

Prior Notice Exclusion Bars Coverage for Defense of Criminal Prosecution

October 2009

The Delaware Superior Court has held that a prior notice exclusion bars an insured's claim for defense costs incurred in a criminal prosecution despite the insured's argument that its insurers knew about the existence of the criminal investigation at the time the policies were issued. The court held, however, that the prior acts exclusion in the policies did not bar coverage for that reason. *HLTH Corp. v. Clarendon Nat'l Ins. Co.*, 2009 WL 2849779 & 2009 WL 2849777 (Del. Super. Ct., Aug. 31, 2009).

Certain former directors and officers of a corporation were indicted for conspiracy to commit securities, mail and wire fraud as well as money laundering between 1997 and 2003 (the Indictment). During the relevant time period, the corporation was twice acquired and renamed. The acquiring corporation sought coverage for defense fees and costs for the criminal case under three separate directors and officers insurance programs. Program 1 had a policy period of January 30, 1999 to July 23, 2005. Program 2 had a policy period of December 14, 1997 to December 14, 2000, with an extended reporting period expiring on September 12, 2006. Program 3 had a policy period of September 13, 2005 to September 13, 2006. After it had exhausted the coverage available under Programs 1 and 2 (or settled with the carriers on those programs), the acquiring corporation sought coverage under Program 3. The insurers on Program 3 denied coverage and sought summary judgment based on a prior notice exclusion and a prior acts exclusion in their policies.

The prior notice exclusion in the primary policy provided that the "Insurer shall not be liable to make any payment for Loss in connection with any Claim made against an Insured alleging, arising out of, based upon or attributable to the facts alleged, or the same or related Wrongful Acts alleged or contained in any Claim which has been reported, or in any circumstances of which notice has been given, under any policy of which this policy is a renewal or replacement or which it may succeed in time." (Certain excess insurance policies contained different language, but the court did not address those provisions.) The insurers contended that the prior notice exclusion applied because the insured tendered notice of the Indictment under Program 1 on July 21, 2005 but did not give notice under Program 3 until December 22, 2005. In response, the insured corporation contended that the policies in Program 3 were not "renewal[s] or replacement[s]" of the policies in Program 1 and did not "succeed" those policies in time. In addition, the insured argued that the insurers on Program 3 explicitly had agreed to provide coverage for the indictment, or had waived or were estopped from asserting application of the prior acts exclusion, because the insurers knew about the existence of the

criminal investigation that led to the indictment at the time they issued the policies. Specifically, the insured pointed to an "Amend Retention" endorsement in the Program 3 primary policy. That endorsement provided for a \$10 million retention for any "Medical Manager Claim," defined as any "Claim alleging, arising out of, based upon, attributable to or related to the investigation of the Organization conducted by the United States Attorney for the District of South Carolina" Finally, the insured argued that the prior notice exclusion should not apply because the named insured under Program 1 was not the same named insured under Program 3.

The court agreed with the insurers that the plain language of the exclusion barred coverage for the indictment. First, the court held that Program 3 succeeded Program 1 in time, and therefore notice under Program 1 triggered the exclusion, because the policy periods of the two programs did not overlap at all. The court also rejected the insured's argument that Program 1 and Program 3 were not issued to the same named insured because the language of the prior acts exclusion did not turn on the identity of the entity giving notice. Finally, the court held that the prior notice exclusion did not conflict with the "Amend Retention" endorsement because the insurers were not aware that the insured had provided notice under Program 1 at the time they issued their policies. The court accordingly rejected the insured's waiver and estoppel arguments as well.

However, the court rejected the Program 3 insurers' arguments that the prior acts exclusion in the primary policy barred coverage for the indictment. The prior acts exclusion provided that "[i]n consideration of the premium charged, it is hereby understood and agreed that the Insurer shall not be liable to make any payment for Loss in connection with any Claim made against an Insured alleging any Wrongful Act which occurred prior to February 10, 1999. This policy only provides coverage for Wrongful Acts occurring on or after February 10, 1999 and prior to the end of the Policy Period and otherwise covered by this Policy. Loss arising out of the same or related Wrongful Act shall be deemed to arise from the first such same or related Wrongful Act." The insurers argued that the indictment alleged an overarching conspiracy with Wrongful Acts occurring as early as 1997. The insurers further argued that, even if the indictment alleged various categories of Wrongful Acts, the earliest Wrongful Acts in each category allegedly were committed before February 10, 1999. In response, the insured corporation argued that the "Amend Retention" endorsement indicated that the parties specifically had contemplated coverage for any indictment resulting from the criminal investigation. The insured further argued that, at the time the Program 3 policies inceptioned, the insurers knew that the government was investigating conduct dating back to 1997. Finally, the insured argued that the prior acts exclusion was not a complete bar to coverage because the indictment did not specify when each co-conspirator allegedly entered and exited the conspiracy.

The court agreed with the insured that the "Amend Retention" endorsement "reflects the parties' knowledge that as a result of the Government's then ongoing investigation, claims for coverage were forthcoming." The court further found that, at the time they issued the Program 3 policies, the insurers knew that the "investigation concerned activity that occurred as far back as 1997." The court buttressed its conclusion by stating that the insurers specifically could have excluded any claim resulting from the criminal investigation but did not.