

Nature of Consumer Class Action, Not Percentage of Meritorious Claims, Determines Coverage and Allocation

June 2012

The Appeals Court of Massachusetts, the state's intermediate court of appeals, has held that an excess liability policy may afford coverage for indemnity costs associated with a consumer class action settlement without regard to the percentage of individual claims that were ultimately determined to be meritorious. *Allmerica Financial Corp. v. Certain Underwriters at Lloyd's, London*, 81 Mass. App. Ct. 674 (Mass. App. Ct. Apr. 30, 2012). The court held that the settlement was comprised of "both covered and uncovered" claims and therefore required allocation under the policy to determine what portion of the claims, if any, were covered.

The underlying class action litigation that gave rise to the coverage dispute involved alleged fraud, misrepresentation, negligent supervision, negligent misrepresentation, and other conduct in connection with so-called "vanishing premium" misrepresentations in the sale of life insurance. The insured settled the lawsuit by establishing a process of adjudicatory review that provided differing levels of compensation to members of the claimant class depending on a numerical category assigned to reflect the severity and level of resulting damages, if any. That process determined that only 27 percent of the underlying claimants had meritorious claims.

In light of this finding, the trial court in a subsequently-filed coverage action determined that the number of "wrongful acts" involved in the 27 percent of meritorious claims could never reach a level of loss sufficient to reach the excess insurer's layer, which provided coverage for loss in excess of \$20 million. The insured appealed this ruling. The intermediate appellate court reversed the lower court's decision, holding that the number of individual claims found to be meritorious was not relevant to coverage under the excess policy. The court noted that the policy afforded coverage for "wrongful acts," defined as "actual or alleged" misstatements or misleading statements. The court reasoned that the policy affords coverage for alleged, but not necessarily actual wrongdoing, and that a "loss" was incurred in establishing a process to respond to the underlying claim.

In addition, the court held that the underlying class action included some factual allegations and counts that would be covered under the policy because they alleged negligence, inaction, negligent supervision, failure to supervise, and reckless conduct. The underlying action also included numerous allegations and counts that

would be excluded under the policy with respect to alleged fraud and other improper conduct. The court concluded that “[h]aving determined that damages resulting from allegations of wrongdoing as well as actual wrongdoing are within the policy’s coverage, and having determined that the costs incurred by [the insured] in defending, then settling, the class action are potentially attributable in some proportion to claims that are covered by the policy, we must address allocation.” The court remanded the case for proceedings to determine what portion, if any, of the insured’s damages were attributable to covered allegations as opposed to uncovered allegations. In doing so, the court emphasized that “the percentage of claims ultimately resulting in adjudicated awards is not relevant to such a determination; neither the denial nor the payment of an award signifies the basis of the claim, it merely signifies whether the adjudicators considered the misstatement to be ‘actual’ or ‘alleged,’ a distinction, as we have seen, that is irrelevant for purposes of determining coverage.”