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AG's Letter a Prior "Demand," Eliminates Exec's Defense

Why it matters

A letter stating that a government entity "may" bring an enforcement action against the policyholder if it did not "voluntarily" cease specified activity was a claim under a directors and officers (D&O) liability insurance policy, a panel of the Second Circuit Court of Appeals has ruled, allowing an insurer to deny coverage based on a prior and pending litigation exclusion. In 2012, an executive was indicted in federal court on fraud and conspiracy charges and turned to the company's D&O insurer for defense coverage. But the insurer relied upon the prior and pending litigation exclusion for "any demand, suit or other proceeding pending" against an insured, arguing that a 2007 letter from the Maryland Attorney General to the company precluded coverage. The letter accused the company of making false and deceptive statements, adding that the AG "may" bring an action if the activity did not stop. The federal appellate panel agreed with the insurer, holding that the letter constituted a demand or "an imperative solicitation for that which is legally owed" under New York law.

Detailed discussion

Multivend LLC purchased a directors and officers (D&O) liability insurance policy from Axis Surplus Insurance. The policy excluded coverage for "any Claim … in any way involving … any demand, suit or other proceeding pending … against any Insured on or prior to [February 20, 2008], or any Wrongful Act, fact, circumstance or situation underlying or alleged therein."

In November 2007, the Securities Division of the Maryland Attorney General's Office sent a letter to Multivend. The letter required the company to provide certain documents and information to determine the extent of Multivend's compliance with the Maryland Business Opportunity Sales Act.

Although the letter did not affirmatively state that the company was in violation of the state law, it did ask the company to "acknowledge in writing that it will immediately cease all offers and sales of [a] business opportunity to Maryland residents." The AG's office explained that the request was being made pursuant to its authority "to investigate and take action against any person who violates" the Act, including by bringing a civil action.

Multivend's failure to respond to the letter "may result in more formal legal action," the letter cautioned. Several years later, Edward Morris Weaver, the former CEO of Multivend, was indicted in Florida federal court by the Department of Justice on counts of conspiracy and fraud. Weaver tendered defense of the action to Axis, but the insurer refused, relying upon the prior and pending litigation exclusion and pointing to the 2007 letter.

Weaver filed a breach of contract action seeking a declaratory judgment that Axis was required to provide him with a defense because the AG's letter was not a "demand" within the meaning of the exclusion.

Affirming a federal court judge, the Second Circuit Court of Appeals looked to the definition of the term under New York law. As distinguished from a request carrying no legal consequences, "a demand requires an imperative solicitation for that which is legally owed," the panel explained, and the November 2007 letter met these requirements.

The AG's letter not only insisted that Multivend provide certain documents and information but acknowledge in writing that the company would cease activity in violation of state law. The letter also noted the AG Office's "authority to investigate and take action against any person who violates" the Act and that a failure by Multivend to respond could result in formal legal action.

"This was sufficient to make the November 2007 Letter a 'demand' because it set forth the Division's request under a claim of right, including its entitlement to the documents identified therein, and put Multivend on notice of the legal consequences of any failure to comply," the panel said.

Because the November 2007 letter constituted a "demand" as a matter of New York law, the Second Circuit said the policy's prior and pending litigation provision "unambiguously excluded coverage for Weaver's defense of the DOJ action on the grounds that it involves the same facts and circumstances as the Letter, which predated Section IV's Pending

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Speaker: Susan P. White
New York, NY
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and Prior Claims Date. Accordingly, the district court correctly awarded summary judgment to Axis on this basis."

To read the summary order in *Weaver v. Axis Surplus Insurance Co.*, click here.

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Court Orders Coverage Where Breach Merely Alleged

Why it matters

Narrowly interpreting a policy's breach of contract exclusion, a federal court judge in California ruled that the exclusion applied only to actual breaches of contract and that an alleged breach in the underlying complaint against the policyholder was insufficient to eliminate coverage. A competitor filed suit against the insured, charging the policyholder with making disparaging comments so that its offer of employment would appear more attractive and "to solicit [the competitor's] employees in breach of a written and implied contract." The insurer rejected the policyholder's request for defense, relying on a breach of contract provision in its commercial liability policy. But the court said the allegation was just that—an allegation—and not an actual breach of contract. Other policy exclusions used the term "actual or alleged," the court noted, implying that the insurer knew how to include and elected not to use such language for the breach of contract provision.

Detailed discussion

Federal Insurance Company provided coverage to financial performance analytics software provider MedeAnalytics under two commercial liability insurance policies that provided the insurer would "pay damages that the insured becomes legally obligated to pay by reason of liability … imposed by law … for … personal injury to which this coverage applies." The term "personal injury" was defined to include "injury, other than bodily injury, property damage or advertising injury, caused by an offense of … electronic, oral, written or other publication of material that libels or slanders a person or organizations (which does not include disparagement of goods, products, property or services)."

Importantly, the policy also contained an exclusion stating: "This insurance does not apply to advertising injury or personal injury arising out of breach of contract."

Two Ukrainian corporations sued MedeAnalytics in California federal court alleging five claims: breach of contract, breach of the covenant of good faith and fair dealing, intentional interference with contract, intentional interference with prospective economic advantage, and negligent interference with prospective economic advantage.

Specifically, the complaint alleged that MedeAnalytics solicited the plaintiffs' employees to work directly for MedeAnalytics in an attempt to drive the plaintiffs out of business and in breach of a nonsolicitation clause found in an agreement between parties. The complaint further alleged that MedeAnalytics "ma[d]e disparaging comments about [the plaintiffs] and [their] directors and officers."

These allegations triggered at least the potential for coverage under the personal injury coverage for libel and slander provided by the policy, U.S. District Court Judge Jon S. Tigar said. "While the allegations in the underlying complaint did not provide factual support for each element of a libel or slander claim, because 'the underlying complaint alleged publication to third persons, and the content of the statements were allegedly disparaging[,] [t]hese allegations sufficed to give rise to a potentially covered claim' for libel and slander," he wrote.

The court rejected each of Federal's counterarguments. Under California law, a plaintiff pleading a claim of libel or slander is not required to specifically allege the statements were false, the complaint did not suggest that the allegedly disparaging statements made by MedeAnalytics were merely statements of opinion, and more detail about content of the allegedly disparaging statements was not necessary, the court said.

Having established that Federal owed a duty to defend MedeAnalytics because the underlying complaint showed that a potential for personal injury coverage existed under the policy, Judge Tigar turned to potential exceptions.

Federal told the court that any potential for coverage based on libel or slander was eliminated by the express exclusion for personal injury arising out of breach of contract. MedeAnalytics responded that the exclusion was not applicable because Federal failed to demonstrate that a breach of contract actually occurred.

The court agreed. The exclusion could have been written more broadly so as to cover all claims for injury arising out of any "alleged" breach of contract in addition to all claims arising out of actual breaches of contract, Judge Tigar said.

"Indeed, other exclusions in the policy here incorporate such 'actual or alleged' language," the court said. "As Mede notes, '[i]f Federal had intended its Breach of Contract exclusion to apply to an "alleged" breach of contract, then it certainly knew how to say so.' The fact that Mede did not include the 'actual or alleged' language in the breach of contract exclusion therefore 'implies a manifested intent not to do so.' "

"Because the Court must strictly construe the breach of contract

exclusion, the Court holds that 'to avoid its duty to defend, [Federal] must point to "conclusive evidence" establishing that any potential liability that the insured faced for allegedly defaming [the underlying plaintiffs] necessarily arose out of an actual breach—not an alleged breach—of the [agreement between the parties] or some other contract,' " Judge Tigar wrote, granting summary judgment in the insured's favor on the duty to defend. "Federal does not argue that it has 'conclusive evidence' of an **actual** breach of contract. Accordingly, the Court concludes that the breach of contract exclusion does not apply, and that Federal had a duty to defend Mede against the underlying action."

To read the order in *MedeAnalytics v. Federal Insurance Company*, click here.

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Validity of "No Voluntary Payments" Provisions Upheld in Colorado

Why it matters

In a blow to policyholders, the Colorado Supreme Court determined that an insured could not be indemnified for a settlement agreement reached without providing notice of the claim to the insurer, upholding the validity of the policy's "no-voluntary-payments" clause. Stresscon, a concrete subcontractor, reached a deal with its contractor over a construction accident before litigation was initiated—and before notifying Travelers Property Casualty Company about the claim. When Travelers refused to indemnify the settlement agreement, relying upon a no-voluntary-payments clause in the policy, Stresscon sued. A trial court and an appellate court sided with the policyholder but the state's highest court reversed. The policy provision unambiguously excluded any payments made or obligations assumed without the insurer's consent regardless of whether or not the insurer could demonstrate prejudice, the Colorado Supreme Court wrote, and therefore, Stresscon's deal with the contractor fell outside the scope of coverage. Three members of the court dissented, writing that the state's existing rule requiring insurers to demonstrate prejudice from a failure to comply with a notice requirement should be extended to no-voluntary-payments provisions, a standard clause in commercial general liability policies.

Detailed discussion

A serious construction accident occurred in July 2007. The general contractor sought damages from Stresscon, a subcontracting concrete company, and the parties entered into a settlement agreement before the general contractor had filed suit or initiated arbitration.

Stresscon turned to Travelers Property Casualty Company to indemnify the deal, but the insurer refused pursuant to a clause in the policy that stated: "No insured will, except at that insured's own cost, voluntarily make a payment, assume any obligation, or incur any expense, other than for first aid, without our consent."

The policyholder filed suit and a jury awarded Stresscon damages for bad faith breach of the insurance contract. An appellate panel affirmed the verdict, relying upon the Colorado Supreme Court's 2005 decision in *Friedland v. Travelers Indemnity Co.* In that case, the court held that insurers are required to demonstrate prejudice from an insured's failure to comply with a notice requirement of its insurance contract.

Extending the holding in *Friedland*, the appellate court found the no-voluntary-payments provision could relieve Travelers of indemnification only if the insurer suffered prejudice from Stresscon's settlement. Travelers appealed again and the Colorado Supreme Court reversed.

Reviewing the policy considerations that provided the justification for the notice-prejudice rule, the Colorado Supreme Court said they did not apply with the same force to no-voluntary payment-provisions. The timely notice requirements of the occurrence policy in *Friedland* was a technicality from which insurers could "reap a windfall," the court explained, and did not define the scope of coverage.

"[A]n insurance policy is a contract, the unambiguous terms of which must be enforced as written, unless doing so would violate public policy," the court wrote. "[T]he contract clause at issue in this case, far from amounting to a mere technicality imposed upon an insured in an adhesion contract, was a fundamental term defining the limits or extent of coverage. This so-called 'no voluntary payments' clause clearly excluded from coverage any payments voluntarily made or obligations voluntarily assumed by the insured without consent, for anything other than first aid. The insurance policy emphatically stated that any such obligations or payments would be made or assumed at the insured's own cost rather than by the insurer."

The no-voluntary-payments clause does not impose a duty on the insured to do anything "whether for the purpose of assisting in the insurer's investigation or defense of a claim, or otherwise," nor does it impose a duty on the policyholder to refrain from doing something, the court noted.

Instead, the no-voluntary-payments clause "actually goes to the scope of the policy's coverage," the court said. "Rather than a provision purporting to bar an insured from voluntarily making payments or incurring expense without the consent of the insurer, for the breach of which the insurer would be absolved of compliance with its obligations under the policy, the no-voluntary-payments provision makes clear that coverage under the policy does not extend to indemnification for such payments or expenses

in the first place, and instead, the no-voluntary-payments clause merely specifies that as uncovered expenses they will not be borne by the insurer."

Depriving an insurer of its choice to defend or settle in the first instance has important practical implications for the risks that insurers undertake and the premiums paid by insureds, the court explained, and enforcement of the provision "can hardly be characterized" as reaping a windfall.

Extending the *Friedland* notice-prejudice rule "would treat no-voluntary-payments clauses of insurance contracts, including the one in this case, as nothing more than a technicality, unenforceable in the absence of prejudice, whether or not any actions of the insurer had exposed its insured to an excess judgment," the court said. "The result of such a rule would be to ignore the competing interests and risks of collusion or fraud … and would effectively deny insurers the ability to contract for the right to defend against third-party claims or negotiate settlements in the first instance. Public policy demands no such restriction on the right to contract."

The court reversed the jury verdict and remanded the case, ordering the trial court to enter a directed verdict for Travelers.

To read the opinion in *Travelers Prop. Cas. Co. v. Stresscon Co.*, click here.

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