Simpson Thacher

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A Delaware court ruled that a Securities and Exchange Commission subpoena and a subsequent securities action were not "meaningfully linked" for purposes of applying an Interrelated Wrongful Acts provision and a Prior Notice Exclusion in a D&O policy. *Alexion Pharmaceuticals, Inc. v. Endurance Assurance Corp.*, 2024 Del. Super. LEXIS 103 (Del. Super. Ct. Feb. 15, 2024). (Click here for full article)

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– *Chambers USA* 2023

Texas Supreme Court Rules That Policyholder Suffered A "Loss" By Virtue Of Underlying Settlement, But That Settlement Is Not Binding In Coverage Litigation

Granting conditional mandamus relief, the Texas Supreme Court ruled that a policyholder suffered a covered "loss" because an underlying settlement rendered it "legally obligated to pay," but that the settlement was neither binding nor admissible in related coverage litigation. *In re Illinois National Ins. Co.*, 2024 Tex. LEXIS 158 (Tex. Feb. 23, 2024). (Click here for full article)

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The First Circuit ruled that an insurer is not entitled to recover costs incurred in defending its insured or in settling an excluded underlying claim. *Berkley National Ins. Co. v. Atlantic-Newport Realty LLC*, 93 F.4th 543 (1st Cir. 2024). (Click here for full article)

Sixth Circuit Rules That District Court Erred In Dismissing Equitable Contribution Claim By Insurer Against Fellow Insurers Based On Untimely Notice

Reversing an Ohio district court decision, the Sixth Circuit ruled that an insurer's equitable contribution claim for reimbursement of pre-tender defense costs from non-defending insurers should not have been dismissed based on untimely notice alone. *ACE American Ins. Co. v. Zurich Am. Ins. Co.*, 2024 U.S. App. LEXIS 5535 (6th Cir. Mar. 5, 2024). (Click here for full article)

Fifth Circuit Rules That Insurance Dispute Is Subject To Arbitration Under The Convention, Notwithstanding Dismissal Of Foreign Insurers

HOLDING

The Fifth Circuit granted domestic insurers' motion to compel arbitration, finding that a Louisiana statute barring arbitration of insurance disputes did not reverse preempt the Convention on the Recognition and Enforcement of Arbitral Awards (the "Convention"). *Bufkin Enterprises, L.L.C. v. Indian Harbor Ins. Co.*, 2024 U.S. App. LEXIS 5176 (5th Cir. Mar. 4, 2024).

BACKGROUND

Bufkin purchased surplus lines coverage from eight domestic insurers and two foreign insurers. Each policy included an arbitration clause, as well as a provision stating that the policy "shall be constructed as a separate contract" between Bufkin and the insurer. The parties disagreed as to whether the policies constituted a "single, all-encompassing agreement" or discrete agreements between each insurer and Bufkin.

When a coverage dispute arose, Bufkin initially sued only the domestic insurers, but subsequently filed an amended petition naming the foreign insurers as defendants for the sole purpose of dismissing them with prejudice and foregoing all rights against them. The domestic insurers moved to compel arbitration pursuant to the Federal Arbitration Act ("FAA") and the Convention.

The district court denied the motion, ruling that the Convention did not apply because only the domestic insurers remained parties to the dispute. The district court also rejected the insurers' contention that the Convention could be invoked under an equitable estoppel theory. Having determined that the arbitration provisions were governed only by the FAA, the district court concluded that the FAA was reverse preempted by a Louisiana law barring arbitration of insurance disputes pursuant to the McCarran-Ferguson Act. The district court therefore denied the insurers' motion to compel arbitration. The Fifth Circuit reversed.

DECISION

The Fifth Circuit ruled that the district court abused its discretion by failing to compel arbitration under the Convention pursuant to the equitable estoppel doctrine. The Fifth Circuit explained that the domestic insurers had a right to compel arbitration under the Convention, despite the fact they were non-signatories to Bufkin's policies with the foreign insurers. The court held that equitable estoppel applies where, as here, allegations involve substantially "interdependent and concerted misconduct by both the non-signatory and one or more of the signatories to the contract.'" More specifically, the court found that Bufkin alleged "substantially interdependent and concerted misconduct" by the domestic and foreign insurers because Bufkin submitted its claim to both the foreign and domestic insurers and its "formal proof of loss ascribed to the insurers, as a group, a common course of conduct."

The court deemed it irrelevant that Bufkin was no longer pursuing claims against the foreign insurers, emphasizing that the standard for equitable estoppel was met because Bufkin "named the foreign insurers as defendants and accused them of the same malfeasance as the domestic insurers." The court stated:

> in focusing on Bufkin's dismissal of the foreign insurers, the district court neglected to consider the foreign insurers' part in the seamless coverage

agreement struck by the parties, and Bufkin's interactions with the insurers. Honing in, that coverage arrangement included the arbitration clause that afforded the insurers – foreign and domestic – "predictability in resolving disputes dealing with the substantial risks presented by a surplus lines insurance policy."

COMMENTS

The decision highlights an important distinction between motions to compel arbitration pursuant to the FAA (a domestic "Act of Congress" under the McCarran-Ferguson Act) as compared to the Convention (an international treaty). Under Fifth Circuit precedent, a state statute that precludes arbitration of insurance disputes (such as the Louisiana law at issue here), reverse preempts the FAA under the McCarran-Ferguson Act, but does not reverse preempt the Convention. As discussed in previous Alerts, federal courts of appeals are split as to whether a state law barring arbitration of insurance disputes reverse preempts the Convention pursuant to the McCarran-Ferguson Act. The Fourth, Fifth and Ninth Circuit have ruled that there is no reverse preemption of the Convention, whereas the Second Circuit has allowed reverse preemption under the Convention.

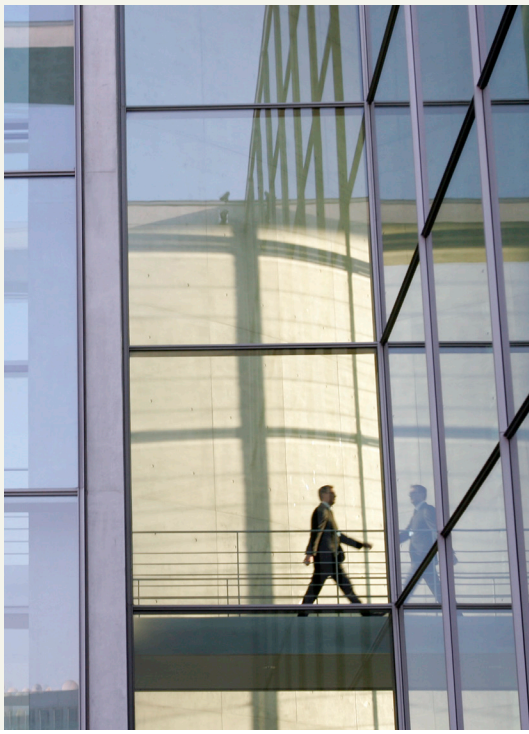
Applying "Meaningfully Linked" Standard, Delaware Court Rules That Securities Action Is Not "Related" To Previous SEC Action

HOLDING

A Delaware court ruled that a Securities and Exchange Commission ("SEC") subpoena and a subsequent securities action were not "meaningfully linked" for purposes of applying an Interrelated Wrongful Acts provision and a Prior Notice Exclusion in a D&O policy. *Alexion Pharmaceuticals, Inc. v. Endurance Assurance Corp.,* 2024 Del. Super. LEXIS 103 (Del. Super. Ct. Feb. 15, 2024).

BACKGROUND

In March 2015, Alexion, a pharmaceutical company, received an SEC Order notifying the company of an investigation relating to, among other things, allegedly improper accounting practices, bribes to foreign officials, and matters relating to the recall of a drug called Soliris. In a subpoena issued in May 2015, the SEC sought documents related to Alexion's foreign and domestic grant-related activities, its compliance with the Foreign Corrupt Practices Act ("FCPA") and the recall of Soliris. In July 2020, Alexion settled with the SEC and agreed to remedy certain areas of noncompliance and pay over $21 million in penalties.



In December 2016, a class of stockholders filed a securities suit against Alexion and its executives, alleging that they "overpaid for stock that was propped up by illegal activity." The complaint alleged that the defendants misled investors and violated ethical standards and federal securities law.

Alexion sought coverage for the securities action under two towers of insurance: a 2014-2015 program, and a 2015-2017 program. The operative primary policy in the 2015-1017 program provided that all claims arising out of "Interrelated Wrongful Acts" are deemed to be one claim—first made on the date the earliest of such claims were made. Additionally, a "Prior Notice Exclusion" barred coverage for any claim attributable to any wrongful act that was the subject of any written prior notice under that policy or any previous policy for which the instant policy was a renewal or replacement.

In ensuing coverage litigation, Alexion moved for summary judgment on the issue of "relatedness," arguing that the SEC subpoena and the securities action were not related as a matter of law, and therefore that the securities suit "is properly placed in the 2015-2017 coverage tower." The court granted the motion.

DECISION

The court ruled that the question of relatedness between the SEC subpoena and the securities action for purposes of applying the Prior Notice Exclusion and the Interrelated Wrongful Acts provision, is determined by a "meaningful linkage" analysis. The court then concluded that there was no meaningful linkage between the two actions.

The court explained that the SEC subpoena was "broadly concerned with Alexion's compliance with the FCPA," and ultimately involved findings related to accounting controls and payments to foreign officials, whereas the securities action focused on the artificial inflation of Alexion's value through various acts of misconduct. The court acknowledged that certain alleged activity in Brazil was relevant to both actions, but concluded that this "tangential link" was insufficient to establish meaningful linkage between the two actions. Additionally, the court emphasized that the actions involved different parties, raised "entirely different" theories of liability, relied on different evidence and sought different relief.

COMMENTS

This decision illustrates the distinction Delaware courts may draw between two actions being "related" for purposes of applying an Interrelated Wrongful Acts provision or Prior Notice Exclusion, as opposed to two actions involving "related" evidentiary material. Here, the securities action plaintiffs relied on the SEC findings in arguing that Alexion engaged in a pattern of illegal conduct. Deeming this reliance "unremarkable," the court stated: "[t]hough accusations of general wrongdoing may lend support to the sweeping allegations in the Securities Action, such abstract notions are not helpful to a relatedness analysis."

Texas Supreme Court Rules That Policyholder Suffered A "Loss" By Virtue Of Underlying Settlement, But That Settlement Is Not Binding In Coverage Litigation

HOLDING

Granting conditional mandamus relief, the Texas Supreme Court ruled that a policyholder suffered a covered "loss" because an underlying settlement rendered it "legally obligated to pay," but that the settlement was neither binding nor admissible in related coverage litigation. *In re Illinois National Ins. Co.*, 2024 Tex. LEXIS 158 (Tex. Feb. 23, 2024).

BACKGROUND

Cobalt, an energy company, was named as a defendant in a federal securities action. A court appointed a collection of investment funds that held Cobalt shares ("GAMCO") as lead plaintiff in the suit. Cobalt's insurers denied coverage for the claims and refused to advance defense costs. Cobalt subsequently filed for bankruptcy and settled with GAMCO. The settlement agreement provided for a "Settlement Amount" of $220 million and included an "obligation to satisfy" the amount by Cobalt. However, the parties agreed that it would be "payable exclusively" from any insurance recoveries and that GAMCO would pursue all of Cobalt's claims against its insurers on Cobalt's behalf. The agreement released all claims against Cobalt and its executives, regardless of whether GAMCO was able to recover any insurance proceeds, and required that Cobalt deposit $4.2 million that it had previously received from certain insurers into an escrow account and cooperate with GAMCO in its efforts to obtain insurance coverage.

After a court approved the settlement, GAMCO intervened in a coverage suit between Cobalt and its insurers. The parties cross-moved for summary judgment on three issues: (1) whether Cobalt suffered a covered "loss"; (2) whether GAMCO had standing to sue the insurers; and (3) whether the settlement was binding on the insurers or admissible to establish coverage.

A Texas trial court ruled in GAMCO's favor and the Texas Supreme Court accepted the insurer's petition for mandamus relief.

DECISION

The Texas Supreme Court explained that the first two issues turned on resolution of the same question: whether Cobalt had a "legal obligation to pay" any sums to any party. As the court noted, the relevant policies required a legal obligation to pay in order to establish a covered "loss" and under Texas's "no-direct-action" rule, an injured party may only sue the wrongdoer's insurer after it has established that the insured was legally obligated to pay damages.

The insurers argued that Cobalt was not financially liable to pay GAMCO because the settlement agreement released Cobalt from any liability and required GAMCO to look solely to the insurers for recovery. Further, the settlement agreement allowed Cobalt to recover up to $28.5 million it had spent in defense costs if GAMCO was successful in obtaining insurance proceeds.

The court rejected these arguments and held that Cobalt was "legally obligated to pay." The court noted that Cobalt had already deposited $4.2 million in insurance benefits into an escrow account and remained "legally obligated" to pay any additional benefits it might receive. Further, the court emphasized that Cobalt was obligated to fully cooperate in GAMCO's litigation against the insurers, at its own expense. The court deemed it irrelevant that Cobalt denied liability or wrongdoing in the settlement, reasoning that a

legal obligation to pay does not depend on an admission of liability. Similarly, the court held that a legal obligation to pay can exist even if Cobalt is not required to pay "from its own pockets."

The court acknowledged that Cobalt's release from any liability "require[d] a slightly more complicated analysis," but concluded that the settlement ultimately rendered Cobalt "legally obligated to pay" GAMCO—through both the prior payment and any future payments to the escrow account. In this context, the court emphasized that if Cobalt failed to fulfill its obligations to deliver any future recoverable benefits, the release would be ineffective.

With respect to the third issue, whether the settlement agreement was binding on the insurers or admissible in a coverage action, the Texas Supreme Court held that the trial court abused its discretion and granted conditional mandamus relief. The Texas Supreme Court ruled that the settlement agreement was not binding against the insurers or admissible to establish coverage for the amount of loss because it did not result from a "fully adversarial trial." The court based this holding on its finding that Cobalt lacked the necessary "meaningful incentive" to ensure that the settlement accurately reflected GAMCO's damages. The court explained: "the settlement agreement here 'eliminated any meaningful incentive' because GAMCO 'agreed not to enforce any resulting judgment' and 'not to pursue' Cobalt's non-insurance assets, leaving only the insurance policies 'as a potential source to satisfy any judgment obtained.'"

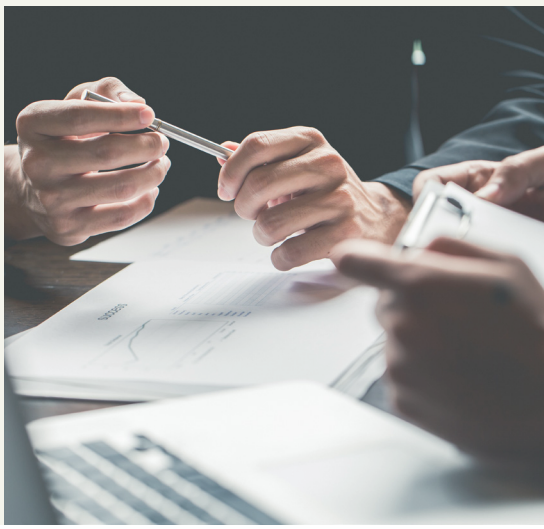
COMMENTS

One important element in the court's decision was the fact that the policies at issue were "liability" policies rather than "true 'indemnity' policies." A liability policy obligates an insurer to pay "on behalf of" the insured the amounts that the insured is legally obligated to pay. In contrast, under an indemnity policy the insurer agrees to reimburse the insured for the amounts the insured "has actually paid" to fulfill a legal obligation. The court deemed this distinction critical in finding that Cobalt was legally obligated to pay, regardless of whether it "ever actually pays out of its own coffers first."

Reversing District Court, First Circuit Rules That Insurer Is Not Entitled To Recoup Defense Costs Or Settlement Payments From Insured

HOLDING

The First Circuit ruled that an insurer is not entitled to recover costs incurred in defending its insured or in settling an excluded underlying claim. *Berkley National Ins. Co. v. Atlantic-Newport Realty LLC*, 93 F.4th 543 (1st Cir. 2024).



BACKGROUND

Berkley National Insurance Company issued a liability policy to Granite Telecommunications that listed Atlantic-Newport Realty as an additional insured. When a personal injury suit was filed against both entities, Berkley agreed to defend under a reservation of rights. While that suit was pending, Berkley commenced an action against Granite and Atlantic-Newport, seeking a declaration

of no coverage and asserting a claim for restitution based on amounts paid to defend the underlying suit. The personal injury suit ultimately settled, with Berkley funding the settlement. Thereafter, Berkley amended its complaint to add a request for restitution of the settlement payment as well.

A Massachusetts district court denied Granite and Atlantic-Newport's motion for judgment on the pleadings. Following discovery, the district court granted Berkley's summary judgment motion, ruling that it had no duty to defend or indemnify the underlying suit based on a policy exclusion, and was entitled to restitution of its defense and indemnity payments. The First Circuit reversed.

DECISION

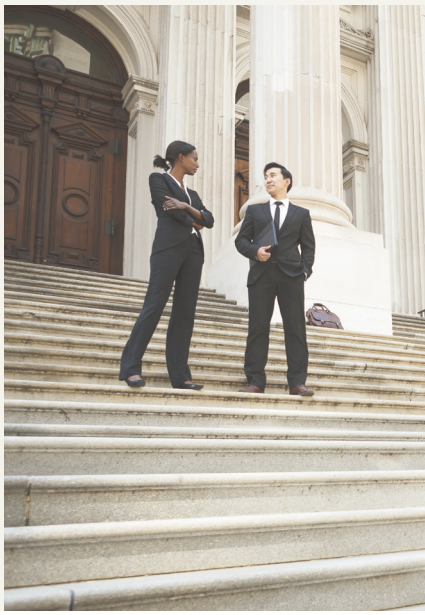
The First Circuit held that the district court's ruling as to restitution of the settlement payment conflicted with Massachusetts precedent. In *Med. Malpractice Joint Underwriting Assoc. of Mass. v. Goldberg*, 425 Mass. 46 (1997), the Supreme Judicial Court of Massachusetts held that where a policy does not contain a provision for reimbursement of settlement payments by the insurer, an insurer may nonetheless seek reimbursement only where the following conditions are met:

> if the insured has agreed that the insurer may commit the [insurer's] own funds to a reasonable settlement with the right later to seek reimbursement from the insured, or if the insurer secures specific authority to reach a particular settlement which the insured agrees to pay.

The district court had concluded that *Goldberg* was distinguishable from this case because unlike the insured in *Goldberg*, Granite and Atlantic-Newport had participated significantly in the settlement process and had essentially "whipsawed" Berkley into settling. The First Circuit disagreed, finding *Goldberg* controlling authority and further holding that the *Goldberg* conditions were not met. In this respect, the First Circuit emphasized the undisputed fact that the insureds never agreed to Berkley's request for reimbursement.

The First Circuit also rejected Berkley's contention that *Goldberg* is no longer good law in light of a subsequent decision that allowed an insurer to bring a restitution claim based on a reservation of rights that included a right to seek recoupment. The First Circuit emphasized that case involved a disability policy, whereas this case involved a liability policy, and therefore held that the decision did not conflict with *Goldberg*.

The First Circuit reached the same conclusion with respect to Berkley's claim for restitution of defense costs. The court reasoned that Berkley's "full" reservation of rights to disclaim coverage is not the equivalent of a reservation of the right to seek reimbursement of defense costs, and that there was no basis in Massachusetts law for allowing a claim for restitution of defense costs absent any such express reservation.



COMMENTS

As the First Circuit noted, and as we have discussed in previous Alerts, courts in other jurisdictions have allowed insurers to seek reimbursement of defenses costs following a ruling of no duty to defend, under various circumstances. In some cases, the court has relied an insurer's unilateral reservation of right to do so (and the insured's implicit agreement to such reservation by accepting the insurer's defense) and/or theories of unjust enrichment.

Sixth Circuit Rules That District Court Erred In Dismissing Equitable Contribution Claim By Insurer Against Fellow Insurers Based On Untimely Notice

HOLDING

Reversing an Ohio district court decision, the Sixth Circuit ruled that an insurer's equitable contribution claim for reimbursement of pre-tender defense costs from non-defending insurers should not have been dismissed based on untimely notice alone. *ACE American Ins. Co. v. Zurich Am. Ins. Co.*, 2024 U.S. App. LEXIS 5535 (6th Cir. Mar. 5, 2024).

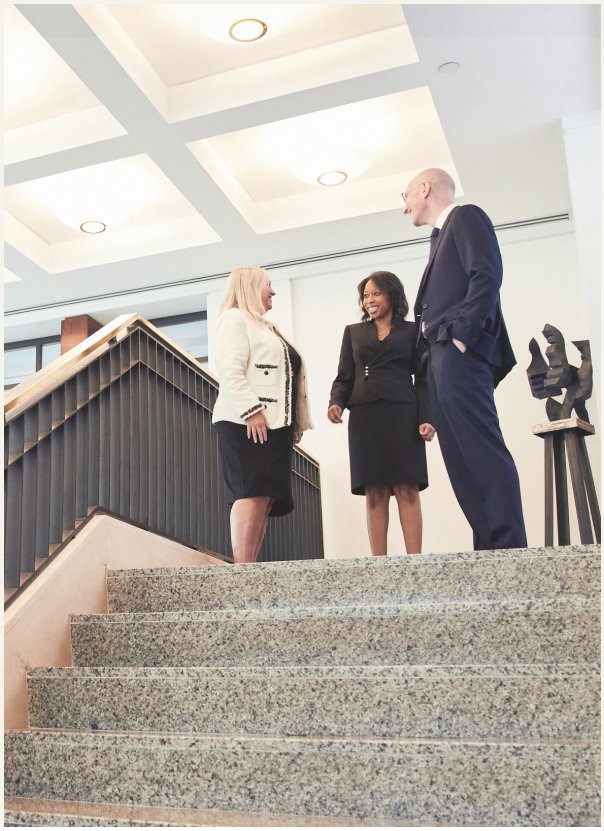
BACKGROUND

Safelite, a windshield repair company, was named as a defendant in a suit alleging Lanham Act violations. Safelite notified ACE, one of its general liability insurers, but did not notify Zurich or Discover, two other insurers that had issued general liability policies during the relevant time period. After paying for Safelite's defense costs for more than a year, ACE inquired about other liability policies, and approximately two years after ACE began funding the defense, notified Zurich and Discover of the underlying suit and its intent to seek equitable contribution from them. Zurich and Discover agreed to equally share future defense costs with ACE, but refused to reimburse ACE for pre-tender defense costs *(i.e.*, defense costs incurred prior to the date they received notice).

An Ohio trial court ruled in favor of Discover and Zurich, concluding that they had no duty to contribute to past defense costs based on untimely notice, regardless of prejudice. The Sixth Circuit vacated and remanded the matter for further proceedings.

DECISION

Under Ohio law, a party seeking equitable contribution must show the existence of a shared obligation, payment by the plaintiff and a failure of the defendant to pay its proportional share. Since there was no dispute that ACE had paid prior defense costs, the central issue was whether Zurich and Discover had a shared obligation for those costs. Resolution of that issue turned on whether ACE's untimely notice of the underlying suit, standing alone, relieved Zurich and Discover of their defense obligations. The Sixth Circuit held that it did not.



The Sixth Circuit explained that under Ohio law, occurrence-based liability policies require a showing of prejudice in order for untimely notice to preclude coverage, and that the district court erred in failing to conduct a prejudice analysis. The Sixth Circuit rejected Discover's assertion that its policy did not require a showing of prejudice because its notice provision, which required notice within thirty days rather than a "reasonable" time, was more akin to a claims-made policy (for which prejudice is not required). The Sixth Circuit explained that regardless of the thirty-day provision, the policy was still an

occurrence-based policy based on language limiting coverage to an "offense…committed… during the policy period."

The Sixth Circuit remanded the matter to the district court for a fact-intensive prejudice inquiry in order to determine whether the insurers had a shared defense obligation. The Sixth Circuit also instructed the district court to consider whether a voluntary payments provision in Zurich and Discover's policies eliminated any potential shared obligation.

COMMENTS

While the Sixth Circuit ruled that ACE's equitable contribution claim should not have been dismissed, it disagreed with ACE's assertion that "special notice rules" applied here in light of Ohio's endorsement of "all sums" allocation. ACE argued that under the "all sums" approach, ACE was the "targeted insurer" and acted appropriately by defending Safelite on its own and then later seeking contribution from other insurers. The court ruled that all sums allocation applies only in progressive injury cases, and was thus irrelevant to the present case, which involved "distinct and identifiable events that occurred at a known or knowable time."

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Simpson Thacher has been an international leader in the practice of insurance and reinsurance law for more than a quarter of a century. Our insurance litigation team practices worldwide.

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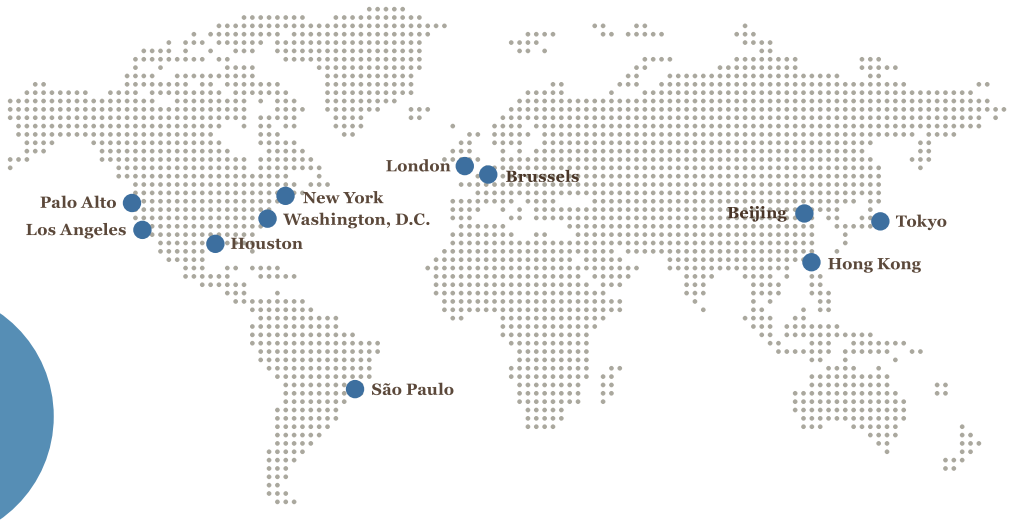

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