Securities Reform Act Litigation Reporter
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Fifth Circuit Rejects Insurers' Unilateral Attempt to Avoid D&O Coverage

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In a recent opinion, the Fifth Circuit upheld a decision that prohibited D&O insurers from refusing to pay for the defense of a number of executives charged with civil and criminal wrongdoing by the SEC and the Department of Justice. *Pendergest-Holt* v. *Lloyd's of London, et al.*, No. 10-20069, 2010 WL 909090 (5th Cir. Mar. 15, 2010). The ruling has implications for insurers and insureds alike, as it will affect the ability of insurers to stop advancement of defense costs and may result in insurers changing the language of their policies.

The case arises out of the widely-reported charges that have been leveled against several executives of Stanford Financial Group. In order to fund their defense, the executives sought coverage for defense costs under two D&O policies. Both policies had an exclusion where the claims arose "in connection with any act or acts (or alleged act or acts) of Money Laundering." The policies provided, however, that the insurers would only pay defense costs "until such time that it [was] determined that the alleged act or alleged acts did *in fact* occur."

Following a plea deal by the former CFO of two Stanford companies, the insurers took the position that money laundering had "in fact" occurred and that coverage for defense costs would be discontinued. In response, the executives sought an injunction requiring the insurers to continue to pay their defense costs pending a *judicial determination* as to whether money laundering had "in fact" occurred. The district court granted the injunction and the insurers appealed.

The Fifth Circuit rejected the insurers' claim that they had the right to make the "in fact" determination unilaterally. Because the exclusion was silent as to who was permitted to make the "determination," the Fifth Circuit invoked the familiar canon of construction that ambiguous policy terms are to be construed in favor of coverage, and adopted the executives' position that a court had to decide whether the executives "in fact" had engaged in money laundering. The Fifth Circuit also held that the "in fact" determination had to be made in a separate coverage proceeding and that the insurers had to continue providing coverage until a court decided the issue.

While the Stanford executives' case presents an extreme case, all executives covered by D&O policies have a legitimate concern that they may be left without coverage precisely at the time it is needed most. As the case demonstrates, particular care needs to be paid to both the language of coverage exclusions and the procedure that needs to be followed by a carrier seeking to invoke an exclusion. The Fifth Circuit's recent opinion provides important guidance to both insureds and insurers as to how existing policy provisions will be interpreted and highlights an issue that needs to be considered when policy terms are negotiated.

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Volume 29, Number 1, April 2010.