

# “Causal Connection” Required to Deny Coverage under Prior and Pending Litigation Exclusion

---

March 2007

In an unreported decision, the Superior Court of California has held that a "reasonable construction" of prior and pending litigation exclusions requires insurers to show a "causal connection" between a prior lawsuit and subsequent lawsuits that were the subject of the coverage dispute. *nVidia Corp. v. St. Paul Mercury Ins. Co.*, No. 05-438278 (Cal. Super. Ct. Jan. 4, 2007).

The insurers issued various D&O policies to a company. Each policy contained a prior and pending litigation exclusion, but the precise language of the exclusions varied. One policy excluded coverage for "all future claims or litigation based upon ... or derived from the same or essentially the same facts." Another excluded coverage for claims "based on, arising out of, directly or indirectly resulting from, in consequence of, or in any way involving" prior litigation. Yet another excluded coverage for any claim "based on, arising out of or in any way involving any fact, circumstance or situation underlying, alleged in or relating to any written demand for monetary damages or other relief" in prior litigation. A fourth version excluded coverage for any claim "based upon, arising out of, directly or indirectly resulting from, in consequence of, or in any way involving any" prior litigation. One policy limited coverage to "Securities Claims" and defined this term as "a Wrongful Act in connection with the purchase of or sale of, offer to purchase or sell, any securities issued" by the policyholder.

The policyholder had previously become embroiled in patent litigation. The litigation was resolved when the company entered into an asset purchase agreement with the second company whereby the policyholder purchased the patents. The second company later filed for bankruptcy. Thereafter, the second company's bankruptcy trustee and two other entities filed suit against the policyholder, its subsidiary and its directors and officers. The suits alleged that the policyholder paid insufficient consideration for the patents.

The court first addressed whether any of the prior and pending litigation exclusions barred coverage for the underlying actions. According to the court, the insureds offered a "reasonable interpretation" of the policy provisions: that the policy language required a "causal connection" between the prior litigation and the new action in order to invoke the exclusion. The court reasoned that this interpretation was consistent with the exclusion's "rationale and purposes" - "to prevent coverage for a known and ongoing loss, and to encourage prompt reporting of potentially covered claims during a given policy period." The court also reasoned that to

the extent the insurers' contrary interpretations were correct, this merely indicated that there was more than one reasonable interpretation, making the language ambiguous and requiring the court to adopt the insureds' position. The court specifically emphasized that the insurers appeared to admit ambiguity in that one insurer focused upon the "in any way connected with" language in its policy whereas another insurer focused upon the "based upon" language in its policy. The court then ruled that to the extent a causal connection was required, the existence of a causal connection was a triable issue of fact that precluded summary judgment.

The court then addressed the insurers' contention that any awards in the underlying actions would merely be for extra consideration wrongfully withheld, and would, therefore, be uninsurable restitution. The court refused to grant summary judgment on this issue, noting that at least two of the underlying actions "sought damages from the [policyholder and its directors and officers] for injuries suffered based on interference with contract, breach of fiduciary duty and other theories, which are not restitutionary." Relying on *Pan Pacific Retail Properties, Inc. v. Gulf Insurance Co.*, 466 F.3d 867, amended on rehearing, 471 F.3d 961 (9th Cir. 2006), the court ruled that, because non-restitutionary theories of relief were available, whether a damages award constituted a "Loss" would be a triable issue of fact.

The court then addressed one insurer's contention that it owed no coverage because its policy only covered "Securities Claims." The court noted that, under the policy, a claim was a "Securities Claim" if it was based on "the purchase or sale of, or offer to purchase or sell" the company's shares. The court held that the evidence that the underlying complaints were based upon allegations that the sale of one million policyholder shares was insufficient consideration for the patents created a triable issue of fact on this issue.