

Delaware District Court Holds D&O Policy Does Not Cover Acts Prior to Insured's Formation, and Rejects Attempt To Obtain Coverage for Post-Policy Claim by Linking It to a Non-Covered Claim

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In a decision addressing several coverage issues under a directors and officers liability policy, a Delaware federal court held that coverage did not extend to claims based on acts alleged to have taken place before the insured entity's formation, and that coverage for a claim first made after policy expiration could not be predicated on treating it as alleging "interrelated wrongful acts" to an earlier non-covered claim.

In *Liberty Ins. Underwriters, Inc. v. Cocrysal Pharma, Inc.*,^[1] Liberty Mutual issued a claims-made D&O policy effective for the January 2, 2015 to May 6, 2018 policy period (the Policy), to Cocrysal Pharma, Inc. (Cocrysal), an entity which had been formed through a merger of two other corporations. During the policy period, the Securities and Exchange Commission subpoenaed documents from the insured entity in connection with an investigation of certain persons who were formerly directors and officers of one of the predecessor companies, Biozone Pharmaceuticals, Inc. (Biozone), and who, after the merger, then served as directors and officers of the insured entity Cocrysal. Liberty agreed to treat the SEC Investigation as a "claim" and reimburse Cocrysal's defense costs subject to a reservation of rights.

Subsequently, after the policy period, the SEC commenced an action against those directors and other persons alleging that, in 2013, three Biozone D&Os engaged in a pump-and-dump scheme to inflate the value of Biozone's shares. Additionally, Cocrysal shareholders commenced derivative actions against Cocrysal (as the successor entity of Biozone) and Cocrysal's D&Os, alleging that Cocrysal was harmed by the pump-and-dump scheme and by the D&Os continuing false or misleading statements that did not disclose the scheme. Liberty denied coverage for the various suits, asserting that, pursuant to the Policy, all allegations are deemed to have occurred prior to the Policy's Prior Acts Date, such that the Policy's Prior Acts Exclusion bars coverage. Based on its conclusion that the Prior Acts Exclusion precluded coverage for the SEC Investigation, Liberty sought to recover the defense costs it had advanced to Cocrysal in connection with that investigation based on Policy language allowing for recoupment.

On cross-motions for summary judgment, the district court determined that no coverage was owed because there was no "claim" that alleged covered "wrongful acts" that was first made during the policy period. The court noted that the Policy applied to "Wrongful Acts" allegedly committed by Cocrysal's directors and officers in their capacities as such, and therefore a "Wrongful Act" only would include "an act or omission by Cocrysal's directors or officers while wearing Cocrysal hats, *i.e.* acting as Cocrysal directors and officers, as opposed to acting in their individual capacities or on behalf of another organization." Because the SEC Investigation and Action was focused entirely on acts that predated the merger in which the insured entity Cocrysal was formed, the directors and officers could not have engaged in those alleged acts in their capacities as directors or officers of Cocrysal, because the insured did not yet exist. Because they were not acting for Cocrysal when they engaged in the scheme, the court concluded that such conduct was not a Wrongful Act that triggered coverage under the Policy.^[2]

With respect to the derivative suits, because they were filed after expiration of the Policy, the court considered whether they should be deemed to relate back to the SEC Investigation pursuant to the "interrelated wrongful acts" provisions of the Policy, which provided that "[a]ll Claims arising from the same Wrongful Act or Interrelated Wrongful Acts shall be deemed one Claim and subject to a single limit of liability. Such Claim shall be deemed first made on the date the earliest of such Claims is first made." The court held that its determination that there was no coverage for the SEC claims of a pump-and-dump scheme eliminated the purported premise of coverage for the post-policy derivative actions. Because the pump-and-dump scheme did not involve "Wrongful Acts" under the Policy, there was "nothing to which the Derivative Actions could relate back. As those claims were not made during the applicable Policy Period, [the insured was] not entitled to coverage for the Derivative Actions."^[3] Having reached these determinations, the court did not address party positions pertinent to the Prior Acts Exclusion.

Thus, as highlighted by this decision, (a) coverage under a D&O policy cannot be predicated on acts taking place before the formation of the insured, and (b) an "interrelated wrongful act" provision does not apply to a claim first made after the policy period unless the claim relates back to a timely made claim that is independently covered.

The decision also touches on several other points:

- The court reaffirmed the long-standing position of Delaware courts that the state of incorporation is the center of gravity of the typical D&O Policy, such that Delaware law is generally applied to D&O coverage disputes where the insured is a Delaware corporation.
- The court enforced the Policy's defense recoupment provision and held that Liberty's failure to issue a supplemental reservation of rights letter when it started to advance defense did not operate as a waiver of its right to recoup the defense costs advanced, applying the principle that coverage cannot be created by waiver.
- The court dismissed the bad faith claim, holding that there can be no bad faith under Delaware law where there is no coverage for the claim.

If you have any questions or would like further information, contact Celestine Montague (montaguec@whiteandwilliams.com; 215.864.6813) or Frank Perch (perchf@whiteandwilliams.com; 215.864.6273).

[1] 2022 U.S. Dist. LEXIS 91839 (D.Del. May 23, 2022)

[2] *Id.* at *15-16.

[3] *Id.* at *18.

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