3 Key D&O Insurance Cases To Watch In 2018

Law360

Courts around the country are set to grapple with critical coverage issues under directors and officers insurance policies in 2018, including at what point a U.S. Securities and Exchange Commission investigation triggers coverage and when an insurer can withhold consent for a policyholder's settlement.

Here, Law360 breaks down three key D&O cases that will have C-suites' attention this year.

Patriarch Partners LLC v. Axis Insurance Co.

Investment firm Patriarch Partners LLC has asked the Second Circuit to revive its bid for $5 million in excess coverage from Axis Insurance Co. to help defray the costs of an SEC probe and enforcement action, in a case that will test the bounds of coverage for inquiries by the federal agency.

The SEC had claimed Patriarch and its chief executive, Lynn Tilton, misled investors about the performance of the firm's so-called Zohar funds by improperly categorizing loans that missed interest payments as current rather than defaulted, allowing for the collection of fees and payments that the agency argued should have been used to pay down the notes instead. An administrative law judge ultimately entered an order in September dismissing the agency's action in its entirety, court records show.

Patriarch incurred more than $25 million in legal bills defending against the SEC proceedings, and three of its D&O insurers agreed to pay $20 million of that sum, according to court documents. Axis, however, refused to pay under its $5 million excess D&O policy, asserting that the SEC probe was already in progress by the time it issued the policy in July 2011, thereby triggering an exclusion for "prior and pending" litigation.

Patriarch argued the SEC investigation did not formally get underway until the firm was served with its first subpoena in February 2012, but U.S. District Judge Valerie Caproni of the Southern District of New

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York found in September that the probe began when the SEC issued its first order of investigation in early June 2011, before the Axis policy went into effect.

On appeal, Patriarch is contending that the district court erred because neither the nonpublic order of investigation nor other informal acts by the SEC constituted a claim under the Axis policy.

“The district court’s conclusion that each of these events constituted a prior or pending claim is erroneous because none of them satisfies the definition of a claim which requires either a demand for nonmonetary relief or a formal ‘investigation,’ both of which must contain an allegation of a ‘wrongful act’ against an insured,” Patriarch argued in its opening appellate brief.

Hunton & Williams LLP partner Syed Ahmad said Patriarch’s appeal presents an unusual situation in which a policyholder is arguing that various developments in an ongoing SEC investigation don’t constitute a claim under a D&O policy, in order to avoid the application of an exclusion. In other circumstances, it may be favorable for a policyholder to assert that a preliminary step in an SEC probe is a claim, so as to maximize coverage.

According to Ahmad, the district court didn’t fully address how, in the context of the specific policy language at issue, a non-public order by the SEC could qualify as a claim.

“As Patriarch argues, ‘until an agency makes a demand upon the target under legal compulsion, there may be no way for a policyholder to even know that it is being investigated, that an order authorizing investigation has been issued against it or what the order of investigation says,'” Ahmad said, quoting from Patriarch’s appellate brief.

Axis’ answering appellate brief is due on March 18.

Patriarch is represented by Finley T. Harckham and Luma S. Al-Shibib of Anderson Kill PC.

Axis is represented by John Gerstein, Elizabeth Jewell and Gabriela Richeimer of Clyde & Co. US LLP.

The case is Patriarch Partners LLC v. Axis Insurance Co., case number 17-3022, in the U.S. Court of Appeals for the Second Circuit.

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Apollo Education Group v. National Union

The Ninth Circuit will have the chance to decide when a D&O insurer may decline to consent to a policyholder's settlement as it weighs University of Phoenix parent company Apollo Education Group's appeal of a ruling that an AIG unit was within its rights to refuse consent for Apollo's $13 million deal resolving a shareholder class action.

Apollo was hit with the class action complaint in 2006 when a Teamsters pension fund claimed the company's top executives made hundreds of millions of dollars by selling backdated stock options. That suit made it to the Ninth Circuit, and in 2014, Apollo agreed to settle for $13 million, hoping AIG unit National Union Fire Insurance Co. of Pittsburgh, Pa., would pay for it under a $15 million policy that expressly covered securities claims for wrongful acts, according to court documents.

National Union refused to pay for the settlement, however, instead preferring to take its chances on appeal.

Apollo sued National Union in Arizona federal court in 2015, seeking a declaratory judgment that the insurer's refusal to pay for the settlement constituted a breach of contract.

In late October, U.S. District Judge Steven P. Logan of the District of Arizona sided with National Union, saying that the insurer acted reasonably in refusing to pay for the settlement because it thought continued litigation was a better tactic. National Union performed an extensive analysis of the circumstances before making its call, the judge found.

John L. Corbett, of counsel at Barnes & Thornburg LLP, said that any case involving an insurer's consent to settle "has the potential to be explosive," given the hefty financial implications.

"If the district court does get overturned here, that would be very big news," Corbett said.

According to Corbett, the Ninth Circuit may take a close look at the evidence of National Union's decision-making process.

"We don't really know for sure how extensive the insurer's actions were from the district court's opinion," Corbett said. "They may well look at that record at the Ninth Circuit. The appeal will likely come down to

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how the Ninth Circuit looks at the facts regarding how the insurance company treated this claim."

Apollo's opening appellate brief is due on Feb. 20.

Apollo Education is represented by Mark J. DePasquale of DePasquale & Schmidt PLC.

National Union is represented by Erin Elizabeth Bradham, Bennett Evan Cooper and Timothy Mark Strong of Steptoe & Johnson LLP.

The case is Apollo Education Group Inc. v. National Union Fire Insurance Co. of Pittsburgh, Pa., case number 17-17293, in the U.S. Court of Appeals for the Ninth Circuit.

HotChalk v. Scottsdale Insurance Co.

The Ninth Circuit is also poised to rule on whether an exclusion in an education technology company's D&O policy for claims related to professional services bars coverage for a False Claims Act suit, and its decision could dictate the breadth of D&O coverage for scores of privately held service providers.

Policyholder HotChalk Inc. is arguing on appeal that U.S. District Judge Claudia Wilken of the Northern District of California erred in holding that the professional services exclusion in its D&O policy with Scottsdale Insurance Co. bars coverage for the now-settled FCA action, which accused HotChalk of offering incentives to employees for student recruitment.

Judge Wilken concluded in her November 2016 decision that the allegations that HotChalk provided improper incentives related directly to the company's services to universities, thereby implicating the exclusion.

But HotChalk has contended in appellate briefs that the district judge failed to differentiate between the company's services to its clients and its in-house practices. Under Judge Wilken's interpretation, the professional services exclusion would foreclose coverage for almost any claim against HotChalk, the company has argued.

"If the decision below is correct, these polices are virtually worthless: The district court's rationale encompasses every activity that an insured performs, so long as that activity is connected, even

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incidentally, to a skilled service," HotChalk's attorneys wrote in the company's opening Ninth Circuit brief.

The district court's ruling raised alarm bells among nonprofit policyholder advocacy group United Policyholders. In an amicus brief supporting HotChalk's appeal, UP asserted that the decision, if affirmed, could effectively erase coverage for privately held firms that exclusively provide services to larger companies and institutions.

"Scottsdale's interpretation of the subject exclusion renders paid-for coverage illusory," UP said in its brief.

The Ninth Circuit will hear oral arguments in the case on Feb. 13.

HotChalk is represented by Peter Roldan and Christopher Wimmer of Emergent LLP.

Scottsdale is represented by Alexis Rogoski and Jonathan Andrew Sorkowitz of Skarzynski Black LLC and Hee Young Lee of Herman & Lee LLP.

The case is HotChalk Inc. v. Scottsdale Insurance Co., case number 16-17287, in the U.S. Court of Appeals for the Ninth Circuit.

–Additional reporting by Rick Archer and Ryan Boysen. Editing by Philip Shea and Katherine Rautenberg.

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