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Late Notice, But Not The "Related Claim" or "Pending/Prior Litigation" Exclusions, Defeat Coverage For Successive Loan Default Suits

A federal district court judge in Connecticut recently agreed that an insurer did not owe coverage under a "claims-made" D&O liability insurance policy where the policyholder failed to give timely notice of a suit arising from a loan default. The decision is *Zahoruiko v. Federal Ins. Co.* and can be found here.

In May 2008, Refresh Software Corporation ("Refresh") began missing payments under a promissory note issued by Premier Capital to Refresh in 1999 (the (1999 Note"). Premier Capital filed suit against Refresh and its officer, Graham Zahoruiko, who personally guaranteed the loan. In response, on May 30, 2008, Refresh and Zahoruiko entered into a forbearance agreement with Premier Capital which, in exchange for a waiver of any defenses to future repayment, worked to defer repayment until April 2012. Refresh and Zahoruiko also signed a new note (the "2003 Note"). Refresh's D&O insurer, Federal Insurance Co., was not notified of the suit.

In 2010, Refresh and Zahoruiko defaulted on the 2003 Note prompting Premier Capital to again file suit against Refresh and Zahoruiko. Federal was not notified of the suit or the repayment demands. Then, in March 2012, and after Federal advised that it would be moving for summary judgment, Zahoruiko notified Federal of the lawsuit. Federal denied coverage and Premier Capital's summary judgment was granted.

Zahoruiko sued Federal for breach of the insurance contract. The court found that Federal's duties under the policy were completely discharged because Refresh failed to give timely notice of Premier Capital's claim. Applying Connecticut law, the court found that Zahoruiko's notice was untimely and that the delay resulted in prejudice to the insurer insofar as Federal had been denied any opportunity to participate in the settlement of Premier Capital's suit over the 1999 Note, where such participation could have allowed Federal to negotiate better terms for the 2003 Note and/or avoid the accrual of defense costs.

Also of significance was the court's rejection of Federal's defenses under the D&O policy's Related Claim and Pending or Prior Litigation Exclusions. In doing so, the court acknowledged that "to permit an insured to recover for claims arising from the same facts, circumstances, situations, transactions, events or wrongful acts alleged in a pending lawsuit or made the subject of a prior notice given to another insurer would be to grant the insured more coverage than he bargained for and paid for, and to require the insurer to provide coverage for risks not assumed." The court further noted that to determine whether a prior litigation provision applies, courts should look to whether a sufficient factual nexus exists between the two suits. Doing so here, the court found neither exclusion applied, explaining that when Premier Capital agreed to settle the 2002 case, and when Plaintiff executed a new note and guaranty, disputes relating to the 1999 Note were definitively resolved and any obligations under that note were extinguished. Because each case involves the breach of a different note, they cannot be said to arise from the "same or any substantially similar fact, circumstance or situation.

This decision is a reminder that a policyholder should immediately notify its insurer of all potential claims, even if it believes it can resolve the matter on its own. Even seemingly beneficial conduct, like entering

into a forbearance agreement, can jeopardize coverage where the agreement ultimately works to prejudice the insurer.

The decision also is instructive as to when successive or seemingly "related" claims or lawsuits are, in fact, *in*sufficiently related to implicate a D&O policy's related claim and pending or prior litigation exclusions. As the *Zahoruiko* lawsuit illustrates, even where successive lawsuits are traceable to a common genesis (here, the 1999 Note), the facts that give rise to the actual claims (or lawsuits) against the policyholder may nevertheless be sufficiently distinct to allow avoid application of a D&O policy's Related Claim and Pending or Prior Litigation exclusions. A critical review by experienced coverage counsel at the facts giving rise to the claims or lawsuit should be made.

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