

Insurance Coverage For Sub- Prime Litigation Liabilities

Richard F. McMenamin, Esq.

Carol C. Carty, Esq.

Morgan, Lewis & Bockius LLP

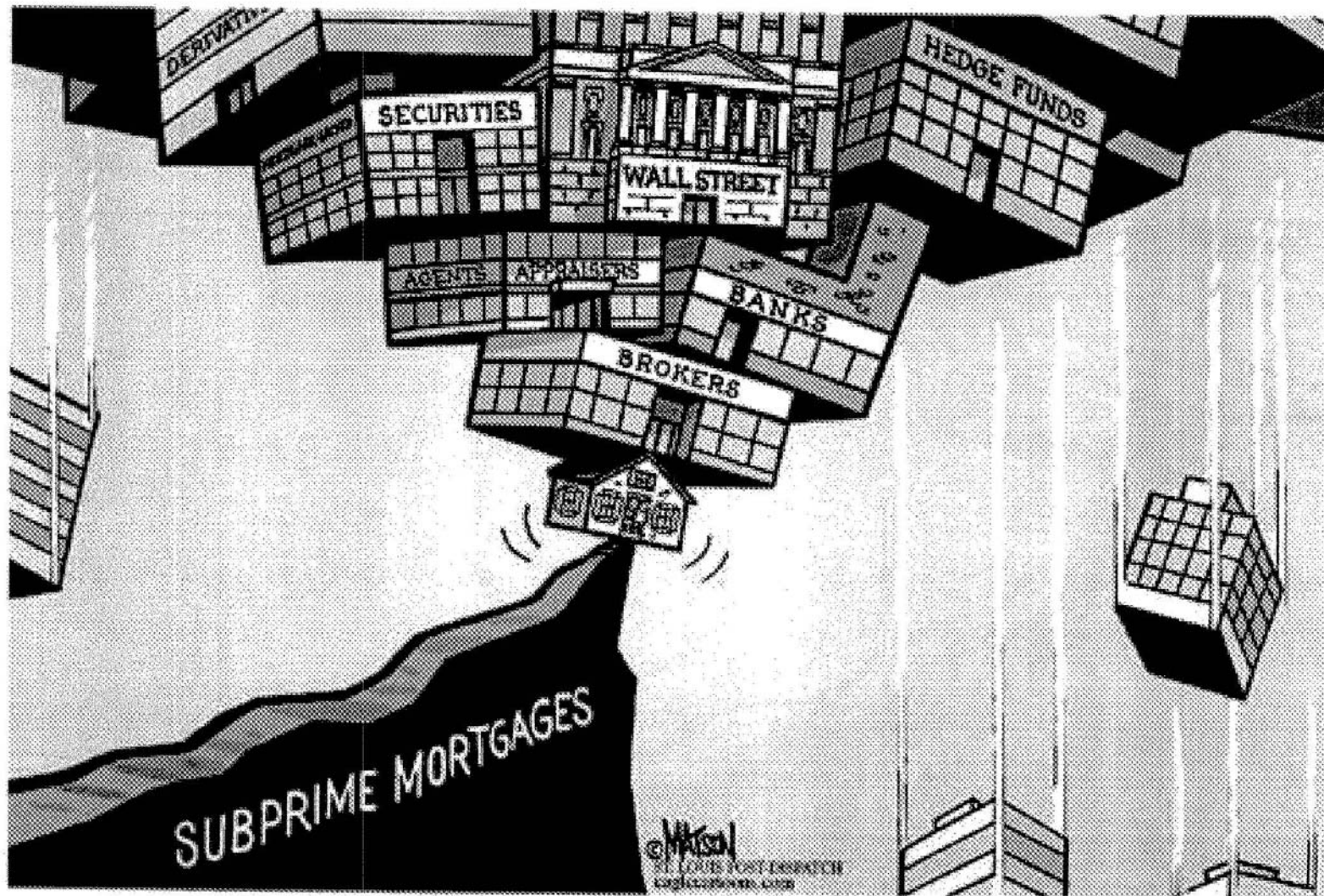
1701 Market Street

Philadelphia, PA 19103

215.963.5596

The Sub-prime Crisis In Brief

- Brokers sold people houses that they could finance only if house values kept rising.
- House values stopped going up and even fell.
- Millions defaulted because they could not re-mortgage.
- Investors who bought securities collateralized by the assumed value of the houses lost a lot of money.



"I THOUGHT WE WERE JUST BUYING A HOUSE!"



Lisa©2008 3-26
Dist by WashPostMattersGroup

© Original Artist
Reproduction rights obtainable from
www.CartoonStock.com



"We lost our shirts on the sub-prime mortgage fiasco."

Some Key Coverage Issues Likely To Arise Under D&O Policies For Sub-Prime Mortgage Coverage Claims

- Timely Notice
- Choice Of Forum And Choice Of Law
- Number Of Claims And Occurrences

Some Key Coverage Issues Likely To Arise Under D & O Policies For Sub-Prime Mortgage Coverage Claims, cont'd.

- Insured's Right To Advancement Of Defense Costs
- Insured's Right To Settle
- Bankruptcy Considerations

Timely Notice

Timely Notice

- TIMELY NOTICE OF A CLAIM IS ESSENTIAL.
- Notice usually must be in writing but an e-mail will suffice.
- Important to read notice requirements in the policy.

Timely Notice

- Insured not broker should send notice
- Late notice is an absolute defense.
- Prejudice rule does not apply to d & o policies.
- Notice of circumstance may also be important.

National Union Fire Insurance Company v. General Star Indemnity Company, 2007 U.S. App. LEXIS 3559 (3d Cir. February 16, 2007)

- Excess carrier's late notice defense upheld.
- Initial verbal notice to excess carrier after unexpectedly large verdict.
- Written notice was mandatory policy requirement.
- Reasoning – sophisticated parties and no indication of waiver of notice requirement.

Oakland-Alameda County Coliseum, Inc. v. National Union Fire Ins. Co. of Pittsburgh, Pa., 480 F. Supp. 2d. 1182 (N.D. Ca. 2007)

- Notice section of D&O policy did not dispense with timing requirement.
- Insurer had not waived timeliness defense.

Choice of Law/Choice of Forum

Choice Of Law/Choice Of Forum

- Less of an issue in d & o coverage claims.
- Insurer does not have a duty to defend.
- Fewer issues that may be litigated before resolution of the underlying case.
- Policy also may have a dispute resolution clause.

Choice Of Law/Choice Of Forum

- Clause may require non-binding mediation or mandatory arbitration.
- Mandatory arbitration provision often requires AAA arbitration in New York or another forum.
- Absent dispute resolution clause, consider promptly whether choice-of-law issues are presented.

Key Pennsylvania Choice Of Law Cases

- Budtel Associates v. Continental Casualty Co., 915 A.2d 640 (Pa. Super 2006)
- Hammersmith v. TIG Insurance Co., 2007 WL 777560 (3d Cir. Mar. 15, 2007)
- PhotoMedex, Inc. v. St. Paul Fire & Marine Ins. Co., 2008 WL 324025 (E.D. Pa. February 6, 2008)

Hammersmith v. TIG Insurance Co., 2007 WL 777560
(3d Cir. Mar. 15, 2007)

- Conflicting decisions in the Third Circuit regarding Pennsylvania choice of law in contract cases.
- Hammersmith follows Budtel – apply most significant contacts and governmental interest analysis.
- Contacts assessed for significance to insurance contract, not to underlying tort.

Number of Claims

Number Of Claims

- Significance of the issue?
- Which policies are triggered?
- May multiple policies be triggered by multiple lawsuits?
- Policies have “prior acts” and “prior litigation” exclusions.

Number of Claims

- Policies cover Loss for Claim for Wrongful Acts
- Claim – any written or oral demand for damages or other relief against any of the insureds, or any civil, criminal, administrative or regulatory proceeding
- Wrongful Act -- actual or alleged act, error, omission, misstatement, misleading statement, neglect or breach of duty....

Number of Claims

- Is each complaint a “Claim”
- Is each cause of action in a complaint a “Claim”
- Are causes of action grouped in some way as a “Claim”

AT&T Corp. v. Faraday Capital Limited, 2007 WL 329218 (Del. Feb. 5, 2007), cont'd.

- Form of the demand is irrelevant in determining number of “Claims” asserted.
- Court finds that each cause of action may be a Claim.
- Court also accepts AT&T argument that multiple causes of action may be grouped as a single “Claim.”

Insured's Right To Advancement Of Defense Costs

Advancement Of Defense Costs

- Insured not insurer must defend claims.
- Insurer generally not liable for pre-notice costs and costs to which it has not consented.
- Policies generally include requirement for undertaking to re-pay defense costs.

Advancement of Defense Costs

- Some policies also may have panel counsel provisions restricting choice of counsel.
- Issue as to use of panel counsel where insurer has reserved its rights to deny coverage.
- Insurers typically rely on “litigation guidelines” to control the costs of defense.

G-I Holdings Inc. v. Reliance Ins. Co., 2006 WL 776809 (D.N.J. 2006).

- Hartford argues that duty to pay defense costs arises only when coverage defense resolved.
- G-I Holdings argues coverage for “Loss” that “insureds shall become legally obligated to pay as a result of a Claim” requires advancement of defense costs.
- Court agrees with G-I Holdings.

In re Worldcom, Inc. Securities Litigation, 354 F. Supp. 2d 455 (2005)

- Director seeks advancement of defense costs.
- Policy contains standard Insurer “must advance defense costs” language.
- Continental claims fraud in the application process (failure to disclose accounting irregularities); seeks to rescind as to all insureds.
- Court holds that policy remains in effect until defense proven.

Insured's Right To Settle

Right to Settle

- Settlement most difficult part of d & o claim.
- Insurer unquestionably has right to consent.
- Insurer needs to be integrally involved in the negotiations.
- Mutual obligations of good faith and fair dealing apply, particularly to individual directors/officers.

Right to Settle

- Often “good cop” “bad cop” roles with plaintiffs’ counsel.
- Insurer seeks discount for coverage defenses
- Multiple insurers and multiple policy years complicate negotiations.

Vigilant Ins. Co. v. Bear Stearns Companies, Inc., 2008 WL 656260 (N.Y. Ct. of Appeals, March 13, 2008)

- Insured agrees to settlement in principle and executes consent agreement to pay \$80 million without advising Vigilant.
- Policy contains standard insurer consent to settlement provision.
- Bear Stearns asserts no settlement until later court approval of agreement in principle.
- Court holds that Bear Stearns contractual agreement to settle without obtaining consent violated unambiguous consent to settlement provision.

Qualcomm, Inc. v. Certain Underwriters at Lloyd's London, No. D050433 (Cal. Ct. App. March 25, 2008)

- Qualcomm settles with National Union for \$16 million of \$20 million limit.
- Lloyd's excess policy provides it is liable "only after National Union has "paid or ... been held liable to pay the full amount of [its limits]"
- Qualcomm pays \$4 million "gap" and seeks \$9 million from Lloyds.
- Court holds no liability.

Conteras v. U.S. Security Insurance Co., 927 So.2d 16
(Fla. Dist. Ct. Appeal, Fourth District 2006)

- May insurer settle claim against one insured-defendant but not other insured-defendant? Yes.
- May insurer do so where settlement for one insured will exhaust policy limits? Yes.
- Is the insurer potentially liable for bad faith refusal to settle if it fails to settle for the insured as to whom settlement can be achieved? Yes.

Bankruptcy Considerations

Bankruptcy Considerations

- Automatic stay is not a stay against the officers and directors. Side “A” coverage is triggered.
- If Side “C” coverage, trustee may face suits, argue she is an “Insured” and try to block or control payments under the policies.
- Even without Side “C” coverage, trustee may try to control the asset as an asset of the estate.
- Insurers frequently will not pay director and officer defense costs under Side A coverage without bankruptcy court approval.

Bankruptcy Considerations

- Courts frequently will limit the amounts that directors and officers may access under Side “A” coverage.
- Separate Side “A” coverage for the directors and officers can avoid the bankruptcy problems.
- Independent directors Side “A” coverage is another policy that avoids bankruptcy problems.