The Year in Review: 2021 Key D&O Insurance Coverage Decisions[i]

As we begin 2022, we take a moment to look back at the key insurance coverage decisions from 2021 involving perennial coverage issues for insurers and policyholders.

Definition of "Claim"

It goes without saying that the existence of a "claim" is a fundamental requirement to claims-made coverage, and what falls within the scope of a particular policy's definition of a "claim" is a question that frequently arises in D&O coverage disputes.

One such case in 2021 to address what constitutes a "claim" was *Ditech Fin., LLC v. AIG Specialty Ins. Co.*[ii] There, the policyholder received an email from the Executive Office of the U.S. Trustee ("EOUST") identifying certain perceived deficiencies in the insured's mortgage servicing practices. The email also indicated that the Department of Justice "intends to move forward with discussions concerning a national settlement with Ditech that addresses all of the mortgage servicing deficiencies for borrowers in bankruptcy, rather than trying to carve out the loan modification issues and address those in a separate national settlement." The question was whether the foregoing communication constituted a "claim," which was defined in the insured's policy to include, in relevant part, "any written notice received by an insured that any person or entity intends to hold any Insured responsible for a Wrongful Act."

According to the policyholder, because the policy only covered "*monetary loss*," a monetary element should also be imputed to the policy's definition of "claim," such that it would read: "a written notice that a claimant intends to hold the insured responsible *for some monetary loss*."

The court rejected the policyholder's arguments, finding the EUOST's email to be a "claim," and observing that the communication was "not a simple request for . . . information or a mere inquiry into some untoward event . . . [but] contains a specific demand for Ditech to rectify the legally cognizable damage created by its escrow analysis deficiencies." Additionally, because the plain language of the policy did not require a "claim" to be "for monetary loss," the court didn't incorporate that requirement into the policy. The *Ditech* decision should serve as a reminder to policyholders and insureds alike to review all communications relating to the notice of claim provided to the insurer. Readers should note, however, that the policyholder appealed the court's decision on October 14, 2021.[iii]

Another perennial issue involving what constitutes a claim is whether a subpoena directed to an entity constitutes a written demand for non-monetary (or injunctive relief) pursuant to the first definition of a claim found in most D&O policies and, if so, whether the subpoena asserts a wrongful act. In *Conn. Municipal Electric Energy Coop.*[iv], the district court found that this issue had not yet been decided under Connecticut law. The court rejected the argument that certain subpoenas rose to the level of a "claim," notwithstanding an implied threat of criminal prosecution. There, the policyholder (CMEEC) received a subpoena from the U.S. Attorney's Office directing it to "provide any and all documentation associated with personnel from your company who attended the annual retreats in Kentucky and West Virginia during 2013, 2014, 2015, and 2016." The 2016 Subpoena was accompanied by a letter, stating that "[t]he subpoena commands the

production of records described in the attachment," and that "[the] subpoena has been issued as part of a federal grand jury investigation into the possible commission of a felony." Another subpoena was issued in 2017, requesting copies of any documents associated with various aspects of CMEEC's operations, including a "[l]ist of all CMEEC Board members," "bylaws and operating procedures that govern the activity of CMEEC Board Members." The insurer denied coverage for the subpoenas on grounds that they did not constitute a "claim" and therefore did not trigger the policy's insuring agreement.

In the ensuing coverage litigation, the court concluded that the policyholder failed to establish that the subpoenas constituted "claim" for a "wrongful act" because they did not "'assert' or 'declare' that a wrongful act has occurred, but rather demanded documents as part of an "investigation into the *possible* commission of a felony."[v] As in years past, *Conn. Municipal Electric Energy Coop* demonstrates that caselaw analyzing whether a subpoena constitutes a claim asserting a wrongful act continues to be largely a jurisdictional and language specific inquiry.

Interrelation

In recent years, the number of D&O insurance coverage litigations commenced in Delaware state courts by policyholders has mushroomed. This is primarily attributable to the fact that Delaware trial courts have developed a decidedly pro-policyholder reputation. Further, given that Delaware is still a relatively new venue for D&O coverage litigation, case law interpreting perennial D&O insurance coverage issues is still in its nascent stages, with many perennial coverage issues – including interrelation - having yet to be decided by Delaware's Supreme Court. However, there is currently one trial court decision involving interrelatedness that is now on appeal to the Supreme Court. That decision is *First Solar, Inc. v. Nat'l Union Fire Ins. Co.*[vi]

In *First Solar*, the policyholder sought coverage under its D&O tower for a 2014 securities lawsuit (the "*Maverick* Action") brought against it by a group of shareholders who had previously opted out of an earlier securities action against First Solar (the "*Smilovits* Action"). The insurers denied coverage on grounds that the *Maverick* Action related back to the *Smilovits* Action, which was filed prior to the inception of the relevant policies. The policyholder filed suit against the insurer, arguing that the lawsuits in question were not "related claims" under the applicable policies because there were differences with respect to: (1) the identity of the claimants; (2) the wrongdoing alleged, (3) the class periods specified, (4) the legal theories relied upon, (5) the corrective disclosures identified, and (6) the relief sought.

The trial court rejected First Solar's argument. The trial court afforded little weight to the minor legal and factual differences between the allegations in the two lawsuits, and instead focused on the "substantial similarities" between the *Maverick* and *Smilovits* Actions. The court concluded that because the two lawsuits "involve the same fraudulent scheme" and "primarily rely on the same facts and occurrences," "the similarities between the *Smilovits* and *Maverick* cases outweigh any differences and go beyond mere 'thematic similarities.'"

Although the trial court still applied the "fundamentally identical" standard, which has been applied by several Delaware trial courts evaluating questions of interrelatedness, the trial court's decision establishes that this standard may be satisfied despite several non-trivial dissimilarities

between two different claims. While it remains to be seen how the Delaware Supreme Court will rule, assuming the trial court's decision is sustained, it appears that Delaware's "fundamentally identical" standard may not represent such a radical departure from the interpretation of interrelation provisions afforded by other jurisdictions (e.g., New York).

Questions of Capacity

Yet another perennial D&O coverage issue that has received notable attention in 2021 is the issue of "capacity." Typically, D&O policies limit coverage for individual insureds to misconduct committed in their "insured capacity," i.e., as a director, officer or in any other role or position pursuant to which they qualify as an insured under the applicable policy.

Capacity was at issue in *Calamos Asset Mgmt. v. Travelers Cas. & Sur. Co. of Am.*[vii] Specifically, the court addressed coverage for a shareholder action against Calamos Asset Management, Inc. ("CAM"), which alleged that its CEO, John Calamos, breached his fiduciary duties in two distinct capacities: (1) as an officer and director of CAM, and (2) as a controlling shareholder of CAM. The policy at issue covered Mr. Calamos in his capacity as a director and officer of CAM, but not as a shareholder of the company.

The court took the allegations in the complaint at face value, concluding that the stockholder claim was asserted against the Mr. Calamos based on his actions as a stockholder. As such, pursuant to the "allocation" provision of the policy, the court held that Mr. Calamos was entitled to recover the sums incurred to defend and settle the underlying action that were allocable to the claim against him as a director and officer of the insured entity, but not those sums allocable to the claim arising from his misconduct as a shareholder.

Disgorgement, Restitution, and the Definition of "Loss"

It is known that D&O liability policies do not cover all forms of relief that may be awarded or agreed upon in the resolution of a claim. For example, a number of courts have held that D&O policies do not cover disgorgement, which represents the return of unlawfully acquired sums, as opposed to compensation for damages inflicted. However, issues sometimes arise concerning the labels assigned to sums paid to resolve a claim. This was the case in each of the actions discussed below.

In the longstanding *J.P. Morgan Secs. Inc. v. Vigilant Ins. Co.*[viii] coverage litigation, New York's Court of Appeals addressed coverage for $160 million payment made by Bear Sterns to the the SEC. There, the underlying settlement payment was explicitly labeled "disgorgement" in the settlement agreement. Thus, Bear Sterns' insurers denied coverage on the basis that the payment was not insurable "loss" under the policies. In the ensuing coverage litigation, Bear Stearns argued that $140 million of the "disgorgement" payment represented disgorgement of its *clients'* gains, as compared with Bear Stearns' own revenue, and therefore qualified as insurable "loss" under the policies.

At the trial level, the court granted Bear Stearns' motion for summary judgment, concluding that the disgorgement of $140 million in client gains constituted an insurable loss. Following the

insurers' appeal, the Appellate Division reversed the trial court. Regardless of whether the $140 million constituted true disgorgement, the Appellate Division found that payment to be a "penalty," and the definition of "loss" specifically excluded "fines or penalties imposed by law." In reaching this conclusion, the Appellate Division relied on a recent decision by the U.S. Supreme Court in *Kokesh v. SEC*[ix], holding that the five-year statute of limitations for SEC "penalties" applied to disgorgement claims brought by the SEC.

In November 2021, the New York Court of Appeals reversed the Appellate Division's ruling. As a threshold matter, the Court found that the exception to the definition of "loss" for "fines or penalties imposed by law" constituted an exclusion. As such, the burden was on the insurers to demonstrate that the $140 million SEC disgorgement payment constituted a penalty. The Court found that the insurers had not satisfied this burden. First, it recognized that the term "penalty" is "commonly understood to reference a monetary sanction designed to address a public wrong that is sought for purposes of deterrence and punishment rather than to compensate injured parties for their loss." According to the Court, because the $140 million was placed in a fund to compensate injured parties, the disgorgement payment did not fit the ordinary mold of a penalty. The Court also rejected the insurers' arguments that the SEC lacks authority to seek compensatory relief, and that compensation of injured parties is only a secondary goal, not the primary purpose, of disgorgement. Finally, the court concluded that *Kokesh* was not controlling because that decision did not involve insurance or apply New York law, and because it was rendered nearly two decades after the parties executed the relevant insurance contract and could not have informed their understanding of the policy terms.

Likewise, in *Astellas US Holding, Inc. v. Starr Indem. & Liab. Co.*[x], the District Court for the Northern District of Illinois found that a settlement payment qualified as insurable "loss" despite the fact that it was labeled "restitution" in the settlement agreement between the insured and the DOJ. The underlying settlement arose from a DOJ investigation regarding Astellas' practice of donating to charities that used such donations to assist with certain patients' co-payment obligations in connection with Astellas' drugs. Pursuant to the settlement with the DOJ, Astellas paid the United States $100 million, plus interest. The settlement agreement explicitly stated that $50 million of the total settlement amount was "restitution to the United States." A coverage dispute arose as to whether the settlement payment constituted "loss" under Astellas's primary policy, which defined the term to include: "damages, settlements or judgments . . . [and] the multiplied portion of any multiple damage awards . . . but only to the extent that such damages . . . are insurable under the applicable law most favorable to the insurability of such damages."

As was the case in *J.P. Morgan*, the court concluded at the outset that the carveout from the policy's definition of "loss" was an exclusion, such that the insurer bore the burden of establishing that Astellas's settlement payment was uninsurable under applicable law. The court concluded that the insurers failed to satisfy that burden. First, it rejected the insurers' argument that the $50 million "restitution" payment was uninsurable. While the court acknowledged the general rule that restitution of ill-gotten gains is uninsurable under Illinois law, it found that the $50 million "restitution" payment was not excluded from the definition of "loss," because the phrase "restitution to the United States" is boilerplate language used in FCA settlements, which was merely intended to distinguish the tax-deductible portion of the settlement payment in compliance with the Tax Cut & Jobs Act. Second, the court rejected the argument that the FCA solely allowed

for restitutionary relief, finding instead that the FCA permits compensatory damages. Lastly, the court rejected the argument that public policy forbids coverage for the $50 million settlement payment was uninsurable because it indemnified fraudulent conduct. According to the court, while the settlement was based on allegations of Astellas's fraudulent conduct, such conduct was only *alleged*—not admitted. Based on the foregoing, the court held that Astellas' $50 million "restitution" payment to the DOJ was covered and insurable under Illinois law. On November 8, 2021, one of Astellas' insurers appealed the district court's holding to the Seventh Circuit Court of Appeals.[xi] Given the recent significant uptick in the filings of FCA actions, the Seventh Circuit's decision in *Astellas* will be of utmost importance for insurers and policyholders in those industries most vulnerable to FCA scrutiny (e.g., healthcare).

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As in prior years, D&O insurers and policyholders alike should anticipate that the perennial coverage issues discussed above will continue to generate significant coverage litigation in 2022, and the case law analyzed above will likely influence the outcomes of such litigation. Accordingly, D&O insurers and policyholders alike should closely review the 2021 case law with an eye towards 2022.

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[ii] 2021 U.S. Dist. LEXIS 178422, (M.D. Fla. Sept. 20, 2021).

[iii] *See Ditech Financial, LLC v. AIG Specialty Insurance Company, et al.*, Case No. 21-13510 (11th Cir.).

[iv] 2021 U.S. Dist. LEXIS 173998 (D. Conn. Sept. 14, 2021).

[v] CMEEC filed a Motion to Reconsider on September 21, 2021, which the court granted on October 29, 2021. While the court did not reverse its determination that the subpoenas did not constitute "claims" for "wrongful acts," it found that: (1) subsequent indictments did qualify as such; and (2) because the insurer agreed to treat the subpoenas as a "notice of circumstance," the indictments were deemed claims first made in 2016, when the first subpoena was received. *See* Ruling on Plf's Mot. for Prtl. Recons., ECF No. 156 (Oct. 29, 2021).

[vi] 2021 Del. Super. LEXIS 489 (Del. Super. Ct. June 23, 2021).

[vii] 2021 U.S. Dist. LEXIS 203014 (D. Del. Oct. 21, 2021).

[viii] 2021 N.Y. LEXIS 2519 (Nov. 23, 2021).

[ix] 137 S. Ct. 1635 (2017).

[x] 2021 U.S. Dist. LEXIS 195236 (D. Ill. Sept. 23, 2021).

[xi] *See Astellas US Holding, Inc. v. Federal Insurance Company*, Case No. 21-3075 (7th Cir.).