

# Side A Insurers Not Required to Drop Down to Provide Coverage to Claims Deemed First Made in Prior Policy Period

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The Superior Court of Arizona has held that two Side A insurers did not have an obligation to drop down and provide coverage for underlying litigation deemed related to litigation filed in a prior policy period. *SP Syntax LLC v. National Union Fire Ins. Co.*, CV 2011-019071 (Ariz. Super. Ct. Jan. 7, 2014). In an earlier decision, the court held that a specific litigation exclusion in an underlying primary and two follow-form insurance policies barred coverage under the later policy period, but allowed the plaintiffs, as the assignees of the insureds, to conduct discovery to determine whether there was any extrinsic evidence to support the plaintiffs' contention that the parties mutually intended for two Side A/Difference in Condition policies to drop down in the circumstances presented. Wiley Rein represented one of the Side A insurers.

At issue were two successive towers of claims-made D&O insurance issued to a company for the policy periods of November 30, 2006 to November 30, 2007 (Tower 1) and November 30, 2007 to November 30, 2008 (Tower 2). Tower 1 was comprised of four policies, each with \$5 million limits of liability, and Tower 2 was comprised of five policies, each with \$5 million limits of liability. Tower 2 included a primary policy, two policies that followed form to the primary policy, and two Side A policies that did not follow form and provided "drop down/difference in condition" coverage.

Shortly before the expiration of the Tower 1 policy period, investors brought suit against certain of the company's D&Os for securities fraud (the Securities Action), and the officers tendered the Securities Action to the Tower 1 insurers. In light of the Securities Action, the Tower 2 primary and follow-form carriers added a specific litigation exclusion to their policies that identified the Securities Action by name. The specific litigation exclusion provided that all Claims arising out of or related to the Securities Action were deemed made during the Tower 1 policy period and excluded from coverage under Tower 2. The Side A insurers did not adopt the specific litigation exclusion, but their policies contained related claims provisions and prior notice exclusions.

The Securities Action was followed by additional litigation filed during the Tower 2 policy period, including a lawsuit by two private entities that had loaned money to the insured company during the Tower 1 policy period (the Underlying Action). After the Underlying Action was tendered to the Tower 1 and Tower 2 insurers, all of the insurers determined that the Underlying Action arose out of the same facts and circumstances as

the Securities Action and therefore related back to Tower 1.

The D&Os and the claimants settled the Underlying Action for a stipulated judgment of \$26.47 million and an assignment of rights under the Tower 2 policies, and the Tower 1 insurers paid \$1.47 million of the settlement in accordance with the stipulated judgment. The claimants then brought a coverage action seeking the remaining \$25 million of the stipulated judgment from the Tower 2 insurers.

On motions to dismiss filed by the insurers, the court dismissed the primary and follow-form insurers on the basis that, applying the plain language of the specific litigation exclusion, the Securities Action and the Underlying Action were related, and the Underlying Action was therefore excluded from coverage under Tower 2. The court further determined, however, that discovery was appropriate to determine whether the Side A insurers were required to drop down in the circumstances presented because the Side A insurers had not adopted the specific litigation exclusion and the related claims and prior notice exclusions did not reference the Securities Action by name.

Following the completion of discovery, the Side A insurers and the claimants filed cross-motions for summary judgment. The court concluded that the related claims and prior notice provisions in the Side A policies applied to relate the Underlying Action back to the Securities Action under Tower 1. The court rejected the claimants' arguments that the parties mutually intended for the Tower 2 Side A policies to drop down and afford coverage for a Claim related to the Securities Action and that the insureds reasonably expected the Tower 2 Side A policies to do so. Instead, the court agreed with the insurers that the D&Os' tender under the Tower 1 policies and the claimants' receipt of settlement funds paid under a Tower 1 Side A policy belied the claimants' arguments in the coverage litigation.

The court also rejected the claimants' argument that the date in prior or pending litigation exclusions in the Tower 2 policies, which barred coverage for all Claims pending as of or prior to November 30, 2006, controlled the operation of the related claims and prior notice provisions and impliedly afforded coverage for the Underlying Action in Tower 2 because it was not pending before that date. The court observed that it "simply cannot be the case" that the date in a prior or pending litigation exclusion mandated coverage for the Underlying Action and expressly rejected the claimants' reliance on *Gastar Exploration Ltd. v. U.S. Specialty Insurance Co.*, 412 S.W.3d 577 (Tex. App. 2013). The court noted that the prior or pending date did not "override the related claims and prior notice provisions, which make no reference to a pending and/or prior date and operate independently of it."

The court also rejected the claimants' argument that the premiums charged for the Side A policies "cannot be reconciled with an interpretation that excludes coverage for all claims regarding [the insured company's] financial statements or business relationships . . . ." In this regard, the court noted that the "related claims and prior notice provisions do not foreclose coverage," but merely "specify which policy period and corresponding tower of coverage will respond to a claim."

The court therefore granted summary judgment in favor of the Side A insurers.