

Court Refuses To Stay Discovery Against Insureds In Coverage Action

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The United States District Court for the Southern District of Texas, applying Texas law, refused to stay discovery issued by insurers in a coverage proceeding sought to establish whether the insureds had "in fact" engaged in money laundering. *Pendergest-Holt v. Certain Underwriters at Lloyd's of London*, 2010 WL 3199355 (S.D. Tex. Aug. 11, 2010).

The insureds, corporate executives of companies founded by R. Allen Stanford, who face various civil and criminal actions for, among many other things, money laundering, sought coverage under a directors and officers liability policy. The insurers originally advanced defense costs subject to a reservation of rights, but later denied coverage, relying on an exclusion that "bars coverage for loss (including defense costs) resulting from any claim arising directly or indirectly as a result of or in connection with any act or acts (or alleged act or acts)" of money laundering, as that term is defined in the policy.

The trial court initially issued a preliminary injunction prohibiting the insurers from withholding defense costs until after trial of the underlying merits. The Fifth Circuit Court of Appeals affirmed the injunction but remanded the case for further "expedited" proceedings on the coverage issues. On remand, the trial court announced that the "in fact" determination of whether money laundering occurred would be made at a trial in the context of a non-jury preliminary injunction hearing. The insureds then moved for a protective order shielding them from discovery in connection with the expedited coverage proceeding. The insureds contended that a stay was necessary to shield them from the "Hobson's choice" of "either answering discovery-potentially waiving their Fifth Amendment privilege" or "invoking the privilege and risking adverse evidentiary inferences" in the coverage action.

In rejecting the insureds' request to stay discovery, the court held that the insureds failed to meet their burden of showing the necessity of a protective order. The court reasoned that staying discovery would impose an undue hardship on the insurers, which are under an affirmative order to pay defense costs until a determination of fact is made with respect to whether money laundering in fact occurred. In this regard, the court held that the insureds "will not be permitted to seek through this suit affirmative relief of enforcement of the Policy as they construe it . . . while simultaneously denying [the insurers] discovery that [the insurers] seek in an effort to defend themselves against [the insureds'] claims and thus liability for those costs."

Finally, the court declined to reach the issue of whether adverse evidentiary inferences should be made against insureds should they invoke their Fifth Amendment rights in response to the discovery requests. Holding that this request was premature, it denied that portion of the insureds' motion without prejudice.