Consumer & Commercial Law State Bar of Texas

Federal judge ordered that D&O liability insurer is liable for $4.5 million for arbitration defense costs

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The Southern District of New York recently ordered a directors and officers ("D&O") liability insurer to pay up to $4.5 million to reimburse an insured investment firm for the costs the firm incurred defending an arbitration proceeding brought by a former executive. In *Seabury FXOne LLC v. U.S. Specialty Insurance Company*[1], the court, in denying the insurer's motion for summary judgment, held that allegations of constructive termination and related retaliation triggered an exception to the D&O policy's "Insured v. Insured" exclusion for employment-related wrongful acts.

The CEO of Seabury FXOne LLC ("Seabury"), the former owner of FXOne LLC prior to its merger with Seabury, alleged corporate misconduct by Seabury. Shortly thereafter, the CEO reiterated his initial allegations, adding that he had been "'retaliated against'" and "'cut off from obtaining access to important materials to stop the abuse'."[2] The CEO later resigned, and the parties mediated the dispute without reaching a resolution. Seabury then notified its D&O carriers, U.S. Specialty Insurance Co. ("U.S. Specialty") and RSUI Indemnity Co. ("RSUI"), of the CEO's claims. Subject to the policy's conditions, limitations, and terms, U.S. Specialty recognized coverage on the basis that "'the allegations set forth by [the CEO] constitute Wrongful Termination, which is a Wrongful Act under the Policy'."[3]

Three years later, the CEO and FXOne commenced arbitration against Seabury, demanding $32 million in damages. During this time, Seabury repeatedly communicated with U.S. Specialty regarding the defense costs Seabury incurred to defend the CEO claims. Two years after initially recognizing coverage for the CEO claims, U.S. Specialty denied coverage based on the policy's "Insured v. Insured" exclusion. U.S. Specialty argued that the CEO was an "Insured Person" under the policy, triggering the exclusion, and that none of the exceptions stated in the exclusion applied to provide coverage. Specifically, as relevant here, the exclusion carved out coverage for a "Claim" of an "actual or alleged Employment Practices Wrongful Act."[4] The policy defined an "Employment Practices Wrongful Act" ("EPWA") as "any actual or alleged: discrimination, retaliation, sexual harassment, workplace harassment, workplace tort, wrongful termination, or violation of the Family and Medical Leave Act."[5] Importantly, the policy further defined all "Claims" stemming from related facts or circumstances as one "Claim" under the policy.

After the arbitration panel issued its decision, seemingly in favor of the CEO, Seabury again wrote to its insurers regarding its claim for coverage, but U.S. Specialty reasserted its denial. Seabury filed suit against the insurers for reimbursement of defense costs. The court was asked to determine whether the underlying claim fell within the "Insured v. Insured" exclusion's EPWA exception. On their cross motions for summary judgment, Seabury argued that the CEO asserted three types of EPWAs in his demands. U.S. Specialty, on the other hand, argued that the EPWA exception was inapplicable because the arbitration dispute arose from a shareholder dispute over a Joint Venture, relating to the merger of Seabury and FXOne, rather than an EPWA. The court ultimately held that the "Claim" giving rise to Seabury's coverage request was "for" alleged EPWAs.[6]

The court held that U.S. Specialty, who recognized coverage for the mediation demand, failed to meet its burden of proving the applicability of the exclusion in the context of the arbitration, since the factual basis for both the CEO's mediation demand and arbitration proceedings were the same. In fact, the parties previously agreed that the mediation

and arbitration constituted a single claim first made during the policy period.

The court rejected U.S. Specialty's argument that allegations in the mediation demand were replaced by the arbitration demand. Allegations cannot be "replaced" as the policy at issue called for all claims stemming from the same set of facts to be considered one claim.[7] The court noted that case law suggesting that an amended complaint supersedes an original complaint was unpersuasive in this instance where the court was not considering an additional or changed claim for relief filed in court. Instead, Seabury's claim constituted a series of demands by the CEO that had to be assessed together as one claim pursuant to the terms of the policy. As such, the circumstances giving rise to Seabury's claim for reimbursement of arbitration defense costs arose from various types of accusations, including allegations concerning wrongful termination, squarely bringing the claim within the scope of the EPWA exception to the exclusion.

The court's decision, in this case, is a reminder to policyholders to carefully analyze how their D&O policies define a "Claim." Even though a policy may exclude certain types of claims from coverage, exceptions to these exclusions could trigger coverage where an uncovered claim is related to or originates from a covered claim. Consistently using coverage counsel to review all policies and insurance programs to ensure that subject D&O policies utilize a broad definition of "Claim" can help protect against these types of issues.

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