UNITED STATES DISTRICT COURT

CENTRAL DISTRICT OF CALIFORNIA

AXIS REINSURANCE COMPANY., a corporation, Plaintiffs, v. NORTHROP GRUMMAN CORPORATION, a corporation Defendant.	Case No. 2:17-CV-8660-AB (JCx) **REDACTED ORDER GRANTING PLAINTIFF'S MOTION FOR SUMMARY JUDGMENT**

Before the Court is Plaintiff AXIS Reinsurance Company's ("AXIS") Motion for Summary Judgment ("Motion", Dkt. No. 78). Defendant Northrop Grumman Corporation ("Northrop") opposed the motion and AXIS filed a Reply. The Court heard oral argument on November 9, 2018. For the following reasons the Court **GRANTS** the motion.

I. BACKGROUND

This case concerns whether AXIS's secondary excess insurance coverage to Northrop was unnecessarily triggered as a result of improper erosion. AXIS's coverage was triggered—and accordingly AXIS had to pay $[redacted]—after

Northrop settled ERISA violations in unrelated litigation. AXIS reserved its rights to challenge the payment on the grounds that it was not a covered loss under the terms of AXIS's policy.

II. UNDISPUTED FACTS

The facts of this case are undisputed.[1]

National Union Fire Insurance Co. of Pittsburgh, Pa provides primary layer coverage to Northrop pursuant to Employee Benefit Plan Fiduciary Liability Insurance Policy No. 672-80-19 for the 06-07 Policy Period. SUF. 1. National Union's coverage contains a per claim and aggregate limit of liability of $15 million, excess of the applicable retention. SUF. 3.

National Union's "Insuring Agreements" provision states, in part

> [s]olely with respect to Claims first made against an Insured during the Policy Period or the Discovery Period (if applicable) and reported to the Insurer pursuant to the terms of this policy, and subject to the other terms, conditions and limitations of this policy, this policy shall pay the Loss of each and every Insured arising from a Claim against an Insured for any actual or alleged Wrongful Act by any such Insured (or by any employee for whom such Insured is legally responsible).

SUF. 5. National Union's policy also provides a definition for loss which provides that

> [l]oss means damages, judgments (including pre/post-judgment interest on a covered judgment), settlements, and Defense Costs; however, Loss shall not include: (1) civil or criminal fines or penalties imposed by law, except . . . (iv) the 20 percent or less penalty imposed upon an Insured under Section 502(1) of ERISA, with respect to covered settlements or judgments; . . . or (6) matters which may be deemed uninsurable under the law pursuant to which this policy shall be construed.

Id. In addition, the National Union policy excludes coverage for losses from

[1] AXIS provided the Court with its Statement of Undisputed Facts ("SUF"). Thereafter, Northrop provided an Opposition to Undisputed Facts ("Opp. SUF") which did not dispute any of Axis's facts, but included additional undisputed facts.

claims "arising out of, based upon or attributable to the gaining of any profit or advantage if a judgment or final adjudication or a binding arbitration proceeding adverse to the Insured(s) establishes the Insured(s) was not legally entitled to such profit". Opp. SUF. 57.

Continental Casualty Company ("CNA") provides first layer excess coverage to Northrop pursuant to Policy No. 120196961 for the 06-07 Policy Period. SUF. 6. CNA's coverage contains a per claim and aggregate limit of liability of $15 million in underlying insurance and the applicable retention. SUF. 8.

Section V of the CNA policy provides in part

> [o]nly in the event of exhaustion of the limits of the Underlying Insurance by reason of the Underlying Insurance carriers and/or the Insureds paying in legal currency loss which, except for the amount thereof, would have been covered thereunder, this policy shall continue in force as primary insurance, subject to its terms and conditions and any retention applicable to the Primary Policy, which retention shall be applied to any subsequent loss in the same manner as specified in the Primary Policy.

SUF. 9. AXIS provides second layer excess coverage to Northrop pursuant to SecureExcess Policy No. RLN 715998/01/2006 for the 06-07 Policy Period. SUF. 10. AXIS's coverage contains a per claim and aggregate limit of liability of $15 million, excess of $30 million in underlying insurance and the applicable retention. SUF. 12. Section 1 of AXIS's excess insurance policy provides in part

> "[w]ith respect to each Insurance Product, the Insurer shall provide the Insureds with insurance during the Policy Period excess of all applicable Underlying Insurance. Except as specifically set forth in the provisions of this Policy, the insurance afforded hereunder shall apply in conformance with the provisions of the applicable Primary Policy and, to the extent coverage is further limited or restricted thereby, to any other applicable Underlying Insurance. In no event shall this Policy grant broader coverage than would be provided by the most restrictive policy constituting part of the applicable Underlying Insurance. The insurance afforded under this Policy shall apply only after the Underlying

> Insureds and/or the Insureds or the Policyholder shall have paid the full amount of the Underlying Limits for covered loss under the Underlying Insurance and the Policyholder or the Insureds shall have paid the full amount of the applicable retention amount under any Underlying Insurance."

SUF. 13. Section V of AXIS's policy provides in part "[t]his policy does not provide coverage for any Claim not covered by the Underlying Insurance, and shall drop down only to the extent that payment is not made under the Underlying Insurance solely by reason of exhaustion of the Underlying Insurance through payments thereunder, and shall not drop down for any other reason." SUF. 14. The Underlying Insurance referenced in AXIS's policy consists of the National Union primary policy and the CNA excess policy. SUF. 15.

On February 12, 2016, the Department of Labor ("DOL") sent a letter to Northrop [redacted]

The DOL investigation involved a broad inquiry into the administration of the Northrop Grumman Savings Plan, which later evolved into an investigation of a number of Northrop related plans, and ultimately resulted in assertions of wrongful activity by a number of Northrop-related entities and individuals. Opp. SUF 59.

Subsequently, Kim Melvin, counsel for Arch Insurance Company ("Arch"), sent a letter to Barry Fleishman, counsel for Northrop regarding the DOL investigation. The letter provides that the primary policies do not cover the amount sought by the DOL. SUF. 25.

[redacted]

After the DOL provided this information to Northrop, Fleishman sent an email

to counsel for various insurers, including Ommid Farashahi, counsel for AXIS, regarding the DOL investigation. SUF. 31. Fleishman's letter indicated that [redacted]

Farashahi responded to Fleishman's letter by email on September 1, 2016. SUF. 33. In his response, Farashahi took the position that settlement of the DOL investigation "does not contemplate any monetary contribution" from AXIS, and that AXIS agreed not to raise failure to obtain consent to settlement as a bar to coverage with respect to the settlement of the DOL's investigation but reserved all other rights. SUF. 34.

On December 9, 2016, the DOL entered into a settlement agreement with Northrop (the "DOL Settlement"). SUF. 35. Pursuant to the DOL Settlement, Northrop consented to pay $[redacted] to the DOL; $[redacted] *Id.* The DOL Settlement resolved the investigation into Northrop's violations. SUF. 41.

On December 27, 2016, Farashahi sent a letter to Fleishman providing that Northrop's repayment of funds to the Northrop Grumman Savings Plan pursuant to the DOL Settlement constituted "uncovered and uninsurable disgorgement". SUF. 43. Further, Farashahi wrote that AXIS would not recognize erosion to the Underlying Insurance for the DOL Settlement.

National Union and CNA paid $[redacted] pursuant to the DOL Settlement. SUF. 44. By its payment of its portion of the DOL Settlement, National Union paid a total amount equal to the remaining limits of liability on its policy. SUF. 45. CNA's payment contributed to the erosion of its limits of liability on its policy. SUF. 46.

On June 6 and 7, 2017, Northrop agreed to settle the *Grabek* Action for a $16,750,000 payment ("*Grabek* Settlement"). SUF 48. Northrop requested payment

from CNA in the amount of $7,043,762.08 to fund a portion of the *Grabek* Settlement. SUF 50. Northrop requested payment from AXIS in the amount of $9,706,237.92 to fund the remainder of the *Grabek* Settlement. SUF. 51. On November 30, 2017, Kim West sent a letter to Fleishman, reserving AXIS's rights to seek reimbursement of the $[redacted] portion of the DOL Settlement indemnity payment which AXIS asserts it did not properly owe. SUF 53.

III. LEGAL STANDARD

A motion for summary judgment must be granted when the pleadings, the discovery and disclosure materials on file, and any affidavits show that there is no genuine issue as to any material fact and that the movant is entitled to judgment as a matter of law. Fed. R. Civ. P. 56(c); *Anderson v. Liberty Lobby, Inc.*, 477 U.S. 242, 247-48 (1986). The moving party bears the initial burden of proving the absence of an issue of material fact. *Celotex Corp. v. Catrett*, 477 U.S. 317, 323 (1986). Where the nonmoving party will have the burden of proof at trial, the movant can prevail merely by pointing out that there is an absence of evidence to support the nonmoving party's case. *Id*. The burden then shifts to the nonmoving party to "set forth specific facts showing that there is a genuine issue for trial." *Anderson*, 477 U.S. at 248.

Interpreting an insurance policy is a question of law this Court may address at the summary judgment stage. "While insurance contracts have special features, they are still contracts to which the ordinary rules of contractual interpretation apply." *Bank of the West v. Superior Court*, 2 Cal.4th 1254, 1264 (1992). "The rules governing policy interpretation require the Court to look first to the language of the contract in order to ascertain its plain meaning or the meaning a layperson would ordinarily attach to it." *Waller v. Truck Ins. Exchange, Inc.*, 11 Cal.4th 1 (1995).

IV. DISCUSSION

To determine whether AXIS is entitled summary judgment, the Court must first determine whether the DOL Settlement is an uninsurable loss. Next, the Court must determine whether AXIS was, nonetheless, compelled to provide coverage as a result

of National Union and CNA's decision to pay Northrop for the DOL Settlement. AXIS is only entitled to summary judgment if it was not required to provide coverage as a result National Union and CNA's coverage decisions.

A. The DOL Settlement is an Uninsurable Disgorgement

AXIS takes the position that the DOL Settlement is an uninsurable disgorgement under the terms of its insurance policy. Under Section 1 of its policy National Union was required to pay "the Loss of each and every Insured arising from a Claim against an Insured for any actual or alleged Wrongful Act by any such Insured." SUF. 4. "Loss" is broadly defined as "damages, judgments, settlements, and Defense Costs". SUF 5. The National Union policy also provides that "Loss shall not include (1) civil or criminal penalties imposed by law, except . . . (iv) the 20 percent or less penalty imposed upon an Insured under Section 502(1) of ERISA, with respect to covered settlements or judgments . . . or (6) matters which may be deemed uninsurable under the law pursuant to which this policy shall be construed." *Id.*

"It is well established that one may not insure against the risk of being ordered to return money or property that has been wrongfully acquired. Such orders do not award 'damages' as that term is used in insurance policies." *Bank of the West* at 1266 (1992). The policy rationale behind this proposition is apparent; "[w]hen the law requires a wrongdoer to disgorge money or property acquired through a violation of the law, to permit the wrongdoer to transfer the cost of disgorgement to an insurer would eliminate the incentive for obeying the law." *Id.* at 1269. Based on this understanding of California law,[2] the DOL Settlement falls squarely within the category of uninsurable disgorgement.

---

[2] Northrop argues, in passing, that there are questions as to whether California law applies to this case. This Court already determined that "California has a strong interest in seeing its laws applied to a dispute arising out of an insurance contract issued in California. AXIS's 2006 policy was issued in California and contains a California amendatory endorsement. AXIS bases its claims in the California Lawsuit in part on California case law interpreting insurance policies." Dkt. No. 34, p. 14-15 (citations omitted).

Northrop argues it is unclear what amount of the DOL Settlement was specifically paid as disgorgement. It argues that this lack of clarity raises questions as to whether the National Union payment was uncovered. It is apparent that the DOL Settlement required disgorgement from Northrop. First, in its negotiations and discussions with Northrop regarding its settlement, the DOL consistently refers to the monies Northrop was required to pay as "disgorgement." *See e.g.*, SUF. 28. Throughout the course of the investigation, the DOL made it clear that it sought disgorgement because [redacted]

While the DOL Settlement Agreement does not specifically use the word, the language persuades the Court that Northrop agreed to a payment of disgorgement. The DOL specifically instructed Northrop to restore all payments or reimbursements made in violation of ERISA. An order for disgorgement "may compel a defendant to surrender all money obtained through an unfair business practice even though not all is to be restored to the persons from whom it was obtained or those claiming under those persons." *Kraus v. Trinity Management Services, Inc.* 23 Cal.4th 116 (2000). Reading the language plainly, the DOL Settlement instructs Northrop to disgorge its ill-gotten gains.

Next, Northrop maintains that the concept of restitution in the insurance context is limited "to situations in which the defendant is *required* to restore to the plaintiff that which was wrongfully acquired." *Jaffe v. Cranford Ins. Co.*, 168 Cal.App. 3d 930 (1985) (emphasis added). To support its claim, Northrop asserts that the DOL Settlement was not an "order" or similar requirement which mandates Northrop's payment as anticipated by *Bank of the West* and its progeny. In *Bank of the West*, the court articulated the policy behind excluding disgorgement payments from insurance

coverage, stating "[t]o permit the [retention of even] a portion of the illicit profits, would impair the full impact of the deterrent force that is essential if adequate enforcement [of the law] is to be achieved. One requirement of such enforcement is a basic policy that those who have engaged in proscribed conduct surrender all profits flowing therefrom." 2 Cal 4th at 1267. Notwithstanding this policy rational, Northrop argues that because there was no "order" or final adjudication of the matter, *Bank of the West* does not apply. The DOL Settlement is a binding agreement between the government and Northrop compelling Northrop to repay ill-gotten gains. Such settlement falls squarely within the ambit of *Bank of the West* and its kin. Accordingly, Northrop cannot offset the DOL Settlement's costs to its underlying insurers.

As an initial matter, the DOL Settlement includes a section which reads: [redacted] While the DOL Settlement does not specifically include the term "disgorgement", it is clear from the settlement itself and the prior discussions between the DOL and Northrop regarding the investigation, that Northrop was required to return monies gained in violation of ERISA.

In arguing that the DOL Settlement is not an "order" or final adjudication, Northrop overstates the voluntary nature of its settlement with the DOL. Settlement with a governmental agency is unlike a settlement between two private actors. In its July letter to Northrop, the DOL writes, [redacted]

[redacted] The policy rationale behind *Bank of the West* must be followed where a governmental agency identifies violations in a thorough and timely investigation but, nonetheless, enters into a settlement of those violations rather than expend precious resources litigating for a final resolution.

At the conclusion of its investigation, the DOL made a determination that Northrop was required to restore $[redacted] of funds to their rightful source. There is little doubt that the DOL Settlement involved the disgorgement of money wrongfully obtained by Northrop and that Northrop was required to pay this settlement amount. As such, the DOL Settlement is uninsurable.

B. The Binding Impact of National Union and CNA's Decisions to Pay the DOL Settlement

While the DOL Settlement is properly viewed as disgorgement, AXIS must also establish that it was not otherwise required to provide coverage to Northrop after National Union and CNA's coverage limits were reached. AXIS's excess policy provides that the policy "shall apply only after the Underlying Insurers and/or the Insureds or the Policyholder shall have paid the full amount of the Underlying limits for covered loss under the Underlying Insurance and the Policyholder or the Insureds shall have paid the full amount of the applicable retention amount under any Underlying Insurance." SUF. 13. Under its policy terms, AXIS is not required to pay any amount unless it is for "covered loss". Thus, AXIS is not required to provide coverage simply because of the independent decisions of primary insurers.

AXIS relies on *Shy v. Insurance Co. of the State of Pennsylvania*, 528 Fed.Appx. 752 (9th Cir. 2013) to assert that it is not bound by the decisions of Northrop's other underlying insurers with respect to payment of the DOL Settlement. AXIS correctly argues that *Shy* stands for the proposition that an excess insurer is not

bound by another insurer's decision to provide coverage under its policy. *Id.* at 754. Thus, the only issue is whether, pursuant to its policy, AXIS was required to provide insurance coverage to Northrop after its primary insurer decided to insure the DOL Settlement.

Northrop contends that AXIS, as a follow-form excess carrier, cannot challenge or undermine the primary carrier's decision to pay out its coverage limits. *Edward E. Gillen Co. v. Ins. Co. of Pennsylvania*, No. 10-C-564, 2011 WL 1694431 (E.D. Wisc. May 3, 2011). *Gillen* stated that where an excess liability insurer's policy was triggered by the primary insurer's decision to pay, it could not challenge that decision. The *Gillen* court wrote that a follow-form insurer "assumes the risk that the primary insurer will adjust claims in a certain manner and in such a way that *triggers the potential for liability* (and the duty to defend) under the excess policy." *Id.* at *4 (emphasis added). Here, however, AXIS does not argue that it would not have to pay had National Union and CNA's decisions triggered its policy, rather it argues that neither payment triggered AXIS's policy in the first place. In essence, AXIS argues that it cannot be on the hook for payments made outside the scope of its policy as a follow-form insurer simply because its primary insurer made the independent decision to cover an uninsurable payment. Such a decision would render the terms of excess insurer policies useless. Were AXIS required to pay, without any opportunity to dispute the validity of its payment, any excess insurer could be liable to cover payments totally outside of the scope of its excess coverage policy. AXIS's policy explicitly triggers where there is covered loss; Northrop has failed to identify any such loss here. As such, AXIS's policy was prematurely triggered.

Contrary to Northrop's position, its other cited case strengthens this point. In *Chartis Specialty Ins. Co. V. Scott Homes Multifamily, Inc.*, No. CV-13-00601-PHX-ROS, 2014 WL 12729090, at *4 (D. Ariz. Mar. 31, 2014), the District Court rejected the assertion that an excess carrier could challenge the coverage determination, because the express terms of the excess carrier's policy clearly indicated that the

policy was implicated. *Id at* *3. In *Chartis*, it was clear that the primary insurer's coverage was paid pursuant to its obligations under the policy. Further, the *Chartis* Court noted that plaintiffs failed to identify whether the primary insurer's payment was for uncovered damages. *Id.* at *4 ("It is therefore entirely plausible that the Evanston payment went solely to claims covered by the Evanston Policy. Plaintiffs have therefore failed to demonstrate that the Evanston payment went to anything other than covered claims").

Considering both issues in the current case, they are contrary to the circumstances in *Chartis*. First, National Union's coverage of the DOL Settlement was not paid pursuant to its obligations under the policy. National Union's policy also applies only to covered loss. Opp. SUF. 57. As discussed above, the DOL Settlement was uninsurable; thus, National Union's decision to pay for the DOL Settlement could not have been pursuant to its obligation to pay covered loss. Moreover, the Court has already identified that the entirety of the DOL Settlement was uncovered loss. ERISA sought disgorgement in the amount of $[redacted] for Northrop's misappropriated funds. This amount is uninsurable under California law. There is no ambiguity here as to what was covered by the DOL Settlement which specifically sought disgorgement as the only remedy applicable for Northrop's violation of ERISA under Section 409. ERISA § 409(a), 29 U.S.C. § 1109(a).

Northrop asks this Court to determine that AXIS is required to provide insurance coverage to a payment that does not trigger AXIS's policy. AXIS is not forced to cover uninsurable payments simply because its primary insurers have provided coverage. The decision by AXIS to provide temporary coverage for the settlement while reserving its rights to challenge the coverage does not persuade the Court otherwise. AXIS took the prudent step of providing temporary coverage while reserving its rights to challenge the payment. As a matter of law, AXIS's payment of $[redacted] for the DOL Settlement was not covered by its excess coverage policy.

V. CONCLUSION

For the following reasons, the Court **GRANTS** AXIS's Motion for Summary Judgment. AXIS is entitled to reimbursement of $[redacted] for its excess coverage.

IT IS SO ORDERED.

Dated: November 21, 2018

HONORABLE ANDRÉ BIROTTE JR.
UNITED STATES DISTRICT COURT JUDGE