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Recent Case Law Illustrates Importance Of Wording For "Final Adjudication" Requirement In D&O Exclusions

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Charles P. Edwards
Partner
Insurance Recovery and Counseling Group
Co-Chair, Litigation Department
Vice-Chair

Directors and officers and management and professional liability policies generally contain so-called "conduct exclusions," which exclude coverage for deliberate fraud, willful violation of a statute, the gaining of a profit to which the insured was not entitled and similar conduct. Most policies today, however, require a "final adjudication" for these exclusions to apply.

Disputes frequently arise between insureds and insurance companies about what constitutes a final adjudication and what that adjudication must contain to exclude coverage. Several courts have held that a settlement does not constitute a final adjudication within the meaning of these exclusions.

For example, in *U.S. Bank N.A. v. Indian Harbor Ins. Co*. (D. Minn. Dec. 16, 2014), a federal court in Minnesota applying Delaware law held that coverage was not excluded for a $55 million settlement of a class action alleging improper overdraft charges against the policyholder bank. The settlement

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contained no admission of liability and did not characterize the payment as restitution. The court held that, “[b]y excluding from coverage a payment that a final adjudication in the underlying action determined to be restitution, the parties implicitly granted coverage for a payment that is merely alleged to be restitution.”

In *JP Morgan Securities, Inc. v. Vigilant Ins. Co*. (N.Y.A.D. Jan. 15, 2015), the court considered the “final adjudication” requirement in the context of an SEC order involving alleged improprieties at Bear Stearns. The SEC order directed Bear Stearns to disgorge $160 million and pay civil penalties of $90 million as well as to cease and desist from future violations. The insurance companies involved argued that the SEC order was a “final adjudication.” But the court noted that final adjudication alone is not enough; it must establish the excluded conduct, which the court held meant “to put beyond doubt.” The court held that the SEC order did not establish guilt because it stated that Bear Stearns did not admit guilt and it stated that “[t]he findings herein are made pursuant to [Bear Stearns’s] Offer of Settlement and are not binding on any other person in this or any other proceeding.” The court distinguished this language from earlier cases that found no coverage under circumstances where the adjudications specifically linked the disgorgement payment to the improper activity alleged by the SEC. The terms of a settlement with the government are even more important in light of the courts’ limited role in approving such settlements.

S.E.C. v. Citigroup Global Markets, Inc. (2nd Cir. Jun. 4, 2014), for example, involved a district court’s refusal to approve a consent decree because it did not believe the consent decree was fair, reasonable and adequate when compared to other SEC settlements. On appeal, the appellate court reversed and held that the district courts must determine whether the settlements are fair and reasonable, but should not question their adequacy. On remand, a clearly frustrated district court approved the consent decree, noting “[t]hey who must be obeyed have spoken.” Corporate policyholders and their directors and officers should ensure their policies contain “final adjudication” language; and, in the event of a government investigation or enforcement action, they should carefully consider their insurance coverage when resolving those matters.

As evidenced by these recent cases, how such matters are resolved and the wording involved can have an impact on whether coverage may be available for any required payments.