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Expert Analysis

Related Claims Are in the Eye of the Beholder


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Under the terms of typical professional liability and directors' and officers' insurance policies, multiple claims that arise out of interrelated wrongful acts are treated as a single claim deemed to have been first made at the time the first of the related claims was made against the insured. Whether the treatment of multiple related claims as a single claim benefits the insured or the insurer depends on the circumstances. Consequently, you may find an insured or an insurer on either side of a related-claims dispute.

In some situations, a claim may be covered under a policy only because it arises out of the same facts as a prior claim. In other circumstances, the existence of a prior related claim may result in the denial of coverage or a limitation on available policy limits.

For example, when a claim is made against an insured after the expiration of a policy, the insured might argue that the new claim relates back to a prior claim, made during the policy period, so that the new claim will be deemed to have been made during the policy period and thus be eligible for coverage. On the other hand, where an insurer has issued consecutive annual policies to an insured, it may be the insurer who argues that a new claim is related to a prior claim, in order to confine coverage for the related claims to the limits of one policy rather than adjusting the two claims under separate policies. Likewise, an insurer may argue that a new claim relates back to a prior claim in order to invoke an exclusion for prior pending claims or for previously noticed claims.

Resolution of disputes over whether two claims are interrelated necessarily turns on analysis of the facts surrounding the underlying claim. As a result, court rulings resolving such disputes are largely fact-specific and broad conclusions based on case law precedent can prove elusive. Courts in New York have tried to introduce some consistency by focusing on whether there is a "sufficient factual nexus" between the two claims. However, it is questionable whether this standard is consistent with the policy language much less whether the standard provides useful guidance. Even with this articulated standard, a degree of subjectivity remains, as demonstrated by the recent ruling by Judge Deborah A. Batts in *Glascoff v. OneBeacon Midwest Ins.*,[1] a case pending in the U.S. District Court for the Southern District of New York.

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Claims Against Bank Directors

In *Glascoff*, former directors of the failed Park Avenue Bank sought insurance coverage for a claim made by a group of investors who alleged that the directors were liable for the investors' loss under a control person liability theory and under Arizona securities law. The investors filed a lawsuit claiming that they had been induced by the bank's former president and CEO to invest in two transactions in which the CEO had defrauded the investors for his own personal profit. According to the pleadings, the investors claimed that the directors were liable due to lax oversight, failure to control the CEO and failure to enforce a "reasonable and proper ongoing system of appropriate supervision and internal controls."[2]

The insurance policy issued by the defendant-insurer, OneBeacon, had expired on Nov. 9, 2010, over a year before the filing of the investors' lawsuit. Consequently, the insurer denied coverage on the grounds that the investors' lawsuit was not a claim made during the policy period. In response, the directors argued that the investors' lawsuit was related to a prior claim made against the directors by the Federal Deposit Insurance Corp. (FDIC), which was made during the policy period and for which the insurer had granted coverage. The directors contended that because the two claims arose out of interrelated wrongful acts, the investors' lawsuit should be deemed to have been made at the time of the FDIC claim, during the policy period, and therefore the investors' claim is also covered under the policy.

The governing terms of the insurance policy were not in dispute and, in fact, the District Court held that the key terms were clear and unambiguous. The policy contained a standard definition of wrongful act[3] and provided that interrelated wrongful acts are "Wrongful Acts which have as a common nexus any fact, circumstance, situation, event, transaction or series of related facts, circumstances, situations, events or transactions."[4]

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The policy further provided that "[a]ll claims based upon or arising out of the same Wrongful Act or Interrelated Wrongful Acts committed by one or more Insureds shall be considered a single Claim… Each such single Claim shall be deemed to be first made on the date the earliest of such Claims was first made, regardless of whether such date is before or during the Policy Period."[5]

Insufficient Factual Nexus

Batts explained that to determine whether two claims arise out of interrelated wrongful acts, courts will examine whether the claims share a "sufficient factual nexus." Case law precedent establishes that "[a] sufficient factual nexus exists where the Claims 'are neither factually nor legally distinct, but instead arise from common facts' and where the 'logically connected facts and circumstances demonstrate a factual nexus' among the Claims."[6]

The FDIC had asserted claims against the directors for breach of duty, negligence and gross negligence in connection with their role in the failure of the bank. The FDIC demand letters asserted that the claims arose from the directors' failure to "supervise, manage, conduct and direct the business and affairs of the Bank to ensure compliance with the laws."[7] Although the FDIC claim primarily focused on the deficient policies, controls and practices that had led to the bank's failure (including inadequate policies to approve and monitor loans, and oversee collection procedures and employee compensation), the FDIC also expressly alleged that the directors failed to act on allegations of improper conduct by the CEO, which ultimately caused significant financial harm to the bank.

In comparison, the investors' lawsuit alleged that the CEO had fraudulently induced them to invest in two transactions by making material false statements, misrepresentations and omissions. The investors claimed that the directors were liable for their lax oversight of the CEO and for failing to maintain procedures to oversee and control the activities of the CEO.

The directors argued that the two claims were interrelated because both the FDIC and the investors brought claims against the directors for the alleged failure to oversee and manage the CEO. Batts rejected the directors' argument, holding that the claims did not share a sufficient factual nexus and explaining that, although there was some factual overlap between the two claims, the nexus was "tenuous at best." According to Batts, the overlap was limited to the directors' alleged failure "to act properly with respect to the [CEO], whether it be their control and oversight of him, as alleged in the [investor] Complaint, or their failure to investigate allegations of his misconduct, as alleged by the FDIC."[8]

Batts acknowledged that, if "painted in broad strokes," the two claims could both be considered to arise out of a deficient corporate structure or the directors' lack of oversight. Nevertheless, Batts concluded that the directors' interrelatedness argument fell short because the FDIC claim merely referenced the CEO's general misconduct, while the investors' claim concerned specific allegations of fraud, and the directors were unable to point to any specific common fact, event or circumstance.

A Line of Close Calls

Overall, Batts' ruling, like much of the precedent on which the ruling relies, appears to underscore the fact-specific nature of related claims decisions and the subjectivity inherent in making such fact-specific rulings. Certainly, one can understand the perspective of the court and the insurer—the FDIC claim concerned the general mismanagement of the bank, in contrast to the investor claim, which was a securities fraud claim involving two specific transactions and the resulting investor loss. From that perspective, the claims do not seem all that interrelated.

However, the insureds' perspective was arguably equally legitimate. After all, the policy language does not seem to require a very substantial interrelatedness. Rather, an interrelated wrongful act is defined to include "wrongful acts which have as a common nexus any fact, circumstance, situation, event, transaction, or series of related facts, circumstances, situations, events or transactions." It does not seem to be that much of a stretch to argue that the two claims were interrelated because both arose, at least in part, from the underlying conduct of the CEO or the failure to supervise that conduct.

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The cases relied on by Batts, while consistent with the ruling in *Glascoff*, do not provide much more clarity on the issue. For example, the court discussed *Zahler v. Twin City Insurance*,[9] a dispute between insurance carriers regarding whether an Employee Retirement Income Security Act (ERISA) litigation and a securities litigation arose out of interrelated wrongful acts. In that case, the Southern District found that the claims were interrelated, even though the claims involved different claimants and different causes of action, because the claims arose out of the same public statements that misrepresented the insured's financial health.

Similarly, in *Zunenshine v. Executive Risk Indemnity*,[10] the Southern District also found a strong nexus between two claims, holding that a noteholders' lawsuit and shareholders' lawsuits were interrelated because they arose out of the same allegedly false and misleading financial statements. Likewise, in *Quanta Lines Ins. v. Investors Capital*,[11] the Southern District found that two claims that both arose out of the alleged failure to supervise a representative's sale of the same unregistered securities arose out of a sufficient factual nexus to be deemed interrelated claims.

In *Seneca Ins. v. Kemper Insurance*,[12] another dispute between insurers, the Southern District also held that two claims were interrelated, even though the claims involved different claimants (although represented by the same counsel), because the claims involved the same type of conduct. In *Seneca*, two different claimants brought suit jointly against the insured, an entity that organized horse shows in Florida. The claimants each alleged that the insured had declined to certify certain horse shows due to alleged mileage conflicts in a manner that constituted an illegal restraint on competition in violation of antitrust laws. The District Court held that the claims were interrelated because they alleged the same wrongful conduct and the same legal theory, even though the certification denials were made with regard to unrelated applications from unrelated businesses.

Looking Forward

Each of the cases relied upon by Batts in *Glascoff* appears to have reached the correct conclusion regarding the related claims question presented, but that seems more likely to be due to the specific underlying facts rather than any clarity provided by the "sufficient factual nexus" standard.

Regardless of the outcome in *Glascoff*, there does seem to be a disconnect between the "sufficient factual nexus" standard and the policy language that declares that two wrongful acts are interrelated whenever they have as a common nexus "any fact, circumstance, situation, event, transaction or series of related facts, circumstances situations, events or transactions."

Based on the current body of case law and the fact-specific results, there is little to discourage parties from litigating these related-claims disputes. Consequently, it appears that the courts will have ample opportunity to add to the case law precedent. We can hope that future cases will make an effort to establish a clear standard that is consistent with the policy language and provides guidance for future disputes.

1. *Glascoff v. OneBeacon Midwest Insurance Co.*, 13 Civ. 1013 (DAB), 2014 WL 1876984 (S.D.N.Y. May 8, 2014).
2. Id.
3. Id. (Under the terms of the policy, Wrongful Act means "any actual or alleged act, error, omission, misstatement, misleading statement, neglect or breach of duty…").
4. Id.
5. Id.
6. Id.
7. Id.
8. Id.
9. *Zahler v. Twin City Fire Insurance*, No.) 4 Civ. 10299 (LAP), 2006 WL 846352 (S.D.N.Y. March 31, 2006).
10. *Zunenshine v. Executive Risk Indemnity,* No. 97 Civ. 5525 (MBM), 1998 WL 483475 (S.D.N.Y. Aug. 17, 1998).
11. *Quanta Lines Insurance Co. v. Investors Capital*, No. 06 Civ. 4624 (PKL) 2009 WL 4884096 (S.D.N.Y. Dec. 17, 2009).
12. *Seneca Insurance v. Kemper Insurance*, No. 02 Civ. 10088 (PKL), 2004 WL 1145830 (S.D.N.Y. May 21, 2004).

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