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Policy Language Trumps 'Factual Nexus' Test in NY

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The United States Court of Appeals for the Second Circuit recently held that, under New York law, a “related claims” provision should be interpreted and applied pursuant to the “plain language” of the contract. It rejected application of the so-called “factual nexus” test that many lower federal courts had employed over time. *Nomura Holding America Inc. v. Federal Insurance Co.*, No. 14-3789 (2d Cir. Oct. 21, 2015). However, given the breadth of most professional liability insurers’ “related claims” provisions, the Second Circuit’s holding is unlikely to change the outcome in many cases implicating this issue. Indeed, the *Nomura* court ultimately upheld the district court’s holding, albeit on different grounds.

The insureds, a holding company, its subsidiaries and their directors and officers, acted as sponsors, depositors, and underwriters for various securitizations of residential mortgage-backed securities (RMBS). In January 2008, the insureds were named as defendants in a lawsuit alleging that misrepresentations were made in offering the documents for RMBS securitizations. In 2011 and 2012, five additional lawsuits were filed against the insureds alleging misrepresentations in various RMBS securitizations. The insureds tendered the 2011 and 2012 lawsuits to its insurer for coverage under a D&O policy covering the 2011 to 2012 policy period. The insurer denied coverage for the five lawsuits, concluding, in part, that the five lawsuits related back to the 2008 suit and therefore were deemed first made before the inception of the policy. The policy defined “related claims” as “all claims for wrongful acts based upon, arising from, or in consequence of the same or related facts, circumstances, situations, transactions or events or the same or related series of facts, circumstances,

Authors

Nicole Audet Richardson
Consulting Counsel
202.719.3746
nrichardson@wiley.law

Practice Areas

Insurance

situations, transactions or events." The policy further specified that all related claims are deemed a single claim made at the time the earliest of the claims was first made.

Following the insurer's denial of coverage for the five lawsuits under the 2011-2012 policy period, the insured initiated coverage litigation. The trial court held that coverage was precluded because the five lawsuits were related claims, all of which related back to the 2008 suit and therefore were deemed first made before the inception on the policy. The court reached this decision by applying a "factual nexus" test, whereby "[a] sufficient factual nexus exists where the claims are neither factually nor legally distinct, but instead arise from common facts and where the logically connected facts and circumstances demonstrate a factual nexus among the claims."

The Second Circuit affirmed the trial court's decision with respect to the application of the related claims provision contained in the policy but opined that the trial court erred in employing the "factual nexus" test instead of interpreting the policy pursuant to its "plain language as required by New York law. According to the court, the proper analysis focuses on whether the underlying claims are "based upon, arising from, or in consequence of the same or related facts, circumstances, situations, transactions or events or the same or related series of facts, circumstances, situations, transactions or events," and not whether the claims "are neither factually nor legally distinct, but instead arise from common facts and circumstances demonstrate a factual nexus among the claims." Because the Second Circuit agreed that there was no genuine dispute that the claims in the five lawsuits were related to the claim first made in 2008, as defined within the policy, the court upheld the decision of the trial court for the insurer.

This decision directs New York district courts to reject a generalized "factual nexus" test in favor of plain policy language. As the Second Circuit noted, it is "axiomatic" that under New York law, a policy's plain language must serve as the centerpiece for the analysis of the court. According to the Second Circuit, courts applying New York law incorrectly have utilized the "factual nexus" test even where the policy at issue provided a definition to guide the relatedness inquiry. For instance, in 2009, the United States District Court for the Southern District of New York utilized the "factual nexus" test to determine whether claims were "interrelated" even though the policy defined "interrelated wrongful acts" differently. *Quanta Lines Insurance Co. v. Investors Capital Corp.*, (S.D.N.Y. Dec. 17, 2009) (the policy at issue defined "interrelated wrongful acts" to mean: "any wrongful acts that are: similar, repeated or continuous; or connected by reason of any common fact, circumstance, situation, transaction, casualty, event, decision or policy or one or more series of facts, circumstances, situations, transactions, casualties, events, decisions or policies"). Similarly, in 2014, the same lower court found that where a policy defined "interrelated wrongful acts," the proper inquiry was whether there was a sufficient "factual nexus" despite a different definition in the policy. *Glascoff v. OneBeacon Midwest Insurance Co.*, (S.D.N.Y. May 8, 2014) (the policy at issue defined interrelated wrongful acts to mean those "which have as a common nexus any fact, circumstance, situation, event, transaction or series of related facts, circumstances, situations, events or transactions"). Other courts applying New York law have also placed the "factual nexus" test at the forefront of the inquiry into whether claims are interrelated. The Tenth Circuit has held that under New York law, even where the parties agree that none of the policy provisions is ambiguous and where the policy provided a definition for interrelated wrongful acts, the "factual nexus" test controlled.

Breck & Young Advisors Inc. v. Lloyds of London Syndicate 2003, 715 F.3d 1231, 1238 (10th Cir. 2013) (the policy at issue defined interrelated wrongful acts to mean those “connected by reason of any common fact, circumstance, situation, transaction, casualty, event, decision or policy or one or more series of facts, circumstances, situations, transactions, casualties, events, decisions or policies”).

Ultimately, the *Nomura* decision may not affect the outcome of many cases. Related claims provisions often look to an overlap of factual circumstances, acts and events. Nevertheless, courts and litigants will need to tether their analysis to the precise language at issue in the insurance policy, which can vary among policies and insurers.