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Client Alert

Insurance Recovery

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Private Equity Firm Secures $87 Million of Coverage From Its Own Insurers for a Portfolio Company Liability

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What You Need To Know:

- **Private equity (PE) firms can secure insurance coverage for portfolio company liabilities under their own policies.**
- **The duty to defend is broad and applies if there is only a potential for coverage.**
- **Early and broad notice to all potentially applicable policies will maximize insurance recovery.**

Last week, the Fourth Circuit upheld an insurance coverage award of $87 million to a publicly traded PE firm that was involved in mass tort litigation along with one of its portfolio companies. In finding coverage under the PE firm's comprehensive general liability policies, the court reinforced the insurers' broad duty to defend and found the "majority interest" and "joint venture" clauses were ambiguous and must be construed in favor of coverage. This case is an important reminder that PE firms must think broadly about all available insurance coverage when liabilities are presented and make sure that timely notice is provided to all such insurers to maximize recovery. PE firms also should be aware that insurers may seek to modify "standard" policy language to foreclose these types of claims in the future.

The case arose out of a dispute between Charter Oak Fire Ins. Co. and Travelers Prop. & Cas. Co. of America (the "Insurers") and American Capital, LTD ("American Capital"), and Scientific Protein Laboratories, LLC ("SPL"), (the "Insureds"), with respect to insurance coverage for more than 1,000 product liability lawsuits filed against the Insureds by users of the blood-thinning drug heparin (the "Heparin Lawsuits"). The district court awarded the Insureds defense costs and prejudgment interest for the Heparin Lawsuits while rejecting the Insureds' claims that the Insurers failed to act in good faith and belated claims regarding indemnification for the Heparin Lawsuits. Cross appeals were filed to the Fourth Circuit Court of Appeals.

In January 2009, the Insurers filed suit against the Insureds, seeking a declaration that they had no duty to defend or indemnify the Insureds in the Heparin Lawsuits. Specifically, the Insurers argued that the Insureds were not entitled to a defense because (a) SPL was not covered under the insurance policies because those policies were issued to American Capital, and American Capital did not seek coverage for any subsidiaries in its insurance applications, and (b) the Heparin Lawsuits related to the conduct of a noninsured joint venture between SPL and Changzhou Techpool Pharmaceutical Co., Ltd.

To determine whether SPL qualified as an insured, the district court relied on the "majority interest" clause, which provided coverage for "any organization, other than a partnership or joint venture, over which [American Capital] maintain[s] ownership or majority interest on the effective date of the policy." The Insurers argued that the "majority interest clause" required American Capital to have absolute ownership or a controlling interest in an entity for it to be considered an insured. The district court found, however, that the term "majority interest" was ambiguous and must be interpreted in favor of the insured. The district court further found that an equity stake above 50 percent, regardless of voting rights, would satisfy the provision. Because American Capital owned a majority of nonvoting shares in SPL Acquisition Corp., the parent of SPL, American Capital held a "majority interest" in SPL. As a result, the district court found that SPL qualified as an insured under the policies.

The Insurers also argued that the "joint venture clause" precluded coverage for the Heparin Lawsuits. The district court held that the joint venture clause, which provided that "[n]o person or organization is an insured with respect to the conduct of any current or past partnership, joint venture or limited liability company that is not shown as a Named Insured," did not preclude coverage because there were several complaints against the Insureds that did not mention the joint venture, and the evidence before the court reflected that some of the contaminated heparin products "came from a source other than [the joint venture]." The district court rejected the Insurers' position, finding that the duty to defend is broad and requires an insurer to defend "if there is a **potentiality** that the claim could be covered by the policy." Because there was a potential for covered judgments against the Insureds arising from the Heparin Lawsuits, there was a potential for coverage under the applicable policies, and the Insurers had a duty to defend.

After rejecting the Insurers' attempts to avoid their defense obligation, the district court found that the fees and expenses claimed by the Insureds to defend the Heparin Lawsuits were "amply supported by the evidence" and were "reasonable and necessary." The district court further found that the Insureds were ultimately responsible for the defense fees under a joint defense agreement and that the defense fees were actually incurred. Accordingly, the district court awarded the full amount of defense fees (approximately $63 million) upon a finding that the Insureds and their co-defendants were "not only reasonably related but [also] inextricably intertwined."

In addition to defense fees, the district court awarded prejudgment interest in the amount of $24 million because the joint defense costs were readily "calculable, and thus fixed and ascertainable." The district court noted that the Insurers knew that the defense costs were accruing and, but for their breach of contract, would have known the specifics of those costs.

Key Takeaways

The Fourth Circuit's decision reinforces that (a) insurers have a broad duty to defend whenever a claim is **potentially** covered by the policy **and** (b) once there is a potential for coverage, insurers must defend the **entire** lawsuit. Moreover, while PE firms generally prefer to access the insurance coverage available from their portfolio companies before pursuing coverage under their own insurance programs, this ruling provides a clear path for making sure that sufficient insurance coverage is available when substantial liabilities are presented.

However, PE firms should take note that subsidiaries and joint ventures require careful consideration from an insurance policy procurement perspective. Here, American Capital was fortunate that (a) the policy language broadly and vaguely defined "subsidiary" to include entities where the named insured held a "majority interest"–not all insurance policies use this language–and (b) a mix of lawsuits was filed, some of which included the joint venture and some of which did not. If the alleged liability was limited to only the joint venture claims, American Capital likely faced a large uninsured risk exposure.

Finally, it is important to note that the insurance industry aggressively opposed this case on appeal in the Fourth Circuit because it contended that the district court's ruling provided coverage where none was intended by the Insurers. To address critical changes that may be made to the "standard" language considered in this case on future renewals, PE firms will be well-served to consult with experienced insurance coverage counsel to evaluate policy forms so they can avoid unwelcome surprises.

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