LAW360

Portfolio Media. Inc. | 230 Park Avenue, 7th Floor | New York, NY 10169 | www.law360.com
Phone: +1 646 783 7100 | Fax: +1 646 783 7161 | customerservice@law360.com

6th Circ. Says Firm Owes Insurer Part Of Defense Bill

By **Ganesh Setty**

Law360 (April 10, 2024, 5:37 PM EDT) -- A financial advisory firm's professional liability insurer had no duty to defend the company in underlying securities suits after underlying plaintiffs removed their common law violations, the Sixth Circuit ruled, further allowing the insurer to be reimbursed for some of its defense costs.

Affirming a Michigan district court's grant of summary judgment to Great American Fidelity Insurance Co., a unanimous three-judge panel noted in its **unpublished opinion** Monday that "Michigan law has not answered whether an insured must reimburse the insurer for defending claims that the insurer had no duty to defend."

The appeals panel thus chose to make a so-called Erie guess, anticipating how the Michigan Supreme Court would rule on the issue. But the advisory firm, Stout Risius Ross Inc., must reimburse Great American for the roughly $60,000 in defense costs it incurred after the underlying plaintiffs removed their common law fraud and negligent misrepresentation claims, the appeals panel affirmed.

According to court filings, Great American insured Stout under a professional liability policy generally covering claims arising from its rendering or failure to render professional services, even if those claims are "groundless, false or fraudulent." But the policy also contained an exclusion that barred coverage for any claim arising from an actual or alleged violation of the Employee Retirement Income Security Act of 1974, Securities Acts of 1933 and 1944, or "any" state securities law.

The two underlying actions against Stout, dubbed the "Appvion ESOP" and "Halperin" suits in Monday's unpublished opinion, arose from Stout's work for Appvion Inc., a paper manufacturing company owned by Paperweight Development Corp., or PDC. The suits generally alleged that Appvion operated an employee stock ownership plan, or ESOP, which owned PDC stock and was governed by ERISA.

The ESOP's trustees hired Stout as a financial adviser and to value the stock price of PDC from December 2004 through 2017. But Stout overvalued PDC's stock price and induced Appvion employees into investing their own retirement funds into the ESOP, the underlying suits further alleged. After Appvion declared bankruptcy in October 2017, the PDC stock price tanked in turn, causing hundreds of millions of dollars worth of losses, the suits' plaintiffs said.

Great American agreed to defend Stout in the underlying lawsuits under a reservation of rights.

The district court first rejected the insurer's summary judgment bid, finding that because the underlying suits also pleaded common law violations such as fraud and negligent misrepresentation, the exclusion did not wholly bar coverage for the underlying lawsuits.

But by September 2020, the plaintiffs in the Appvion ESOP case amended their suit, solely asserting claims under federal securities law. Thereafter, the court granted Great American's summary judgment bid, finding that the exclusion applied, barring any duty to defend or indemnify. Great American did not renew its coverage defenses with respect to the Halperin action.

The insurer then sought reimbursement for the funds it spent defending Stout in the Appvion ESOP litigation — specifically seeking reimbursement for the nearly $564,000 it spent before September 2020, when the suit was amended, and the nearly $61,000 it spent after that date.

The district court rejected Great American's reimbursement bid for the funds it spent before

September 2020, given its finding that Great American had a duty to defend. But past September 2020, the insurer could get back the funds it spent defending Stout, the court held.

On appeal, Great American argued that it did not have a duty to defend Stout for the underlying actions before September 2020, thus requiring full reimbursement of its defense expenses, while Stout argued that Great American indeed owed coverage for the underlying lawsuits.

"Great American's duty to defend Stout in the underlying litigation turns on how broadly the phrase 'based on or arising out of' extends under Michigan law," Circuit Judge John K. Bush wrote for the panel Monday, finding that the district court interpreted the term correctly.

"The common law claims in the Appvion ESOP action do not allege that a violation of ERISA or securities law caused Stout to commit fraud or negligent misrepresentation, even if they shared similar factual predicates with the ERISA and securities claims," he continued. "Once the common law claims in the Appvion ESOP second amended complaint were dismissed, the district court properly concluded that Great American's duty to defend Stout in that action also ended."

Turning next to the reimbursement question, Judge Bush said that while the Michigan law is silent on whether an insured must reimburse funds an insurer spent defending a suit the carrier had no duty to defend, the state's law generally allows for "implied-in-fact contracts."

"Stout has given us no reason to depart from that analysis," he added.

"Although Michigan law does not clearly establish Great American's entitlement to reimbursement here, the 'relevant data' suggest that the Michigan Supreme Court would recognize an implied-in-fact contract here," the panel concluded, ordering Stout to pay back the roughly $60,000 Great American paid defending the firm after September 2020.

Representatives of the parties did not immediately respond to a request for comment Wednesday.

Circuit Judges Richard Allen Griffin, John K. Bush and Joan L. Larsen sat on the panel for the Sixth Circuit.

Stout is represented by Mark E. Hauck and Andrew M. Gonyea of Hickey Hauck Bishoff Jeffers & Seabolt PLLC.

Great American is represented by Douglas J. Collodel and Alexander E. Potente of Clyde & Co US LLP and by Jeffrey C. Gerish of Plunkett Cooney PC.

The case is Great American Fidelity Insurance Co. v. Stout Risius Ross Inc. et al., case numbers 23-1167/1195, in the U.S. Court of Appeals for the Sixth Circuit.

--Editing by Leah Bennett.