

Second Circuit Affirms Application of Prior Litigation Exclusion

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In an unpublished summary order applying New York law, the United States Court of Appeals for the Second Circuit has affirmed a district court's judgment finding that many of the factual allegations asserted in a complaint against the directors and officers of the bankrupt policyholder were excluded by a prior litigation exclusion, even though some of the excluded losses accrued during time periods not at issue in the prior litigation. *Pereira v. Gulf Ins. Co.*, 2009 WL 1262954 (2d Cir. May 6, 2009). The court also held that the insurer was not estopped from denying coverage based on the prior litigation exclusion.

The bankruptcy trustee sued to recover insurance proceeds allegedly due by virtue of a judgment in an adversary proceeding brought by the trustee against the directors and officers. Many of the factual allegations in the adversary proceeding had been at issue in an earlier suit filed before the date of the policy's prior and pending litigation exclusion, which excluded coverage for any claim "based on, arising out of, directly or indirectly resulting from or in consequence of, or in any way involving" such prior litigation. The final judgment in the adversary proceeding included discrete sets of factual findings made in connection with various monetary components of the judgment. The district court noted that a "claim" is a "demand made against the insureds for money damages" and that each itemized component of the final judgment constituted a separate "loss in connection with [a] claim." To determine which allegations in the adversary proceeding were covered under the policy, the district court compared the facts underlying each itemized portion of the judgment with the facts alleged in the prior litigation. The district court found that the majority of the facts alleged in the trustee's action were based on the prior litigation and therefore excluded. However, the court found that certain of the "claims" were not based upon the prior litigation and, thus, not precluded by the prior litigation exclusion.

The Second Circuit affirmed the lower court, rejecting the bankruptcy trustee's argument on appeal that the district court interpreted the prior litigation exclusion too broadly because it considered losses accruing during time periods other than those alleged in the prior litigation. The court concluded that the district court's approach was appropriate, noting that the district court's opinion "carefully parsed the various factual allegations in the complaint in the prior litigation and assigned dollar-amount increments of loss" to each set of common allegations.

The court also rejected the trustee's argument that the insurer was estopped from denying coverage on the basis of the prior litigation exclusion because the insurer initially denied coverage only on the basis that the policy had expired. According to the court, the trustee could not have reasonably relied on the insurer's declination of coverage letter to assume that the policy provided coverage because the insurer stated that it had not yet identified other potential coverage issues but continued to reserve its right to assert such other defenses.

The district courts' orders on motions to dismiss and for summary judgment were previously discussed in "Single Suit Deemed to Include Multiple Claims, Only Some of Which Are Barred by a Prior Litigation Exclusion," Executive Summary (October 2007), and "Court Denies Motion to Dismiss Based on Prior Litigation and Personal Profit Exclusions and Exhaustion," Executive Summary (September 2006).