Underwriters Under Fire: Increasingly on the Hot Seat
UNDERWRITERS UNDER FIRE: INCREASINGLY ON THE HOT SEAT

MODERATOR:
Kevin Gadbois, Esq., Executive Vice President, Executive Liability Division, Great American Insurance Group

PANELISTS:
Andre Basile, Chief Underwriting Officer, Executive & Professional Lines, Berkshire Hathaway Specialty Insurance
John D. Hughes, Esq., Partner, Edwards Wildman Palmer LLP
Brian Kristiansen, Senior Vice President, Arch Insurance Group, Inc.
Tammy Yuen, Esq., Principal, Skarzynski Black LLC
January 1, 2015

- ABC Insurance Company ("ABC") issues a private company management liability policy to XYZ Capital, LLP ("XYZ")
  - XYZ is a hedge fund whose business is securities arbitrage
- The ABC Policy has a $5,000,000 Limit of Liability
  - The Policy has a $250,000 Retention
  - The ABC Policy Period is from January 1, 2015 to January 1, 2016
Hypothetical:

- With respect to an Insured Organization, the ABC policy defines a claim to include:
  - A formal administrative or regulatory investigation against an Insured commenced by service of a complaint or similar pleading, the filing of a notice of charges, or a similar document, but only while the investigation is simultaneously brought and maintained against an Insured Individual.
**Hypothetical:**

<table>
<thead>
<tr>
<th>Date</th>
<th>Event</th>
</tr>
</thead>
<tbody>
<tr>
<td>April 15, 2015</td>
<td>The SEC sends XYZ a letter requesting all of its trading records with respect to the common stock of Blackacre, Inc. for the period of July 1 through August 30, 2013</td>
</tr>
</tbody>
</table>
| April 16, 2015     | XYZ hires Gorilla Law Firm, LLP to represent it in connection with the SEC’s document request  
|                    | • XYZ pays a $500,000 retainer                                                            |
| May 30, 2015       | SEC issues subpoenas for examinations under oath to Steven Smith and Mary Magoo, two of XYZ’s traders |
June 2, 2015 | Gorilla Law Firm, LLP receives a copy of SEC’s formal order of investigation pursuant to which subpoenas were issued  
- Formal order entitled: “In Re Blackacre, Inc. Insider Trading Investigation”  
- Formal order does not reference either XYZ, Smith or Magoo

June 5, 2015 | XYZ’s Broker, ZZZ Broker sends ABC copies of the SEC subpoenas and requests coverage with respect to the Policy’s definition of Claim pertaining to formal regulatory investigations
Andrew Adjuster, on behalf of ABC, denies XYZ’s request for coverage on the grounds that:
• The SEC’s formal order does not reference XYZ; and
• Even if the SEC’s investigation could be considered to be against XYZ, it doesn’t appear to be against an Insured Individual as well
### Hypothetical:

| June 25, 2015 | ZZZ Broker sends Andrew Adjuster an email exchange dated December 20, 2014 between ZZZ and Emily Underwriter at ABC:  
• Emily – Our client is very concerned about getting very broad entity coverage for regulatory investigations. Will this policy have that?  
  ZZZ Broker  
  • ZZZ – Our entity coverage for regulatory investigations is the broadest in the market.  
  Emily Underwriter  
  ZZZ Broker also offers to send ABC more information about the SEC proceeding’s focus on XYZ if ABC will sign a confidentiality agreement |

<table>
<thead>
<tr>
<th>Date</th>
<th>Event Description</th>
</tr>
</thead>
<tbody>
<tr>
<td>June 30, 2015</td>
<td>Andrew Adjuster re-affirms ABC’s denial of coverage. Adjuster also says that ABC is willing to consider whatever else XYZ would like to submit, but ABC will not sign a confidentiality agreement</td>
</tr>
<tr>
<td>July 1, 2015</td>
<td>Gorilla Law Firm sues ABC on behalf of XYZ alleging not only breach of contract, but bad faith</td>
</tr>
</tbody>
</table>
Claim Notice: SEC letter/document request; formal order; subpoenas; claim letter from ZZZ.

ABC’s Coverage Position:
I. The document request and SEC letter are informal.
II. The formal order and subpoenas pertain to Blackacre, Inc. and do not reference XYZ, Smith or Magoo.
III. Even if against XYZ, not against Smith or Magoo.

Coverage Suit:
I. Breach of contract, breach of defense obligation, failure to properly investigate, and bad faith.
II. Wording is ambiguous and e-mails show intent to provide “broadest” coverage.
III. Alternate count against broker for failure to procure proper coverage.
Legal Principles

Burden of Proof

• Generally
  – Insured bears burden of proving a covered claim; burden shifts to the insurer to show no coverage; and the insured bears the burden to prove exceptions to the exclusions.

• Bad Faith Claim – Burden lies with the insured.
  – To make a prima facie case, an insured must establish:
    • there is a covered claim; and
    • Insurer failed to pay after it had / should have had sufficient information to establish the claim was covered.
  – Burden shifts back to insurer to articulate one or more grounds for disclaiming.
  – Insured bears the burden of showing none of the insurer’s articulated grounds is reasonable.
Legal Principles Cont.

Question of Law vs. Fact

• Generally, policy interpretation is a question of law.
  – Exception – ambiguity where contra proferentem does not automatically apply. (e.g., Del.)
  – In bad faith actions, whether an insurer’s coverage position was reasonable is a question of law.

• Bad Faith
  – What the insurer knew or should have known based on a reasonable investigation and when it knew it are questions of fact.
  – Once these underlying facts are established, whether the insurer had a reasonable basis to deny is a question of law.
Bad Faith Claims arise from:

- **Statute**, e.g., Florida, Georgia, Illinois, Maine, Maryland, Michigan, Minnesota, Missouri, Pennsylvania.
- **Common-law**, e.g., California, Vermont.
- **Statute and common-law**, e.g., Connecticut, Massachusetts, Nevada, North Carolina, Rhode Island, Texas, Washington, West Virginia.
State Law Nuances re: Bad Faith (Cont.)

Washington

• The Washington Insurance Fair Conduct Act RCW 48.30.015.

• Insured may seek attorneys’ fees and treble damages where an insurer violates Washington Administrative Code mandating prompt investigation and fair settlement practices. RCW 48.30.015(5).
Missouri

- Under Mo. Ann. Stat. § 375.420 (West), insured may recover the following in addition to covered loss and interest: 20% of the first $1,500 of the loss, 10% of the amount of the loss in excess of $1,500; plus reasonable attorneys’ fees. Punitive damages also available.
Legal Principles: I v. I Exclusion

History

• D&O policies did not have insured versus insured exclusions until collusive settlements of suits by corporations against its own Ds&Os emerged in 1980’s. E.g., the $110M Seafirst settlement in 1986.

• Now, I v. I raised where the FDIC, the FSLIC, bankruptcy trustees, creditors’ committees and litigation trustees as claimants.

• Who is an Insured, and is the claim brought by the Insured, or on behalf of, or in the right of the Insured?

• Carve-outs for employment claims or those brought by individuals who had not served or been employed by the corporation for years or claims by those protected by whistleblower statutes.

• The evolution of the I v. I wording:
  – The addition of coverage for claims brought by creditors, et al.
  – The removal from the exclusion of claims brought by individuals.
Plaintiff’s Fee Award in Derivative Litigation

• **American Rule**: each party bears its own costs of litigation.
• **English Rule**: a defeated litigant pays the winner’s fees.
• **Derivative suit**: brought by a shareholder to enforce the rights of a corporation against its directors and officers.
• **Corporate benefit theory**: the corporation owes the plaintiff’s fee as it benefits from the derivative suit.
• **Issue**: Who should pay the plaintiff’s fee, the corporation or the defendant directors and officers (D&O carrier)?
• **Policy wordings vary**. Some policies are silent on the issue of payment of plaintiff’s fee awards; some provide coverage and some exclude coverage.
Disgorgement and Restitution

• Recent case law
    • No public policy in NY precluding coverage for restitution
    • Benefits must actually be received by insured
    • Sixth Circuit
    • Thin line between disgorgement and restitution
  – U.S. Bank v. Indian Harbor Insurance Co. (7/3/14)
    • Minnesota District Court Judge applying Delaware Law

• Underwriting intent
Important Reminders

• Must have clear written documentation.
• Must understand the coverage that is asked for and provided.
• Must have a consistent approach to coverage expectations/interpretations.
• BE ON THE SAME PAGE!