

Court Finds Legal Fees for Employees Deposed as Fact Witnesses Are Covered

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The United States District Court for the Southern District of California has determined that a directors and officers liability policy affords coverage for legal fees paid for counsel representing employees of the company deposed as fact witnesses in litigation against the company's officers. *Gateway, Inc. v. Gulf Ins. Co.*, 2011 WL 3607335 (S.D. Cal. Aug. 15, 2011).

Three officers of the policyholder were named in a lawsuit by the Securities and Exchange Commission (SEC). The policyholder retained counsel to represent certain current and former employees who were compelled by subpoena to give deposition testimony in the lawsuit as fact witnesses. The primary policy afforded coverage for Loss "resulting from any Claim . . . against the Directors and Officers," defined to include employees of the policyholder, to "the extent the Claim is for a Securities Law violation."

By endorsement, a separate subparagraph was added to the definition of "Directors and Officers" to add "employees of the Company" but providing that coverage for employees who are not directors or officers shall apply only when an employee is a co-defendant with a director or officer.

An excess insurer denied coverage, contending that no coverage was available for the employees because the definition of "Directors and Officers" had been amended to limit such coverage to cases in which employees are co-defendants with directors and officers of the policyholder.

The court disagreed, finding that the "clear and explicit" reading of the primary policy was that the subparagraphs of the definition of "Directors and Officers" were independent, affording coverage for employees both for claims for "Securities Law Violations" and when employees are named as co-defendants with directors and officers. The court found, in the alternative, that the parties' competing interpretations of the definition of "Directors and Officers" highlighted an ambiguity in the primary policy, which the court interpreted in favor of the insured.

The excess insurer also contended no coverage was available for the fact witness employees because no claim was asserted against the employees. The policyholder argued that coverage was available for the employees because the cost of their counsel was "Loss . . . resulting from" a claim—the SEC's investigation—made against officers of the policyholder. The court found that the insured and the policyholder had each

advanced a reasonable application of the primary policy to the facts of the case and that the primary policy was ambiguous on the issue. Accordingly, the court interpreted the ambiguity in favor of the policyholder.