Wiley Rein LLP

EXECUTIVE SUMMARY

Developments Affecting Professional Liability Insurers | September 2015

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Insurer Not Required to Advance Defense Costs Under A-Side Policy on Pro Rata Basis with Underlying D&O Policy

In a victory for Wiley Rein's client, a federal district court has held that an insurer is not required to advance defense costs under an A-side policy as long as it is advancing defense costs under a D&O liability policy issued for the same policy period. *FDIC v. Gálan-Álvarez*, 2015 WL 4887578 (D.P.R. Aug. 17, 2015). Wiley Rein represented the insurer.

The Federal Deposit Insurance Corporation (FDIC) sued the former directors and officers of a bank in connection with the bank's failure. The insurer agreed to provide a defense under the D&O liability policy and had advanced nearly $11 million to date. The directors and officers sought an order requiring the insurer to reallocate amounts paid to date and to pay defense costs going forward on a pro rata basis between the D&O policy and the A-side policy. The directors and officers argued they were entitled to a defense under the A-side policy if there was even a "remote possibility" of coverage under that policy, asserting that the A-side policy was not a "true excess policy" and that the two policies' "other insurance" provisions should be treated as mutually repugnant so that costs should be shared between the two policies.

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Sixth Circuit Affirms That Tax Shelter Exclusion Bars Coverage for Suits against Accounting Firm

In a win for Wiley Rein's client, a federal appeals court, applying Tennessee law, affirmed a federal district court decision holding that a tax shelter exclusion in an accounting firm's professional liability policy precluded coverage for two underlying complaints alleging that the insured implemented investment strategies constituting illegal tax avoidance schemes. *Financial Strategy Group, PLC v. Continental Cas. Co.*, No. 14-6296 (6th Cir. Aug. 4, 2015). Wiley Rein LLP represented the insurer in this case.

In affirming the district court's decision, the United States Court of Appeals for the Sixth Circuit rejected the insured's contention that the tax shelter exclusion did not apply because the insured did not design the tax shelters at issue, but only

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Pennsylvania Supreme Court Adopts "Reasonableness" Standard for Enforcing Cooperation Provision When Insurer Breaches its "Duty to Settle"

The Pennsylvania Supreme Court has held that a group of insureds could recover from their insurers for a settlement that was "fair, reasonable and non-collusive" regardless of whether the insureds obtained the insurers' consent as required by the policies and regardless of whether the insureds failed to show that the insurers acted in bad faith. *The Babcock & Wilcox Co. v. Am. Nuclear Insurers,* No. 2 WAP 2014 (Pa. July 21, 2015).

The insureds, operators of nuclear facilities, were sued by hundreds of claimants alleging that their facilities had released radioactive or toxic materials. The insureds sought coverage for the suits, and their insurers agreed to defend them subject to a reservation of rights. Over the insurers' objection, the insureds ultimately settled the outstanding claims within policy limits. The insurers refused to fund the settlement, maintaining that the insureds breached the policies' cooperation clause by settling without the insurers' consent.

In the coverage litigation that followed, the court held that the insureds could recover for the settlement from their insurers provided that the settlement was for covered loss and was "fair, reasonable, and non-collusive." The court began its analysis by reviewing Pennsylvania case law and surveying different approaches utilized by courts across the country, and it ultimately adopted a standard permitting settlement without an insurer's consent even short of insurer bad faith. In so doing, the court adopted what it called a "fair and reasonable standard limited to those

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Fifth Circuit Holds That Amended Complaints Relate Back to Original Complaint That Sought Only Injunctive Relief

The United States Court of Appeals for the Fifth Circuit, applying Texas law, has affirmed a district court's decision holding that an original complaint seeking only injunctive relief but alleging negligent conduct constituted a "claim" under an earlier claims-made-and-reported policy and therefore the subsequent amended complaints related back to the original complaint. *NetSpend Corp. v. AXIS Ins. Co.*, 2015 WL 4288977 (5th Cir. July 16, 2015). Because the insured did not provide notice of the original complaint during the policy period of the earlier policy, there was no coverage for the lawsuit.

The insured sold prepaid, reloadable debit cards to consumers and contracted with third party banks to serve as "issuing banks," which held the deposited funds and provided the insured access to payment services. After discovering a $10.5 million "shortfall" in the depository accounts it provided for the insured's customers, an issuing bank filed suit in July 2012 seeking injunctive relief, but not damages. That same month the issuing bank filed a first amended complaint that added a cause of action for breach of contract. In September 2012, the issuing back filed a second amended complaint, which included causes of action for breach of fiduciary duty, fraud and negligence. Thereafter, the insured provided notice of the second amended complaint to its insurer under an August 20, 2012 to August 20, 2013 claims-made-and-reported policy. The insurer denied coverage for the shortfall litigation based on late notice.

The district court found that the original complaint constituted a claim for a wrongful act notwithstanding that it sought only injunctive relief because it included allegations of negligent conduct sufficient to fall within the definition of wrongful act. According to the district court, the relevant analysis must focus on the allegations "that show the origin of the damages rather than on the legal theories alleged." Because the shortfall litigation constituted a claim first made during the earlier policy period for which notice was not provided during the policy period, the district court held there was no coverage for the litigation. The appellate court affirmed the lower court's decision for the reasons set forth by the district court. ■

Prior Acts Exclusion in E&O Policy Bars Coverage for Arbitration Award

Applying New York law, the United States Court of Appeals for the Tenth Circuit held that an insurer had no duty to indemnify an insured for an arbitration award because the prior acts exclusion in the E&O policy barred coverage for the arbitration. *Templeton v. Catlin Spec. Ins. Co.*, 2015 WL 4072128 (10th Cir. July 6, 2015). However, the court held that the insurer, which issued a reservation of rights letter and agreed to defend, breached its duty to defend the arbitration by failing to appoint separate counsel for the insured person.

Two investors filed a Financial Industry Regulatory Authority (FINRA) arbitration against the insured securities broker and brokerage firm for failing to disclose risks associated with a series of investments made both before and after the securities broker joined the brokerage firm. The brokerage firm tendered the arbitration to its insurer under an E&O policy. The insurer agreed to defend the securities broker and the brokerage firm in the arbitration subject to a reservation of rights and appointed defense counsel, who later withdrew. The insurer then rejected the brokerage firm's preferred counsel but agreed to preferred counsel's limited representation of the brokerage firm to reach a settlement with the investors. Although the preferred counsel reached a settlement on behalf of the brokerage firm, the investors refused to release the securities broker. The investors obtained a judgment against the securities broker in the arbitration because counsel did not appear to defend the securities broker. The broker satisfied the judgment in the arbitration and filed suit against the insurer for breaching its duty to defend and indemnify him for the arbitration award.

First, the court held that the insurer breached its duty to defend the securities broker in the arbitration. The insurer did not contest that it had a duty to defend the securities broker because it

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Fifth Circuit Reverses: Insured v. Insured Exclusion Does Not Apply To Indemnity Claim

Applying Louisiana law, the United States Court of Appeals for the Fifth Circuit has reversed a summary judgment ruling in favor of an insurer, holding that a CGL policy's insured-versus-insured exclusion does not apply where the suit between the insureds was for indemnification, and not for property damage. *Kinsale Ins. Co. v. Georgia-Pacific, LLC*, 2015 WL 4529290 (5th Cir. July 27, 2015).

The insurer issued a commercial general liability policy to the insured excavation company. The policy contained an exclusion precluding coverage for "claims or 'suits' for 'bodily injury,' 'property damage,' or 'personal and advertising injury' brought by one insured against another insured" (insured v. insured exclusion).

The insured was hired to perform demolition work by a paper company, which was an additional insured under the policy. After a fire caused damage to equipment leased to the insured, the leasing company sued the insured for property damage. In that suit, the insured filed a third-party demand for indemnification against the paper company, which then sought coverage under the policy. The insurer denied coverage based on the insured v. insured exclusion and filed a declaratory judgment action. The district court granted the insurer's summary judgment motion, holding that the unambiguous insured v. insured exclusion barred coverage because the third-party demand arose as a result of property damage.

On appeal, the Fifth Circuit reversed. Although it agreed with the district court that the litigation between the insureds constituted a "suit" under the policy, it found that the exclusion "requires that the claim or suit for property damage be brought by one of the insureds against another insured." Because the property damage claim was actually brought by a third-party stranger to the policy, while the insured's claim against the additional insured paper company sought indemnification, the court concluded that the "claim" between the

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Maryland Federal Court Holds Coverage Barred by Insured's Prior Knowledge and by "Actual Prejudice" from Late Notice

A federal court in Maryland has held that a "prior knowledge" provision in a claims-made-and-reported policy applied where, prior to the effective date of the policy, other members of the insured's real estate firm had suggested that the insured was responsible for the firm's defense costs in an underlying litigation. *McDowell Building, LLC v. Zurich Am. Ins. Co.*, No. RDB-12-2876 (D. Md. May 7, 2015). The court also found that the insurer had properly denied coverage for a claim on the basis of late notice because the insurer was "actually prejudiced" by the insured's failure to give notice of a claim until after the insured had signed a settlement agreement releasing a potentially-responsible party from the underlying litigation.

The insured, a partner at a real estate firm, failed to obtain state tax credits for a development project on behalf of his real estate firm. When the other partners in the real estate firm discovered the problem with the tax credits, they suggested payment of legal costs from the insured and filed suit against the state government agency to obtain the tax credits. One of the partners in the real estate firm subsequently asserted a cross-claim and third party complaint against the insured for professional negligence. That cross-claim was stayed, however, pending resolution of the underlying suit against the state agency.

Three years later, the insured first gave notice to the insurer of the stayed cross-claim—after the insured entered into a settlement agreement releasing another potentially-responsible party from all claims in the underlying suit. The insurer denied coverage for the cross-claim on the basis of late notice and, alternatively, on the basis that the prior knowledge provision was not satisfied because the insured had knowledge of the cross-claim prior to the effective date of the relevant policy period. The policy provided coverage for claims first made and reported during the applicable policy period, provided that, "prior to the effective date of th[e] policy, [the] Insured had no knowledge of any 'claim' or circumstances, involving an act, error, or omission, which may result in a 'claim' under th[e] policy." In addition, the policy required the insured to provide "prompt notice" in the event of any claim. The insured settled the cross-claim, and the real estate firm, as assignee of the insured, filed a coverage action.

After a three-day bench trial, the court concluded that the "prior knowledge" provision in the policy precluded coverage for the cross-claim. As a preliminary matter, the court stated that it had previously ruled at the summary judgment stage that the provision should be

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Spreadsheet Listing Asserted Damages is a "Claim"

The United States Court of Appeals for the Eighth Circuit has held that the undefined term "claim" in a claims-made liability insurance policy included a spreadsheet detailing monetary damages based on failures of the policyholder's products. *Ritrama, Inc. v. HDI-Gerling Am. Ins. Co.*, No. 2015 WL 4730916 (8th Cir. Aug. 11, 2015).

Applying Minnesota law, the court concluded that "claim" meant an assertion by a third party that the insured may be liable to it for damages within the risks covered by the Policy." The court reasoned that a "mere request for information is generally insufficient to constitute a claim, whereas a demand for relief generally constitutes a claim."

Here, the policyholder's dispute with its customer concerning product failures resulted in the customer sending a spreadsheet containing "the specific total of how much monetary damages [the customer] had sustained thus far," sent before product-defect litigation was filed and before the inception of the claims made policy at issue. The court concluded that there was no reasonable way to interpret the spreadsheet as anything other than a demand for relief and noted further that the policyholder had treated the spreadsheet as a claim. The court therefore concluded that the "claim" at issue had been made prior to the inception of claims-made policy period at issue. ■

Insurer Entitled to File Suit for Unjust Enrichment Directly Against *Cumis* Counsel to Recover Unreasonable and Unnecessary Fees

The California Supreme Court has held that an insurer can file a claim directly against *Cumis* counsel under an unjust enrichment theory to recover for alleged overpayments due to unreasonable and unjustifiable fees charged in connection with underlying litigation. *Hartford Cas. Ins. Co. v. J.R. Marketing, LLC,* No. S211645 (Cal. Aug. 10, 2015).

This case arose from a determination that an insurer breached its duty to defend an insured in connection with underlying litigation. As part of that ruling, the trial court ordered the insurer to defend its insured and to immediately pay all past fees for independent counsel as well as all future fees within 30 days of receipt. The trial court further held that, because the insurer originally breached its duty to defend, it was not entitled to invoke the protections afforded under the *Cumis* statute, California Civil Code Section 2860, which provides that disputes concerning fees of independent counsel must be submitted to binding arbitration by the parties. Finally, the trial court's order provided that "[t]o the extent [the insurer] seeks to challenge fees and costs as unreasonable or unnecessary, it may do so by way of reimbursement after resolution of" one of the underlying lawsuits. The order was affirmed on appeal.

After the underlying litigation concluded, and after independent counsel had charged more than $15 million in fees, the insurer sought reimbursement of excessive fees from its insured. The insurer also brought a cross-complaint in

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Contract Exclusion Bars Coverage for City but Not Individual Officials

The United States District Court for the Northern District of Illinois, applying Illinois law, has held that a contract exclusion barred coverage for a claim against an insured city by the operator of a minor league baseball team which asserted it was a third-party beneficiary to the contract for the construction of a stadium in the city. *OneBeacon Am. Ins. Co. v. City of Zion*, 2015 WL 4572654 (N.D. Ill. July 29, 2015). However, the court held that the insurer did have a duty to defend the city's mayor and economic development director because the claims against them were not wholly precluded by the contract exclusion or by the policy's profit, advantage or remuneration or criminal acts exclusions.

The operator of the minor league baseball team brought suit against the insured city and its mayor and economic development director. The team alleged the city had agreed to build a stadium in consideration for the team coming there to play. The city council had approved the sale of bonds to finance the construction of the stadium, and the city entered a construction contract to build the stadium. The team alleged that the mayor and economic development director then decided not to pursue construction at the site but continued to misrepresent to the team and to the public that construction of the stadium would occur. The team asserted breach of the construction contract against the city, alleging that the team was a third-party beneficiary to the contract. The team also asserted causes of action against the individuals for fraud and civil conspiracy, based on their misrepresentations that the city would build the stadium. The city's insurer brought this coverage action for a declaration that it had no duty to defend the city or the individuals against the team's suit.

The court first considered the contract exclusion in the policy's E&O coverage part. The exclusion barred coverage, in relevant part, for any claim "arising directly or indirectly out of, or in any way related to liability assumed under any contract or agreement o[r] breach of contract to which the insured is a party." The court found that the exclusion precluded coverage for the city because the alleged wrongful acts of the city would not exist but for the breach of the construction contract. However, the court found that the

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Insurer Has Duty to Defend Cross-Claims Against Members of Homeowners' Association

A federal court in California has held that an insurer is obligated to defend claims against members of an insured homeowners' association, even though the association was not a named defendant. *Market Lofts Cmty. Ass'n v. Nat'l Union Fire Ins. Co. of Pittsburgh*, 2015 WL 4594553 (C.D. Cal. July 30, 2015).

The insured, an association formed for the benefit of condominium owners at a development in Los Angeles, filed the underlying action against several defendants for allegedly charging a monthly parking fee in violation of a development agreement. After losing a dispute over the insured association's standing to sue, the underlying defendants filed cross-complaints against 300 of the insured's members but did not directly name the insured association as a defendant. The insurer denied coverage for the cross-complaints on the grounds that a "claim" had not been "made against the Insured."

In the coverage litigation that followed, the court held that the insurer had a duty to defend. The court concluded that the cross-complaints in the underlying action presented a "Claim" that was "made against" the insured. Although the insured was not a named defendant in the cross-complaints, the court ruled that the policy language was ambiguous and could reasonably be interpreted to include coverage for complaints that: (1) name the insured association's members as defendants "in an improper attempt to circumvent the [insured's] interest" in defending the claim, and (2) which the insured had a statutory right to defend. According to the court, "an insurer cannot avoid coverage simply because the complainant seeks a tactical advantage in the lawsuit." ■

Notice Outside Policy's 30 Day Reporting Requirement Untimely As a Matter of Texas Law Notwithstanding Lack of Prejudice

A Texas appellate court has held that an insured's notice of an environmental contamination claim within the policy period but outside a 30 day reporting period is untimely as a matter of law. *Nicholas Petroleum, Inc. v. Mid-Continent Cas. Co.*, No. 05-13-01106-CV (Texas App., 5th Dist. July 21, 2015). Because the reporting requirement was a condition precedent to coverage, the insurer need not show prejudice to deny coverage for late notice.

The operative pollution liability and environmental damage policy required notice of a claim "as soon as possible" but "in any event not later than thirty (30) days after receipt of a Claim by the Insured." The trial court granted summary judgment to the insurer on late notice grounds. On appeal, the insured argued that even though it did not provide notice within 30 days of receipt of the claim, the notice-prejudice rule should apply based on *Prodigy Communications Corp. v. Agricultural Excess & Surplus Insurance Co.*, 288 S.W.3d 374 (Tex. 2009), because it gave notice of the claim during the policy period. According to the insured, *Prodigy* held that an insurer must demonstrate that the insured's noncompliance prejudiced the insurer where an insured gives notice of a claim within the policy period but not "as soon as practicable." The insurer contended that it was not required to show prejudice before denying coverage because the language of the notice provision was different from the one at issue in *Prodigy*, which required notice "as soon as practicable" but not later than 90 days after the expiration of the policy period.

The appellate court agreed with the insurer that its notice provision went beyond what was present in *Prodigy* because it required the insured to not only provide notice of a claim "as soon as possible," but also within 30 days of receipt of the Claim. According to the court, it is undisputed that the policy unambiguously stated that notice is a condition precedent to coverage, and therefore the 30-day requirement was a material part of the bargained-for exchange under the policy, which was materially breached when the insured failed to comply. ■

No Duty to Defend Antitrust Suit Alleging Malicious Disparagement

Applying Texas law, the United States District Court for the Southern District of Texas has held that there is no duty to defend an insured under a CGL policy for allegations of malicious disparagement, where the policy precluded coverage for knowingly false disparagement and knowing attempts to violate others' rights and inflict personal and advertising injury. *Chartis Spec. Ins. Co. v. JSW Steel (USA), Inc.*, No. 4:14-cv-01527 (S.D. Tex. Jul. 8, 2015).

In pertinent part, the policy afforded coverage for "personal and advertising injury," including "oral or written publication, in any manner, of material that slanders or libels a person or organization or disparages a person's or organization's goods, products, or services." The policy excluded coverage for "personal and advertising injury caused by or at the direction of the insured with the knowledge that the act would violate the rights of another and would inflict personal and advertising injury," "personal and advertising injury arising out of oral or written publication of material, if done by or at the direction of the insured with knowledge of its falsity," and "personal and advertising injury arising out of a breach of contract, except an implied contract to use another's advertising idea in [the insured's] advertisement."

The underlying claimant filed suit against the insured and others, alleging that the defendants had conspired to drive the underlying claimant out of business. With regard to the insured, the claimant asserted that the insured agreed to join the conspiracy and to breach its contract with the claimant based on disparaging remarks about the claimant that were made by the other defendants. The claimant also contended that the defendants published false and disparaging statements about the underlying claimant's economic interests "with malice and without privilege." The underlying complaint included counts for violation of the Sherman Act, breach of contract, tortious interference, business disparagement, and conspiracy. At the time of trial, the only remaining claims against the insured were for breach of contract and antitrust violations. The jury returned a verdict in the claimant's favor and against the insured on those claims. Though the insured's carrier had been providing the insured with a defense subject to a reservation of rights, after the verdict was rendered, the insurer denied coverage and refused to pay the insured's defense costs on appeal or indemnify the insured for the judgment.

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Insurer Not Required to Advance Defense Costs Under A-Side Policy on Pro Rata Basis with Underlying D&O Policy *continued from page 1*

The court held that the language of the A-side policy made its coverage excess to the D&O liability policy, and advancement of defense costs under the A-side policy was therefore not available until the D&O policy was exhausted. In reaching this conclusion, the court noted that the A-side policy expressly stated that it was excess of any Insurance Program, which was defined to include "any existing Management Liability insurance." The court held that, in light of this plain language, not even a "remote possibility" of coverage under the A-side policy existed at the time. The court also held that the question whether the "other insurance" clauses were mutually repugnant was immaterial because neither had been invoked to deny coverage, and the insurer was advancing defense costs under the D&O liability policy. ■

Pennsylvania Supreme Court Adopts "Reasonableness" Standard for Enforcing Cooperation Provision When Insurer Breaches its "Duty to Settle" *continued from page 2*

cases where an insured accepts a settlement offer after an insurer breaches its duty by refusing a fair and reasonable settlement while maintaining its reservation of rights and, thus, subjects an insured to potential responsibility for the judgment in a case…." Expounding on that framework, the court "observe[d] that a determination of whether the settlement is fair and reasonable necessarily entails consideration of the terms of the settlement, the strength of the insured's defense against the asserted claims, and whether there is any evidence of fraud or collusion on the part of the insured." The court stated that reasonableness would be determined from whether the settlement was "fair and reasonable from the perspective of a reasonably prudent person in the same position of [the insureds] and in light of the totality of the circumstances."

The court identified several limitations to its ruling, however. First, the court noted that "not all reservations of rights are equal," and that "[p]arties and courts may need to consider whether a particular reservation of rights justifies diverging from the contract's cooperation clause," suggesting that the "standard" set forth in this decision may not apply to cases with different facts, circumstances, and policy language. In addition, the court expressly noted that an insurer's liability for breaching the duty to settle would be limited to policy limits, concluding that an insurer could not be liable for extra-contractual liability absent bad faith. Finally, the court noted that an insurer's obligation for settlements would be for settlements that actually represented covered loss under the relevant policy. ■

Sixth Circuit Affirms That Tax Shelter Exclusion Bars Coverage for Suits against Accounting Firm *continued from page 1*

prepared tax returns. According to the appellate court, the fact that the insured provided tax advice regarding the tax shelters constituted "recommendations" as specified in the exclusion and, therefore, the exclusion applied.

The appellate court also agreed with the district court's finding that all of the allegations in the complaints "arose out of" tax shelters subject to the exclusion. Finally, the appellate court found that the "concurrent causation" doctrine did not apply to save coverage for the underlying complaints because the preparation of the tax returns at issue, which generally is covered under the policy, "amount[ed] to the recommendation of illegal tax shelters" and was, therefore, excluded from coverage. ■

Contract Exclusion Bars Coverage for City but Not Individual Officials *continued from page 5*

contract exclusion did not conclusively bar coverage for the individual defendants because the underlying complaint alleged numerous other wrongful acts by them, including disparaging publications about the team to the public, the failure to issue the construction bonds, and the decision to change the stadium site.

The court then considered whether the E&O coverage part's exclusion for any claim "arising directly or indirectly out of, or in any way related to any insured gaining any profit, advantage or remuneration to which that insured is not legally entitled" would bar coverage for the individuals. The court found that the team could still have pled fraud and civil conspiracy because those causes of action did not require proof that the individuals gained a profit, advantage, or remuneration to which they were not entitled. The court also found that the policy's criminal acts exclusion did not relieve the insurer of a duty to defend the individuals because it contained a final adjudication requirement.

Finally, the court found that there was no coverage for the city under the policy's commercial general liability coverage part. The court declined to determine whether the allegations about the city's announcements to the public about the construction of the stadium constituted personal and advertising injury because it found that the contract exclusion in that coverage part also barred coverage for the city. ■

Prior Acts Exclusion in E&O Policy Bars Coverage for Arbitration Award

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issued a reservation of rights and agreed to provide a defense. However, it contended that it satisfied the duty to defend because it believed the brokerage firm's preferred counsel was defending the insured and that the settlement released the securities broker. The court held that the insurer breached its duty to defend because (i) it never consented to the retention of the brokerage firm's preferred counsel because of conflict issues, (ii) even if it consented to the retention, it agreed to the retention only for purposes of settlement discussions and not for the entire arbitration, and (iii) the securities broker was entitled to separate counsel from the brokerage firm because of a potential conflict of interest. However, the court determined that the insurer did not breach any duty to defend the securities broker after the arbitration concluded because the securities broker had no reasonable basis to appeal the arbitration award.

Second, the court held that the insurer did not breach its duty to indemnify because a prior acts exclusion in the E&O policy barred coverage for the arbitration award. The exclusion barred coverage for any claim "arising out of, based upon or in consequence of, directly or indirectly resulting from or in any way involving . . . any Wrongful Act occurring on or after the Retroactive Date which, together with a Wrongful Act occurring on or prior to such Retroactive Date, would constitute Interrelated Wrongful Acts." The Policy defined "Interrelated Wrongful Acts" as Wrongful Acts that are "similar, repeated, or continuous" or "connected by reason of any common fact, circumstance, situation, transaction, casualty, event, decision or policy or one or more series of facts, circumstances, situations, transactions, casualties, events, decisions or policies." The Retroactive Date was the date that the securities broker joined the brokerage firm. The insurer contended that the prior acts exclusion applied because the securities broker's wrongful acts occurring after the retroactive date were related to the wrongful acts allegedly committed before the retroactive date. The court agreed. It held that "common facts" connected all wrongful acts—namely, failure to disclose risks in multiple investments. Specifically, the investments were sold to the same clients, were solicited by the same securities broker, and were made in subsidiaries of the same company. Further, the securities broker's liability was based on the same conduct with respect to each investment: failure to disclose material facts about the investments, failure to investigate the investments, and failure to investigate the suitability of the investments for the two investors.

Finally, the court held that the insurer was not equitably estopped from relying on the prior acts exclusion. Although the insurer did not specifically reference the prior acts exclusion in its reservation of rights letter, the letter broadly reserved rights to deny coverage. The court held that the insured securities broker could not prove detrimental reliance on the insurer's failure to specifically reference the prior acts exclusion because the insurer generally reserved its rights to deny coverage for the arbitration. ■

Fifth Circuit Reverses: Insured v. Insured Exclusion Does Not Apply To Indemnity Claim

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insureds was not for "property damage." Adding that "the plain meaning of the exclusion makes it inapplicable to an indemnity claim," the court concluded that the insured v. insured exclusion did not apply.

The court acknowledged that the litigation may in fact become a battle between the insureds over liability for the damage caused by the fire, a contest that the insurer undoubtedly sought to avoid with the insured v. insured exclusion, but ultimately concluded that the insurer's underlying purpose in including the exclusion could not trump the exclusion's actual plain language. ■

Maryland Federal Court Holds Coverage Barred by Insured's Prior Knowledge and by "Actual Prejudice" from Late Notice *continued from page 4*

interpreted as applying a subjective standard. In declining to reconsider its previous ruling, the court distinguished several cases decided under Maryland law where the prior knowledge provisions contained "explicit … words triggering an objective standard." Applying the subjective standard, the court ruled that the prior knowledge provision applied to the cross-claim because the insured had "actual knowledge" of a claim a year before the cross-claim was filed, when the other partners of the real estate firm had suggested that the insured pay the legal costs from the tax credit problem.

The court also held that the insurer had demonstrated "actual prejudice" to justify denying coverage based on late notice. As an initial matter, the court stated that Maryland Code § 19-110, which allows insurers to disclaim coverage on the basis of late notice only if the insurer establishes "actual prejudice," requires insurers to demonstrate that the insured's actions have "in a significant way … precluded or hampered [the insurer] from presenting a credible defense to the claim." According to the court, the insured prejudiced the insurer by settling the underlying suit and forfeiting any rights of contribution that the insurer might have had against the other potentially-responsible parties in the underlying litigation. In so holding, the court rejected the assignee's argument that, in order to show actual prejudice, the insurer was required to prove that it was entitled to indemnity or contribution from the other parties as a matter of law. The court explained that the Maryland "actual prejudice" standard "does not require [a] level of absolute certainty" but requires the insurer to demonstrate "a credible theory under which [the insurer] could have avoided liability or minimized the damages which it was responsible for paying." ■

Insurer Entitled to File Suit for Unjust Enrichment Directly Against Cumis Counsel to Recover Unreasonable and Unnecessary Fees *continued from page 5*

the declaratory judgment action, which was still ongoing, directly against the independent counsel for reimbursement of purportedly excessive and unreasonable fees. In so doing, the insurer asserted a common-law, quasi-contractual right to reimbursement under *Buss v. Superior Court*, 939 P.2d 766 (Cal. 1997). The trial court sustained a demurrer to the insurer's cross-complaint, holding that it could not sue the counsel directly. The California intermediate appellate court affirmed.

On appeal, the California Supreme Court reversed, holding that "under the circumstances of this case, the insurer may seek reimbursement directly from *Cumis* counsel." Applying the facts of this case to the precedent under *Buss*, the court observed that this case was distinguishable from *Buss* because the insurer here alleged that the counsel was unjustly enriched because it charged and was paid amounts that were unreasonable and unnecessary for the defense of the claim—and, therefore, that the costs and fees were not incurred for the benefit of the insured. As such—under the assumption that the insured was not "enriched"—the court ruled that it was the law firm that could be liable under an unjust enrichment theory under "principles of restitution and unjust enrichment" if it could be shown, by the insurer, that the bills were objectively unreasonable. In its ruling, however, the court "express[ed] no view as to what rights an insurer that breaches its defense obligations might have to seek reimbursement directly from *Cumis* counsel in situations other that the rather unusual ones … in this case." ■

No Duty to Defend Antitrust Suit Alleging Malicious Disparagement

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The insurer filed suit against the insured, seeking a declaration that it had no duty to defend or indemnify the insured. On cross-motions for summary judgment, the court analyzed the allegations in the underlying complaint and held that the insurer had no duty to defend the insured in the first instance. In the court's view, "[t]he complaint seem[ed] to allege that all of the disparagement was actually committed by parties other than [the insured], and [the insured's] wrongdoing was limited to its breach of contract (also excluded from coverage) in aid of the conspirators' antitrust violations." The court maintained that, "even if the disparagement were alleged or imputed to the [the insured], it would not be covered as it was a knowing attempt to violate [the underlying claimant's] rights . . . ." Moreover, according to the court, the underlying complaint's disparagement allegations were tethered to statements that were purportedly false and malicious and, accordingly, excluded from coverage.

With respect to the insured's duty to indemnify, however, the court concluded that a decision on that issue was premature while the underlying action remained pending on appeal. The court stated that, once there was a final judgment on the claim, the parties could move at that time for a final determination on indemnity coverage. ■

SPEECHES/UPCOMING EVENTS

ACI's 19th Forum on D&O Liability
CHARLES C. LEMLEY, Speaker
• **D&O and Financial Institutions**
Sept. 18, 2015 | New York, NY

DRI Seminar: Data Breach and Privacy Law
LAURA A. FOGGAN, Speaker
• **Coverage for Data Breaches Under Traditional Insurance Policies and Introduction to Cyber Policies**
Nov. 4-6, 2015 | Chicago, IL

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