Westlaw Today
powered by Reuters

Significant D&O cases from the first half of 2022

By Gary L. Gassman, Esq., and Stephanie Nashban, Esq., Cozen O'Connor PC

SEPTEMBER 16, 2022

This article, written by attorneys who specialize in directors and officers liability insurance issues, reflects their choice of significant — and interesting — D&O cases from the first half of this year. The cases reflect the issues that are top of mind to the practitioner and insurers in this area.

Exclusions using 'arising out of' and similarly broad lead-in language

Case: *Sentynl Therapeutics, Inc. v. US Specialty*[1]

The DOJ's Opioid Task Force subpoenaed Sentynl in connection with an investigation of potential federal law violations by anyone illegally profiting from opioids. The investigation focused on Sentynl's marketing and promotion of prescription opioid medications.

The court held that the exclusion's plain language barred coverage for the entire underlying lawsuit because it was brought by plaintiffs who also qualified as "insureds," notwithstanding the non-insured plaintiffs, against defendants who were both "insureds."

The D&O insurer denied coverage, citing a goods and products exclusion that precluded coverage for "'Loss' in connection with a 'Claim' arising out of, based upon or attributable to any goods or products manufactured, produced, processed, packaged, sold marketed, distributed, advertised or developed by the Insured Organization…" The district court found for the insurer.

Affirming, the Ninth Circuit observed that "arising out of" in the exclusion was much broader than "caused by," and "ordinarily understood to mean 'originating from,' 'having its origin in,' 'growing out of' or 'flowing from'." When unambiguous, courts must give effect to the intent of the parties in light of a clause that broadly excludes coverage.

The court agreed that issuance of the subpoenas, the investigation, and the costs of complying with the subpoenas "orginat[es] from, ha[s] its origin in, grow[s] out of or flow[s] from" the production, selling, marketing and distributing of Sentynl's opioid products. The court rejected Sentynl's argument that the exclusion rendered coverage illusory, reasoning that it did not apply to various other claims.

Takeaway: Ruling demonstrates that the phrase "arising out of" will not be narrowly construed just because it is in a policy exclusion.

Case: *TriPacific Capital Advisors, LLC v. Fed. Ins. Co.*[2]

An ex-employee filed an arbitration demand against TriPacific, a financial services firm, for breaches of fiduciary duties and breach of contract, seeking $8.5 million. The ex-employee alleged that in summer 2015, TriPacific offered him various benefits to persuade him to stay.

Specifically, the president and he reached an oral agreement for a promotion and compensation increase, including that the ex-employee would receive 50% of the net profits from investments he managed, converting the relationship to a joint venture.

In January 2016, a revised employment agreement reflected the salary increase and bonus calculation. TriPacific submitted the claim under an asset management policy with D&O coverage. The insurer denied coverage under the "contract exclusion," which barred coverage for any claim "based upon, arising from, or in consequence of any Insured's liability under any contract or agreement regardless of whether such liability is direct or assumed."

The exclusion did not apply to "liability that would attach to an Insured even in the absence of a contract or agreement."

TriPacific asserted that the exclusion was inapplicable to the breach of fiduciary duty claim because the suit did not conclusively establish that it was based upon, arose from, or was in consequence of liability under the employment agreement, and so the insurer had a duty to defend.

TriPacific also argued that the ex-employee did not allege that fiduciary duties arose from the employment agreements. The insurer asserted that all the lawsuit's claims were "based upon, arising from, or in consequence of" the firm's liability under the employment agreements, citing California law holding that the phrase "arising from" in an exclusion is construed broadly.

The court agreed with the insurer and concluded that "arising from" requires only a minimal causal connection or incidental relationship. The court explained: "To the extent that there is uncertainty about

Thomson Reuters is a commercial publisher of content that is general and educational in nature, may not reflect all recent legal developments and may not apply to the specific facts and circumstances of individual transactions and cases. Users should consult with qualified legal counsel before acting on any information published by Thomson Reuters online or in print. Thomson Reuters, its affiliates and their editorial staff are not a law firm, do not represent or advise clients in any matter and are not bound by the professional responsibilities and duties of a legal practitioner. Nothing in this publication should be construed as legal advice or creating an attorney-client relationship. The views expressed in this publication by any contributor are not necessarily those of the publisher.

the source of those fiduciary duties, the only two potential sources are either the alleged oral agreement in the summer of 2015 or the 2016 Employment Agreement." Thus, the source of any fiduciary duty would be a "contract or agreement."

Takeaway: Confirms the trend in California applying such exclusionary language broadly.

Insured v. insured exclusion

Case: *Stoneburner v. RSUI Indem. Co.*[3]

Two insured individuals were sued by the insured entity, non-insureds, and five individuals who also constituted "insureds" under a D&O policy as "past or present officers, directors, trustees, employees, or committee members of a duly constituted committee of" the insured entity. The insurer denied coverage based on the policy's insured-versus-insured exclusion. The defendants sued the insurer, which moved for summary judgment.

The court held that the exclusion's plain language barred coverage for the entire underlying lawsuit because it was brought by plaintiffs who also qualified as "insureds," notwithstanding the non-insured plaintiffs, against defendants who were both "insureds."

Although the court acknowledged as "true enough" the insureds' assertion about a stranger-filed complaint possibly triggering the exclusion, it dismissed that scenario as "quite unlikely," since any attorney who filed such a complaint would almost certainly be sanctioned.

The court rejected the defendants' argument that the policy's definition of "claim" mandated that each cause of action in the lawsuit be considered a separate claim and that the insurer was obligated to defend the causes of action asserted by non-insured plaintiffs. The court explained that such an interpretation was unsupported by the policy language, as the definition of "claim" plainly defined an entire civil proceeding as a single claim.

The court also noted that because every cause of action was brought by insureds, often together with non-insureds, there were no separate covered causes of action that could implicate the policy's allocation provision.

Takeaway: Court applied the insured-versus-insured exclusion even where the policy contained an allocation provision, which would likely not occur in some other jurisdictions.

Case: *RSUI Indem. Co. v. Lichtenberg*[4]

A music fraternity, through its national executive committee, sued the fraternity's president and executive director to bar them from performing their duties, disposing of fraternity assets, or entering fraternity headquarters.

The state court dismissed the lawsuit on the basis that the executive committee lacked standing to sue in the fraternity's name. The court of appeals affirmed. The president and director tendered the lawsuit to the fraternity's D&O policy. The insurer denied coverage based on the insured-versus-insured exclusion and filed a declaratory judgment action.

The insureds argued that the exclusion did not apply because the underlying lawsuit was not brought "by or on behalf of" the fraternity, as evidenced by the ruling that the executive committee lacked such authority.

The insurer argued that the exclusion's applicability could be determined by reference to the complaint alone, which was captioned in the name of the (insured) fraternity. The insureds argued if that were the rule, the insurer could defeat coverage even where a stranger filed a complaint in the fraternity's name.

Ruling for the insurer, the court held that the exclusion's applicability could be determined solely by reference to the complaint because "[i]t is the nature of the claim that defines an insurer's duty to defend, not its merits."

Although the court acknowledged as "true enough" the insureds' assertion about a stranger-filed complaint possibly triggering the exclusion, it dismissed that scenario as "quite unlikely," since any attorney who filed such a complaint would almost certainly be sanctioned. Because the complaint revealed a claim clearly subject to the exclusion, the insurer did not owe a duty to defend.

Takeaway: Confirms that coverage is determined by reviewing the complaint and the insurance policy.

Status as 'insured'

Case: *Dunluck v. Assicuranzioni Generali S.P.A. — UK Branch*[5]

Several individuals worked for the named insured's subsidiary which sought to "develop a cannabidiol processing plant in Eureka, Montana." By fall 2019, the subsidiary began paying the employees with bad checks, although employees continued to work hoping they would eventually receive wages owed.

On December 4, 2019, the insured parent and subsidiary terminated their relationship. On February 26, 2020, the employees sued the subsidiary, complaining that they were terminated on January 4, 2020. The employees secured a default judgment against the subsidiary, with the court finding the subsidiary had wrongfully terminated the employees without cause on January 4, 2020. The employees sought to recover under the former parent's D&O policy, and coverage litigation ensued.

The court agreed with the insurer that the lawsuit was not covered. The court ruled that the subsidiary was not an "Insured" on January 4, 2020, when the employees alleged they were wrongfully terminated, as the subsidiary did not have insured status after it ceased being a subsidiary on December 4, 2019.

 ©2022 Thomson Reuters

The court applied the policy's definition of "management control" and found no evidence that the parent retained "management control" over the subsidiary after that date. The court then independently ruled that no coverage existed because none of the subsidiary's officers or directors were sued in the underlying state court lawsuit.

The insuring agreement provided that "no coverage is provided to a Named Organization under this Coverage Extension unless such Claim is commenced and continuously maintained against an Insured Person." "Insured Person" was defined to include the general partners of the subsidiary (organized as a limited liability company). There was no coverage because the lawsuit was against the subsidiary alone, and not any Insured Person.

Takeaway: Demonstrates a change in status quo's impact on the availability of coverage.

Delaware case roundup

Case: *MPM Holdings, Inc. v. Fed. Ins. Co.*[6]

MPM shareholders filed a pre-closing § 220 books and records action, three consolidated post-merger appraisal actions, and a putative stockholders' class action against MPM and officers and directors, alleging they acted improperly in connection with a merger by negotiating to further their own interests and those of private equity investors and failing to maximize the value of MPM shares.

MPM's D&O insurer acknowledged coverage for the § 220 action and class action, but denied coverage for the appraisal actions on the grounds that seeking to assert a shareholder's statutory right to appraisal does not allege a "Wrongful Act."

The court held that the insurer was not obligated to reimburse defense costs for the appraisal action. The court cited to *Jarden v. Ace American Ins. Co.*, in deciding that an appraisal proceeding is a limited legislative remedy that provides a method for dissenting shareholders to determine the fair value of their holdings and that determination did not involve an inquiry into claims of wrongdoing in the merger.

Takeaway: Good ruling for insurers that appraisal actions do not trigger D&O coverage.

Case: *First Solar, Inc. v. National Union Fire Ins. Co. of Pittsburgh, PA*[7]

In 2012, shareholders sued First Solar for federal securities laws violations from making false or misleading public disclosures about the company's ability to produce solar electricity at costs comparable to conventional energy producers — *Smilovitz*.

The D&O insurers provided coverage for *Smilovitz* and paid limits under the 2011-2012 policies. In 2015, shareholders who opted out of *Smilovitz* filed a separate class action, *Maverick*, claiming violations of the same federal securities laws, but adding state claims for fraud and negligent misrepresentation.

The insured sought coverage for *Maverick* under the 2014-2015 policies. The insurers denied coverage and asserted the actions were related. In 2021, the insured sued the insurers for a finding of coverage, arguing that the actions were unrelated because they involved different plaintiffs, claims, conduct and class periods.

The Superior Court noted that the fundamentally identical test, consistently used by Delaware courts, required examination of the subject of the claims to determine if they are exactly the same and do not merely share thematic similarities, including by assessing whether the claims share "common facts, circumstances, transactions, events, and decisions" (without reliance on a policy's related claims definition).

Finding no coverage for *Maverick*, the court held the actions were fundamentally identical because they alleged violations under the same securities laws, relied on the same disclosures, had class period overlap, and involved the same defendants.

The Delaware Supreme Court affirmed on appeal but stated that the fundamentally identical test should not be used. The Court reasoned that the "fundamentally identical" language was never meant to be a standard at all. Instead, there should not be a uniform test applied in related claims cases, because doing so "disregards the plain language of the policy."

Finding no coverage for Maverick, *the court held the actions were fundamentally identical because they alleged violations under the same securities laws, relied on the same disclosures, had class period overlap, and involved the same defendants.*

The Court noted the provision at issue broadly defined "related claim" as any claim "alleging, arising out of, based upon, or attributable to any facts or Wrongful Acts that are the same as or related to" an earlier claim against the insured. Because *Smilovitz* and *Maverick* both centered on First Solar allegedly misrepresenting the cost of solar power to increase stock prices in violation of the same federal securities laws, the claims were related under the policy.

It was inconsequential that the actions cited violations of different laws, involved different plaintiffs, and sought different damages. The Court also noted that, in a motion, First Solar described the allegations in the two cases as "nearly identical."

Takeaway: A welcome reprieve from a rigid standard — Delaware courts will not disregard a policy's plain language.

Case: *Liberty Ins. Underwriters v. Cocrystal Pharma, Inc.*[8]

Cocrystal was formed through a reverse merger. Following the merger, the SEC served a subpoena *duces tecum* in connection with its investigation of Cocrystal and a predecessor company. The SEC ultimately filed an enforcement action against directors and officers,

 ©2022 Thomson Reuters

alleging they engaged in a "pump-and-dump scheme" to inflate the value of the predecessor.

Then shareholders sued Cocrystal in derivative actions. Cocrystal tendered everything to its D&O insurer. The insurer initially stated that there was no coverage for the subpoenas, but later agreed to advance Cocrystal's defense costs in responding to the SEC investigation.

After the derivative suits were filed, the insurer again reversed its coverage position, contending there was no coverage for the matters as all of the alleged misconduct occurred prior to the merger, and could not have been undertaken by individuals in their capacities as directors or officers of Cocrystal, which was formed at the time of the merger. The insurer sought a declaration of no coverage in the District of Delaware, and recoupment of nearly $1 million in costs paid.

Cocrystal countersued alleging breach of contract, bad faith, and violation of Washington statutory duties. The parties filed cross motions for summary judgment.

The Court applied Delaware law, as argued by the insurer, finding that it is applicable to disputes over D&O insurance where the insured is a Delaware corporation. The court held that there was no coverage for acts of directors and officers that occurred prior to the formation of the insured corporation.

Because the SEC investigation and action were focused entirely on pre-merger conduct, the directors and officers were not acting for Cocrystal when they engaged in the scheme. Thus, the conduct was not "Wrongful Acts" that triggered the Policy.

The court also found no coverage for the derivative suits, noting that the policy expired on May 6, 2018, but the first of the derivative suits was not filed until September 2018 or later. While the policy contained a standard relation back provision, the court held that the "provision applies only when a claim arises from a Wrongful Act or Interrelated Wrongful Act."

Because the pump-and-dump scheme was neither a Wrongful Act nor an Interrelated Wrongful Act, there was nothing to which the derivative actions could relate back. The court also held that Cocrystal had to repay the advanced defense costs.

Takeaway: Illustrates the importance of insured capacity issues in D&O litigation and coverage.

Notes

[1] 2022 WL 706941 (9th Cir. March 9, 2022).

[2] 2022 WL 423409 (C.D. Cal. Jan. 28, 2022).

[3] 2022 WL 1091337 (D. Utah April 12, 2022).

[4] 2022 WL 740756 (S.D. Ind. Feb. 25, 2022).

[5] 2022 WL 684377 (D. Mont. Mar. 8, 2022).

[6] 2022 WL 779563 (Del. Super. Ct. Mar. 15, 2022).

[7] 274 A.3d 1006 (Del. Mar. 16, 2022).

[8] 2022 WL 1624363 (D. Del. May 23, 2022).

About the authors

Chicago attorney **Gary L. Gassman** (L), co-vice chair of **Cozen O'Connor PC**'s global insurance department and co-chair of the firm's professional liability practice, focuses on directors and officers, errors and omissions, employment practices liability, and commercial general liability insurance coverage, counseling, and litigation. He is also chair of the American Bar Association tort trial and insurance practice section (TIPS) for the bar year 2022-23. He can be reached at ggassman@cozen.com. Chicago attorney **Stephanie Nashban** (R) is a member of the firm's global insurance department, where she also focuses on D&O, E&O, EPL and CGL insurance coverage, counseling, and litigation. She can be reached at snashban@cozen.com.

This article was first published on Westlaw Today on September 16, 2022.

© 2022 Thomson Reuters. This publication was created to provide you with accurate and authoritative information concerning the subject matter covered, however it may not necessarily have been prepared by persons licensed to practice law in a particular jurisdiction. The publisher is not engaged in rendering legal or other professional advice, and this publication is not a substitute for the advice of an attorney. If you require legal or other expert advice, you should seek the services of a competent attorney or other professional. For subscription information, please visit legalsolutions.thomsonreuters.com.