

# No Federal Question Jurisdiction for Suit Seeking Coverage for Liability under Section 16(b)

---

March 2004

In an unreported decision, a federal district court for the Western District of Washington granted a motion to remand, holding that there is no federal question jurisdiction for a lawsuit seeking indemnification from insurers for a claim for Section 16(b) liability under the Securities Exchange Act of 1934. *Jain v. Clarendon Am. Co.*, No. C03-2842P (W.D. Wash. Jan. 9, 2004).

A former CEO and his wife sought coverage from their directors and officers liability insurance carriers and indemnification from the corporate insured (Infospace, Inc.) after a court had found them liable for approximately \$200 million allegedly gained in prohibited short-swing trading in violation of Section 16(b) of the Exchange Act. The insurers denied coverage, *inter alia*, because federal law bars indemnification for Section 16(b) liability and Infospace refused to indemnify them. Thereafter, the CEO and his wife filed suit in state court, alleging breach of contract, breach of the duty of good faith and fair dealing, breach of fiduciary duties and intentional interference with contract relations. Infospace removed the suit to the Western District of Washington, arguing that the CEO's and his wife's claims implicated and depended on a substantial federal question—whether indemnity is available for Section 16(b) liability.

The district court rejected Infospace's position, reasoning that the "argument is properly characterized as a defense based on a federal question" and therefore could not provide a basis for removal. Although Infospace could use the prohibition under Section 16(b) against indemnification as a defense to the claims, the court held that Infospace could not rely on such a defense to justify removal because any grounds for removal must appear on the face of the complaint.

In granting the insureds' motion for remand, the court rejected Infospace's argument that the federal court had jurisdiction because the insureds' claims are necessarily federal in character and the insureds' right to relief depends on resolution of a substantial, disputed federal question. The court reasoned that the insureds were not seeking to challenge their federal Section 16(b) liability, but rather, alleging that the insurers had breached their obligations in violation of state law by not insuring that liability. The court concluded "that insurance or indemnification coverage and indemnification are not the same."

The court also rejected the arguments that resolution of the allegations depended on the resolution of a substantial, disputed federal question that was a necessary element of the insureds' state law claims. The court found that the insureds' allegations rested on state contract or tort law. The court also explained that the insureds did not need to prove that their contract was valid to bring a breach of contract claim.

For more information, please contact us at 202.719.7130.