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KD Alert: Federal Court in California Sides With Insurers in IndyMac D&O Dispute

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(June 28, 2012)

A federal District Court in California yesterday handed a major victory to the D&O insurers of failed bank IndyMac in a coverage dispute with the mortgage giant's former directors and officers. XL Specialty Insurance Co. v. Michael Perry (No. 1-02078-RGK (C.D. Cal. June 27, 2012)).

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FACTS.

The decision stems from the 2008 collapse of IndyMac, which led to its bankruptcy and a host of civil and regulatory lawsuits. The bank and its directors and officers were sued in 11 different actions, including class action lawsuits, actions by the Trustee in bankruptcy and a lawsuit brought by the SEC. The bank's executive and board members sought coverage under D&O insurance spanning two successive policy years, 2007-2008 and 2008-2009. The insurers filed an action for declaratory judgment, asserting there was no coverage under the second-year insurance tower because the actions were "interrelated wrongful acts" from an earlier litigation and therefore were not claims made during the second policy year. The insurers also contended the 11 underlying actions were excluded because the insured provided notice of the related claim under an earlier policy.

THE COURT'S OPINION.

Interrelated Acts.

The Court rejected the insureds' argument that the "interrelated wrongful acts" language was ambiguous, commenting, "the fact that a word carries multiple meanings and creates a broad exclusion does not render the language ambiguous." (Citing, E.M.M.I., Inc. v. Zurich Am. Ins. Co., 32 Cal. 4th 465, 472 (2004).) The Court analyzed each of the 11 actions against the insured and found they all arose out of IndyMac's failure to follow its own underwriting standards and resulting issuance of high risk mortgages, which was "sufficiently related" to the pre-policy litigation against the bank. Even the fact that one of the 11 actions focused on only a certain company division, and not IndyMac as a whole, was not enough to differentiate the allegations in the Court's view. The bankruptcy Trustee's claims similarly were interrelated because—even though they focused on breaches of fiduciary duties long after IndyMac was unsalvageable—the claims were the direct result of the financial situation IndyMac faced from its poor mortgage practices, which the Court determined was the focus of the pre-policy litigation.

Prior Notice Exclusion.

The pre-policy litigation also was excluded because of the policy's prior notice exclusion. The Court noted, "The difference between the interrelated wrongful acts limitation and the prior notice exclusion is a subtle one. The interrelated wrongful acts limitation states that claims that fall within the scope of 'interrelated wrongful acts' will be deemed to have been made at the time the first claim was made. The prior notice exclusion states that the policy does not provide coverage for claims that are broadly related to claims that were noticed during a prior policy period." Having found the 11 actions sufficiently related to the pre-policy litigation—notably, the same litigation the insurers specifically referenced and excluded in their policies—the Court refused to discard the prior notice exclusion on ambiguity or other grounds, but rather, strictly enforced it.

IMPACT ON INSURERS.

This decision could have significant meaning in already-pending subprime, credit crisis and FDIC claims. And it could have longer-term impact, particularly in corporate and professional matters with allegations spanning multiple policy periods. D&O and E&O insurers should look carefully at the potential applicability of their policies' "interrelated wrongful acts" provision and prior notice exclusion. It may well be, as the Court found in this IndyMac decision, that the notified matters relate back to earlier lawsuits and allegations and, thus, do not qualify for coverage under later-issued policies.