for loss "arising out of, based upon or attributable to the gaining in fact of any profit or advantage to which the Insured was not legally entitled." The second excluded coverage for loss "arising out of, based upon or attributable to the committing in fact of any deliberate criminal or deliberate fraudulent act by the Insured." Both exclusions were qualified by an imputation clause: "For the purpose of determining the applicability of the forgoing [exclusions] . . . only facts pertaining to and knowledge possessed by any past, present, or future chairman of the board, president, chief executive officer, chief operating officer, chief financial officer or General Counsel (or equivalent position) of an Organization shall be imputed to an Organization."

The insured corporation and its directors faced various civil lawsuits arising out of allegations that the corporation's inside directors conspired to defraud investors. The inside directors also were indicted on federal criminal charges. One inside director, who was the president, chief operating officer and a director of the corporation, pled guilty and admitted to the fraudulent conspiracy. After the corporation exhausted its first and second layers of D&O insurance in connection with the settlement of a derivative action, the outside directors and the corporation sought advancement of defense costs from the third-layer excess insurers for the defense of a separate, ongoing securities class action. The third-layer excess insurers refused to advance, relying on the conduct exclusions and the fact of the insider director's guilty plea. The outside directors and the corporation subsequently initiated a coverage action and moved for partial summary judgment as to the excess insurers' duty to advance.

The court first considered the insurers' argument that material issues of fact existed as to what law applied to the policy's interpretation. The policy contained a Worldwide Extension choice-of-law provision that provided: "In regard to Claims brought and maintained solely in a Foreign Jurisdiction against an Organization formed and operating in such Foreign Jurisdiction or an Insured Person thereof for Wrongful Acts committed in such Foreign Jurisdiction, the Insurer shall apply to such Claim(s) those terms and conditions (and related provisions) of the Foreign Policy registered with the appropriate regulatory body in such Foreign Jurisdiction that are more favourable to such Insured than the terms and conditions of this policy." The excess insurers argued that Canadian law applied to the policy and that the choice of law question raised material issues of fact that precluded granting partial summary judgment. The court disagreed, noting that it could apply general legal principles unless there were clear conflicts of law between the United States and Canada, which the excess insurers had failed to identify. The court therefore left the choice of law issue undecided for purposes of resolving the partial summary judgment motion.

The court then held that the excess insurers' duty to advance under the policy was triggered because the claims in the securities class action "could potentially result in indemnity" under the policy. The court refused to find that the two "personal conduct" exclusions precluded advancement. In doing so, the court noted that the imputation clause did not trigger the exclusions, because the clause only referred to imputation to the corporation, not to the individual outside directors. Although the plea bargain by the corporation's president apparently fell within the scope of the imputation clause, the court explained that it still failed to trigger the exclusions unless the insurers could prove that every allegation in the class action was encompassed by the president's confession. Additionally, the court indicated that "the policy contains an unequivocal duty to advance defense costs prior to the final disposition of a claim." The court noted that the policy contained a provision requiring repayment of defense costs if it were subsequently established that the claim was not covered.

The court also denied the excess insurers' arguments relating to the policy's consent-to-settle and cooperation clauses. The excess insurers argued that the $50 million settlement of the derivative action violated the policy's consent-to-settle provision, which granted the insurers the right to participate in the settlement "of any Claim covered by this Policy which appears to the Insurer to be likely to involve the Insurer." The court stated that the excess insurers could not use the clause to obtain "veto power" over the settlement after they initially reserved rights as to the settlement but later denied coverage. Furthermore, the court asserted that the excess insurers could not rely on the consent-to-settle clause, because the settlement never reached their layer of coverage. As to the cooperation clause, the court held that the excess insurers failed to prove the settlement caused prejudice, which the court defined as proving "that the outcome of the underlying case would have been different had there been cooperation."