

Delaware Supreme Courts Holds That Prior Acts and Prior Notice Exclusions Bar Coverage for Criminal Proceeding Defense Costs

May 2010

The Delaware Supreme Court, applying Delaware law, has held that both prior acts and prior notice exclusions "definitively bar" a corporation's claim for coverage for the defense costs incurred by its former directors and officers in a criminal proceeding. *Axis Reins. Co. v. HLTH Corp.*, 2010 WL 1610623, Del. Apr. 22, 2010). In so holding, the court rejected the corporation's assertions that the policy provisions were ambiguous and that the insurers had waived or were estopped from relying on the exclusions to deny coverage. Wiley Rein LLP represented one of the insurers in the case.

Certain former directors and officers of the corporation were indicted for conspiracy to commit securities, mail and wire fraud as well as money laundering. The corporation filed suit in Delaware state court seeking coverage for amounts it advanced to the directors and officers in connection with their defense of the criminal proceedings under three separate towers of insurance—one issued to itself and two that were issued to two predecessor corporations it had acquired. Program I had a policy period of January 30, 1999 to July 23, 2005. Program II had a policy period of December 14, 1997 to December 14, 2000, with an extended reporting period expiring on September 12, 2006. Program III had a policy period of September 13, 2005 to September 13, 2006. Most of the insurers on Program III moved for summary judgment based on prior notice and prior acts exclusions in their respective policies. The corporation cross-moved. The trial court granted the insurers' motions on the prior notice exclusion and the corporation's cross-motion for summary judgment on the prior acts exclusion. Both sides were granted leave to file interlocutory appeals to the Delaware Supreme Court.

With respect to the prior acts exclusion, the trial court had held below, and the corporation argued on appeal, that the exclusion conflicted with a provision in the primary policy that amended the policy's retentions (the Amend Retention endorsement) and, as such, did not unambiguously bar coverage. The Delaware Supreme Court rejected these contentions and reversed the trial court's ruling. In so holding, the court stated that "reading the Prior Acts Exclusion in tandem with the Amend Retention endorsement does not create an ambiguity, because each has a distinct and independent purpose and function." Specifically, the court noted that the prior acts exclusion "relates to coverage and excludes coverage for any claims occurring before a prescribed date," whereas the Amend Retention endorsement "does not relate to events that trigger or preclude coverage . . . [but rather it] merely increases the amount of retention for any covered claim

specific to [the investigation leading to the indictments]."

The Delaware high court also rejected the corporation's argument that the prior acts exclusion should not be enforced because the Amend Retention endorsement reflected the parties' prior knowledge that claims would arise out of the government investigation that led to the indictments. In so ruling, the court stated that "the parties' *knowledge* of potential claims does not create a conflict with (or otherwise control) the clear policy language." (emphasis in original). It also noted that to read the Amend Retention endorsement as the corporation suggested would "would require us to interpret that language to supersede *all* other endorsements in the policy, including endorsements having nothing to do with retention amounts." (emphasis in original). According to the court, such a reading would lead to an "absurd result" and that a "more reasonable and harmonious interpretation results from reading the Amend Retention endorsement language more narrowly to supersede only those other endorsements that deal with retentions." The court also rejected the corporation's waiver and estoppel arguments, stating that those arguments "are inconsistent with the general principle that the doctrine may 'not . . . be invoked to bring within the coverage of an insurance policy risks, property or losses not covered by [the policy's] terms or expressly excluded therefrom.'"

The court also affirmed the trial court's ruling that the prior notice exclusions applied unambiguously to bar coverage for the corporation's claims because notice was provided to Program I prior to the inception of the Program III policies. First, the court denied the insured's contention that the Program I and Program III insurance towers afforded "concurrent, overlapping coverage." In so holding, the court noted that there was a "break between the two policies" because the Program I policies' policy periods ended on July 23, 2005 and the Program III policies did not incept until September 13, 2005. The court distinguished *Alstrin v. St. Paul Mercury Insurance Co.*, 179 F. Supp. 2d 376 (D. Del. 2002), which the corporation relied on, stating that, in *Alstrin*, the "coverage dates of the policies overlapped for several months" but that the "exact opposite occurred here."

The court also rejected the corporation's argument that an insurer can only deny coverage under a prior notice exclusion "where an insured fails to simultaneously notify insurers" who issued policies to the same named insured. According to the court, the insured's argument "fails to consider the express, broad language of the Prior Notice Exclusion," and, that under Delaware law, "policy language must be given its plain meaning." With respect to the prior notice exclusion, the court held that:

[T]he exclusion plainly and expressly prohibits coverage for acts alleged and claims reported under *any policy* "of which [the Program III primary insurer's] policy is a renewal or replacement or which it may succeed in time." That language does not bar (as [the insured] would like us to conclude) coverage for acts alleged and claims reported under any policy *in the same Tower* as [the Program III primary insurer] and "of which [that insurer's] policy is a renewal or replacement or which it may succeed in time." (emphasis in original).

The court also rejected the corporation's related argument that the prior notice exclusion should be read to apply only when the named insured provides the earlier notice.

Finally, the court rejected the insured's contention that the primary policy's prior notice exclusion was not applicable because "the provision logically refers to renewals or replacements of [the named insured's] policies and, therefore, cannot refer to policies issued to separate and distinct entities." To the contrary, the Delaware Supreme Court concluded that coverage was precluded in its entirety "[b]ecause the Prior Notice Exclusion [in the primary policy] uses unqualified, broad phrases that unambiguously permit prior notice to be given by any entity with respect to any policy and because [the insured] failed to give simultaneous notification to each insurance tower." The court also held that certain of the moving excess insurers' policies contained "similar" prior notice exclusions to which its analysis also applied.