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NEWSLETTER

Prior Notice and Outside Entity Exclusions Inapplicable To Claim Deemed First Made During Policy Period

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The United States District Court for the Northern District of Georgia, applying Georgia law, has held that a lawsuit that contained the same allegations as two lawsuits filed against the insured but not noticed to the insurer by the insured during a prior policy period constituted a claim first made during the latter policy period. *Cox Communications, Inc. v. Nat'l. Union Fire Ins. Co. of Pittsburgh, PA*, No. 1:09-CV-410-TWT (N.D. Ga. Apr. 9, 2010). The court also held that a prior notice exclusion and an outside entity exclusion did not bar coverage.

The insured, a telecommunications company, entered into service distribution agreements with an internet service provider (ISP). The insured also bought significant shares of the ISP's stock, which gave it the right to place a person on the ISP's board of directors. The distribution agreements were renegotiated in March 2000 as part of efforts to improve the ISP's financial performance. In May 2000, shareholders of the ISP filed lawsuits in California state court alleging that the insured, a director it had placed on the ISP's board (the "outside director") and others breached fiduciary duties owed to the ISP by negotiating and approving the new distribution agreements. The ISP reported the lawsuits to the insurer for coverage under a policy issued for the 1999-2000 period. However, the insured either did not report or did not timely report the May 2000 lawsuits to the insurer.

In September 2001, the ISP filed for bankruptcy. The bankruptcy court appointed an official committee of unsecured bondholders to pursue claims arising out of the March 2000 agreements. At the request of the bondholder committee, the bankruptcy court enjoined the state court lawsuits filed in May 2000 and, in September 2002, the bondholder committee filed its own action against the insured, the outside director and certain other defendants. The complaint in the bondholder committee lawsuit, like the complaints in the May 2000 lawsuits, alleged that the defendants breached fiduciary duties owed to the ISP by negotiating and approving the March 2000 agreements. The bondholder committee also alleged that the defendants violated federal securities laws.

The insured reported the bondholder lawsuit to the insurer under a policy issued for the 2002 policy period, which afforded coverage for "Claims first made against an Insured during the Policy Period." The insurer denied coverage on the ground that the lawsuit constituted a Claim first made at the time the May 2000 lawsuits were filed, prior to the 2002 policy period. The insurer also asserted that a prior notice exclusion and an outside entity exclusion in the policy barred coverage. After settling the bondholder lawsuit for $40 million on behalf of itself and the outside director, the insured filed the instant coverage action against the insurer seeking to recover the $30 million policy limit. The insurer moved for summary judgment.

The court denied the insurer's motion for summary judgment, ruling first that the bondholder lawsuit constituted a claim first made in 2002, during the 2002 policy period. The court reasoned that the insurer's position was "inconsistent with the policy's definition of a claim" in that the definition of "Claim" referred to proceedings commenced by service of a complaint rather than to individual causes of action within a complaint. The court concluded that each new proceeding creates a new claim. The court also rejected the insurer's argument that this interpretation undermines the meaning of claims "first made," noting that the policy provides that certain claims will relate back to prior policy periods. In this regard, the court opined that, if the insured had provided timely notice of the May 2000 lawsuits, then the bondholder lawsuit, "which arises out of the same facts as the [May 2000 lawsuits], would be considered related to the [May 2000 lawsuits] and made at the time notice for the [May 2000 lawsuits] was given" under notice provisions in the policy.

Next, the court ruled that the prior notice exclusion in the policy did not bar coverage. This exclusion precluded coverage for Claims "alleging, arising out of, based upon or attributable to the facts alleged . . . in any Claim which has been reported . . . under any policy of which this policy is a renewal or replacement or which it may succeed in time." The insurer argued that the exclusion applied because the bondholder lawsuit arose out of the same facts as the May 2000 lawsuits, the ISP reported the May 2000 lawsuits to the insurer, and the insured's policy issued for the 2002 policy period succeeds in time to the ISP's 1999-2000 policy. The court rejected this argument, ruling that the phrase "succeed in time" should be construed more narrowly to include only prior policies issued to the insured. The court determined that the broader reading would make the words "renew" and "replace" in the exclusion unnecessary and "would [] make the renewal application procedure clearly unreasonable." Regarding renewal applications, the policy provided that the insurer relies on the "Application" as being accurate and complete. "Application," in turn, is defined to include materials submitted in connection with the underwriting of the policy or any policy issued by the insurer of which the policy is a "renewal, replacement or which succeeds in time . . . ." The court reasoned that, if the insured's policy for the 2002 period "succeeds in time" any policy issued to any company, "the renewal application would incorporate documents for every policy issued to any company by the [insurer] or its affiliates that ended before the 2002 policy." Rejecting this result, the court ruled that the phrase "succeed in time" was ambiguous and should be construed more narrowly in light of the preceding terms "renewal" and "replacement."

The court further rejected the insurer's argument that the decision in *HLTH Corp. v. Clarendon National Insurance Co.*, 2009 WL 2849779 (Del. Super. Aug. 31, 2009), which involved the same prior notice exclusion, supported application of the exclusion. The *HLTH* court ruled that the exclusion barred coverage where a

subsidiary of an insured had provided notice to the insurer of a related claim under a separate, prior policy issued to the subsidiary. According to the *HLTH* court, the result would be the same even if the entity that gave notice under the prior policy was a distinct entity from the insured. The court concluded that the *HLTH* court's reasoning was not persuasive because it "did not consider the broader meaning of succeed in time."

Finally, the court ruled that the outside entity exclusion, which barred coverage for Claims "for any Wrongful Act arising out of the Insured Person serving as an Executive of an Outside Entity if such claim is brought by the Outside Entity," did not apply. Under the outside entity endorsement to the policy, the ISP was listed as an outside entity and the outside executive was listed as an outside entity executive. The court rejected the insurer's argument that the exclusion applied because the bondholder committee brought the lawsuit in the name of and on behalf of the ISP. The court reasoned that the policy "did not define outside entity to include a representative of the outside entity's estate," even though other provisions in the policy contemplated the possibility of bankruptcy and representative actions. For example, the court noted that the insured organization was defined to include the debtor-in-possession in the event of a bankruptcy proceeding. The court also distinguished decisions cited by the insurer in which courts applied insured versus insured exclusions to bar coverage for claims in the bankruptcy context. The court reasoned, in part, that these decisions involved broader language barring coverage for claims brought "on behalf of" the insured, or were brought by an "ordinary assignee" as opposed to a statutory assignee.