

December 2010, Vol. 9

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## Federal District Court in Virginia Rejects Insurer's Recoupment Claim Under Kansas Law

The U.S. District Court for the Eastern District of Virginia refused to allow an insurer to recoup indemnity payments made to its insured in settlement of securities liability claims. See *Houston Cas. Co. v. Sprint Nextel Corp.*, No. 1:09-cv-1387, 2010 U.S. Dist. LEXIS 124302 (E.D. Va. Nov. 22, 2010).

### Background

Houston Casualty Co. ("HCC") brought an action against its insured, Sprint Nextel Corp. ("Sprint"), to recover amounts paid by HCC to settle claims against Sprint under a contract for directors and officers liability insurance. Sprint's shareholders brought a suit against Sprint's directors and officers alleging breach of fiduciary duties in connection with Sprint's recombination of certain stocks. The case eventually settled for \$57.5 million, to which HCC contributed its \$15 million policy limits. In a letter to Sprint approving the settlement and agreeing to pay its policy limits, HCC reserved its rights to later deny coverage and seek recoupment of its settlement contribution. Sprint acknowledged HCC's letter and likewise reserved all of its rights and remedies, including those applicable to HCC's asserted right to repayment.

### Decision of the Court

Applying Kansas law, the district court rejected HCC's claim for recoupment.

First, the court determined that the underlying settlement came squarely within the policy's definition of "loss." HCC had argued that the settlement was not an insured "loss" because the settlement payment merely represented a "delayed payment of a preexisting corporate obligation." The court rejected that argument based on the plain language of the policy, which provided that "Loss means . . . damages, judgments, settlements and Defense Costs."

Alternatively, HCC argued that the settlement did not constitute a "loss" because the payment merely redistributed assets among different classes of shareholders. In making that argument, HCC relied heavily on the Massachusetts federal court decision in *Genzyme Corp. v. Federal Insurance Co.*, 657 F. Supp. 2d 282 (D. Mass. 2009), *rev'd in part and remanded*, 622 F.3d 62 (1st Cir. 2010), contending that because the reconstitution of stock did not result in a net loss of assets to Sprint, there was nothing for the insurer to indemnify. But, the court rejected that argument too, noting that the argument ignored the corporate axiom that a corporation and its shareholders are distinct entities. Thus, Sprint did not stand to gain to the extent it made a cash payment to a subset of its shareholders. Indeed, as the court explained, if such payments failed to qualify as a "loss" to the corporation, then "it would be impos-

sible to secure coverage for damages awards in routine securities litigation.”

The court then considered whether the settlement came within the “loss” definition’s exception for amounts uninsurable as a matter of public policy. Here, HCC argued that the settlement violated public policy because (1) the event was non-fortuitous, and (2) the payment was a preexisting corporate obligation. Finding no Kansas authority in support of either contention, the court rejected both. On the first point, the court found that the underlying settlement was hardly a non-fortuitous event, particularly where Sprint’s board had not yet decided to recombine the stocks as of the time Sprint purchased the policy. On the second point, the court concluded that if breaches of fiduciary duties were uninsurable as preexisting corporate obligations, as argued here, then directors and

officers coverage would become a nullity. And, Kansas public policy actually favored enforcement of directors and officers insurance policies in order to encourage board service. Finally, the court noted that the participation of Sprint’s other insurers in the settlement, HCC’s admission that the coverage issue was uncertain, HCC’s “multi-year delay” in seeking recoupment, and the unambiguous policy terms all confirmed that there was no well-established public policy against insuring the underlying settlement.

The court then considered whether equitable remedies would be available to HCC. Concluding that they were not, the court explained that, under Kansas law, the equitable remedies of restitution and quantum merit were not available where, as here, a comprehensive written agreement controlled the rights and obligations

of the parties. That agreement, the court explained, granted the insurer a right of recoupment of some costs, such as defense costs, but not amounts paid in settlement of covered claims. To permit HCC to recoup what the insurance agreement did not expressly allow would amount to an improper amendment of the policy.

### Implications

The *Houston Casualty* decision reiterates that courts in the Fourth Circuit continue to strictly honor the terms of insurance policies, particularly where doing otherwise might result in a forfeiture of coverage. Further, the decision underscores the importance of timely enforcing contractual rights, since a delay might result in a waiver or, as in *Houston Casualty*, operate to undermine a later-asserted litigation position.

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