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NEWSLETTER

Ninth Circuit Rules That No Loss Occurs When Third Party Indemnifies Policyholder

November 2006

The U.S. Court of Appeals for the Ninth Circuit has held that a policyholder who was never required to fund a settlement because of a separate indemnification agreement with an indemnitor suffered no "loss" under a D&O policy in connection with that settlement. *Pan Pacific Retail Properties, Inc. v. Gulf Ins. Co.*, 2006 WL 3026057 (9th Cir. Oct. 26, 2006).

The court also determined that California public policy precluded insuring amounts that are restitutionary, but found there were factual questions regarding whether the entirety of the settlement at issue constituted uninsurable restitution.

The underlying lawsuits alleged various securities and corporate wrongdoing in conjunction with the merger of the two insured companies. According to the underlying plaintiffs, the two companies did not fully disclose all relevant information to their shareholders and, as a result, certain shareholders, agreed to a lower share price for the merger than they otherwise would have. The shareholders pursued both derivative and direct claims. The derivative claims were dismissed, and, at the time of settlement, only the direct claims were outstanding. The companies' insurers denied coverage for the claim, asserting that the shareholders were seeking uninsurable restitution by seeking amounts that constituted extra consideration for their shares. In addition, one of the companies had entered into an indemnity agreement with the other company, whereby one policyholder indemnified the other for the underlying settlement. Accordingly, the insurer of the company that was indemnified asserted that its insured had not suffered insurable "loss."

The court first addressed whether the underlying settlement and dispute encompassed any claims for relief for amounts other than uninsurable restitution. According to the court, California's public policy precludes "coverage for claims seeking the return of something wrongfully received," but not "for claims that seek compensation for injury suffered as a result of the insured's conduct." The court recognized that, to the extent that the underlying claim sought extra consideration that should have been paid for the shares, this would constitute uninsurable restitution, citing *Level 3 Communications, Inc. v. Federal Insurance Co.*, 272 F.3d 908 (7th Cir. 2001). According to the court, this was the only possible measure of damages for the dismissed derivative suit. The court also noted, however, that at the time of settlement, the only remaining allegations were based upon direct claims. The court recognized that the settlement could, at least in part, have been to resolve the outstanding direct claims and stated that it was unclear what kind of damages measure could be

used for such claims.

The policyholders argued that a "value of information" damages theory, which would not constitute restitution, could have provided damages for the cost of providing the information that was withheld. Although acknowledging that there was no evidence that this theory was ever advanced in the underlying litigation, the court held that this theory of relief created a genuine issue of fact precluding summary judgment. As such, the court reversed the district court's ruling that the only relief asserted was uninsurable restitution. Having found that there was thus a possibility of insurable "loss," the court further held that, if it were established on remand that a portion of the settlement was for insurable "loss," then the insurers would be liable for defense costs in connection with the underlying actions.

The court then addressed the contention that the indemnity agreement precluded coverage for the indemnitee policyholder. According to the insurer, the indemnitee suffered no "loss" because another party fully paid for the settlement obligations of its insureds on its behalf. The court noted that, for coverage under the company reimbursement provision of the relevant policy, there was a "requirement that the Company 'has indemnified' its directors and officers." The requirement "appears to require that the Company must in fact make payments on behalf of its officers and directors." Because the insured company admitted that it did not make any payments on behalf of its directors and officers, the court concluded that it had suffered no "loss" under the reimbursement coverage provision.

The court also considered the insured company's claim for entity coverage for the settlement and noted that the policy language for that coverage part required the insurer to pay damages or expenses if the insured was "legally liable as a result of a covered claim." The court concluded the insured had suffered a "loss" under the policy under that coverage part. However, because the company had been indemnified by the other company for such "loss," the court concluded that it did not have "a right to recover twice for the same loss," and held that the insurer had no further obligation to the indemnified policyholder. The court then noted that it "express[ed] no opinion whether [the insurer] could possibly be obligated to contribute to the party" that previously indemnified the policyholder.