

Settlement Payment by Company to Shareholders of Recombined Tracking Stock Constitutes Loss; Insurer Has No Right To Recoup Settlement Payment

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Applying Kansas law, a federal district court has held that a \$57.5 million settlement constituted an insurable "loss" within the meaning of a D&O policy where the settlement arose out of a payment by the insured company to the shareholders of one of two tracking stocks that were later recombined. *Houston Cas. Co. v. Sprint Nextel Corp.*, No. 01:09-cv-1387 (E.D. Va. Nov. 22, 2010). The federal district court further held that an excess insurer did not have a right to recoup its portion of the settlement payment where the policy at issue directed insurers to pay on behalf of the insureds both defense and settlement costs, and specifically granted the insurer the right to recoup defense costs but did not do so for settlement payments.

An excess insurer that participated in the insured's D&O insurance program sought reimbursement of a settlement payment made pursuant to a settlement agreement in a consolidated class action lawsuit. The lawsuit arose after the company recombined two tracking stocks. The shareholders of one of the two tracking stocks sued, contending that the insured's directors and officers breached their fiduciary duties by undervaluing that tracking stock when setting the conversion ratio that was used in the recombination. The insured and the shareholders eventually reached a settlement agreement of \$57.5 million. The insured's D&O insurers consented to the settlement agreement and agreed to provide funding subject to their policy limits and subject to the right to seek recoupment of those amounts.

The policy at issue defined "loss" as "the total amount which the Insured Persons become legally obligated to pay on account of each Claim and for all Claims . . . made against them for Wrongful Acts for which coverage applies, including, but not limited to, damages, judgments, settlements and Defense Costs." The excess insurer argued that the settlement did not constitute a loss because the settlement "merely redistributed assets among different classes of shareholders" and, thus, asserted that the insured did not suffer a loss of assets. The court rejected this argument, noting that a corporation and its shareholders are distinct entities. The court, therefore, concluded that just because a securities settlement results in a transfer from the corporation to a subset of its shareholders does not mean the settlement does not qualify as a "loss" to the corporation.

The excess insurer then argued that its payment should be reimbursed because the settlement violated two public policies: (1) insurance companies should not insure non-fortuitous events, and (2) insurance companies should not insure preexisting corporate obligations. The court, however, determined that no Kansas authority supported the excess insurer's assertion. The court also concluded that the circumstances surrounding the settlement were "far from fortuitous" because the insured had not yet decided to recombine the tracking stocks, let alone set a recombination ratio, when the policy at issue was purchased. Moreover, the court claimed that if breaches of fiduciary duties were considered uninsurable as preexisting corporate obligations, D&O coverage would effectively be a nullity. To that end, the court stated that "[t]he mere existence of generalized obligations to follow the law and honor one's fiduciary duty does not render uninsurable a lawsuit alleging that corporate directors failed to do so."

Lastly, the court concluded that the excess insurer could not seek reimbursement of its settlement payment. The court reasoned that the policy directed insurers to pay on behalf of the insureds both defense and settlement costs, specifically granted the insurer the right to recoup defense costs but did not do so for settlement payments, the insured never agreed to such a right, the excess insurer made the settlement payment voluntarily, and the excess insurer waited more than two years before seeking reimbursement.