

Award of Attorneys' Fees in Derivative Action Constitutes Covered "Loss"

March 2011

A New York appellate court has held that an award of attorney's fees in a derivative suit constituted covered "Loss" under a Management Liability and Company Reimbursement policy. *XL Spec. Ins. Co. v. Loral Space & Comm., Inc.*, 2011 WL 537161 (N.Y. App. Div. Feb. 17, 2011).

The insurer issued a claims-made Management Liability and Company Reimbursement policy to the insured. The policy provided specified coverage for "Loss resulting solely from any Securities Claim . . . for a Company Wrongful Act." The policy defined "Loss" as "damages, judgments, settlements or other amounts (including punitive or exemplary damages where insurable by law) and Defense Expenses in excess of the Retention that the Insured is legally obligated to pay." The insured paid an additional premium to amend the policy's definition of "Securities Claim" to include shareholder derivative claims.

During the policy period, a shareholder derivative action and a class action lawsuit were filed against the insured based on a transaction with a controlling shareholder. The Delaware Chancery Court combined the two lawsuits and found the transaction was unfair to the insured. The Delaware court reformed the terms of the transaction but did not make any findings of fault by the insured and did not order the insured to pay any money damages to the shareholders. The Delaware court did, however, award the shareholders attorneys' fees for both lawsuits, and the insured sought coverage for the attorneys' fees under the policy. The insurer sought a declaratory judgment that no coverage existed under the policy for the attorneys' fees because the fees did not constitute covered "Loss."

The New York court held that the attorneys' fees for the shareholder derivative action constituted "Loss" under the terms of the policy. According to the court, "[t]he policy's definition of 'Loss' is broad" and "covers 'other amounts' the insured becomes 'legally obligated' to pay." The court rejected the insurer's contention that the insured had not suffered covered "Loss" because the Delaware court found no fault and merely restructured the transaction, thus affording a benefit to the insured. The court determined that the award of attorney's fees was a component of the chancery court's equitable judgment and therefore fit squarely within the "other amounts" portion of the policy's definition of "Loss." The court concluded that coverage for the attorneys' fees also was warranted because the insured had paid an additional premium for coverage for shareholder derivative actions and an award of attorneys' fees in such cases is typical. According to the court, "[h]ad the insurers meant to exclude derivative plaintiff's attorneys' fees, they could have limited the definition of 'Loss,'

limited the definition of 'Securities Claim' or drafted an exclusion." Finally, the court held that no coverage existed for attorneys' fees related to the class action lawsuit because it was not a "Securities Claim" as defined in the policy.