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## Federal Court Issues Injunction Requiring Insurer to Advance Defense Costs to Stanford Financial Defendants for DOJ and SEC Proceedings

Yesterday, January 26, 2010, Judge David Hittner of the United States District Court for the Southern District of Texas issued an important opinion in the Stanford Financial case that paves the way for targets of criminal and civil enforcement proceedings to obtain insurance coverage for costs of defending themselves. The decision marks a significant victory for executives who have the misfortune of being caught up in a government prosecution and find themselves otherwise unable to fund their defense. Policyholders generally also should take note of the decision, as it confirms that a carrier's obligation to advance defense costs is determined by the allegations in a complaint or indictment—not by extrinsic evidence selected by an insurer.

### Case Background

When news of the Bernie Madoff scandal broke in late 2008, "ponzi scheme" became a household phrase. Shortly after the Madoff scandal hit the airwaves, the Securities and Exchange Commission initiated a civil action against prominent Texas-born financier, Robert Allen Stanford, and certain officers at Stanford Financial Group for their alleged orchestration of a multi-billion dollar ponzi investment scheme. The U.S. Department of Justice also indicted Stanford and others on twenty-one counts of conspiracy, mail fraud, wire fraud, securities fraud, money laundering and obstruction of justice.

In the SEC proceeding, the Court appointed a receiver, who in turn froze all of the assets of the defendants as well as the related Stanford entities. The defendants thus were left without a meaningful ability to fund their defense in the SEC and DOJ actions—unless they were able to access insurance.

Stanford had purchased a Directors and Officers (D&O) Insurance policy from Certain Underwriters at Lloyd's of London ("Lloyd's"). Lloyd's originally agreed to advance defense costs to Stanford and the other insureds for the civil and criminal actions. Several months after *one* of the officers plead guilty, however, Lloyd's *retroactively* denied coverage for all *other* insureds, purportedly because of the guilty plea.

### The Court's Injunction Requiring Advancement of Defense Costs

In yesterday's ruling, Judge Hittner granted a preliminary injunction that ordered Lloyd's to withdraw its retroactive denial of coverage and pay the insureds' reasonable and necessary defense costs in the SEC and DOJ matters. The decision has important implications not only for the Stanford defendants, but to policyholders generally.

First, the Court granted a preliminary injunction ordering the carrier to pay defense costs where the carrier had denied coverage.

Second, the Court rejected Lloyd's attempt to introduce the guilty plea, judicial findings in the separate receivership proceeding, or other extrinsic evidence to defeat the obligation to advance defense costs. Instead, the Court applied the "eight corners rule," which requires that courts look only to the four corners of the insurance policy and the four corners of the underlying complaint—without regard to the truth or falsity of the allegations.

Although Lloyd's argued that the "eight corners rule" rule applies only in the duty to defend context, not to the duty to advance defense costs commonly included in D&O policies, Judge Hittner noted that no Texas courts had applied any other rule to the duty to advance defense costs. Further, the reasons for applying the eight corners rule apply equally to the duty to advance defense costs as they do to the duty to defend. Judge Hittner recognized that, otherwise, an insurance company could "act as judge and jury and convict its own insureds, thus avoiding any further financial responsibility for the insureds' defense."

Third, the Court rejected Lloyd's attempted reliance on a money laundering exclusion in the D&O policy, which required Lloyd's to advance defense costs only until "it is determined if money laundering did *in fact* occur." Lloyd's argued that it had properly denied coverage because it had independently determined that money laundering did "in fact" occur. Judge Hittner held that whether money laundering "in fact" occurred "may mean something less than a judicial determination but also may mean much more than an insurer's own determination based on nothing more than mere allegations supplemented by the self-serving statements of an indicted co-defendant who elects to plead guilty and cooperate with the prosecution."

Finally, the Court recognized that the defendants would suffer irreparable harm if coverage for defense costs was not made available. The Court held that without access to funds from the insurer, the defendants would be unable to mount the defense required in the SEC proceeding and criminal prosecution. This was alone significant and irreparable harm to warrant the injunction. Further, while not dispositive, the Court also found noteworthy that if the insurance company was not compelled to honor the terms of the policy after a likelihood of success had been shown by the insureds, the U.S. taxpayers would be forced to bear the responsibility of paying for the defense of the criminal prosecutions. The public interest thus also was served by issuing the injunction.

### Conclusion

The decision in the Stanford Financial case highlights that directors and officers who may be targets of regulatory or criminal proceedings should not assume that insurance coverage is not available for their defense. The ruling enforces the notion that a carrier's duty to advance defense costs should be determined by the liberal "eight corners" standard. Thus, the decision should be useful in obtaining coverage for defense costs when directors, officers and other insureds need it most. [For a copy of the opinion, please click here.](#)

If you need advice regarding the defense of a criminal or regulatory enforcement proceeding, or the availability of insurance coverage under D&O or other applicable insurance policies for such matters, please contact one of the members of our White Collar Crime/Securities Litigation or Insurance Coverage Practice Groups listed below.

### White Collar Crime/Securities Litigation

[Katherine Addleman](#)

214.651.5783

[kit.addleman@haynesboone.com](mailto:kit.addleman@haynesboone.com)

[Thad Behrens](#)

214.651.5668

[thad.behrens@haynesboone.com](mailto:thad.behrens@haynesboone.com)

[Lawrence D. Finder](#)

713.547.2006

[lawrence.finder@haynesboone.com](mailto:lawrence.finder@haynesboone.com)

[David Siegal](#)

212.659.4995

[david.siegal@haynesboone.com](mailto:david.siegal@haynesboone.com)

[Ronald W. Breaux](#)

214.651.5688

[ron.breaux@haynesboone.com](mailto:ron.breaux@haynesboone.com)

[Kathleen M. Beasley](#)

214.651.5697

[kathleen.beasley@haynesboone.com](mailto:kathleen.beasley@haynesboone.com)

[Lawrence A. Gaydos](#)

214.651.5622

[larry.gaydos@haynesboone.com](mailto:larry.gaydos@haynesboone.com)

### Insurance Coverage

[Erika L. Blomquist](#)

214.651.5120

[erika.blomquist@haynesboone.com](mailto:erika.blomquist@haynesboone.com)

[Kenneth E. Broughton](#)

713.547.2021

[kenneth.broughton@haynesboone.com](mailto:kenneth.broughton@haynesboone.com)

[Matt W. Holley](#)

214.651.5371

[matt.holley@haynesboone.com](mailto:matt.holley@haynesboone.com)

[Ernest Martin, Jr.](#)

214.651.5641

[ernest.martin@haynesboone.com](mailto:ernest.martin@haynesboone.com)

[Werner A. Powers](#)

214.651.5581

[werner.powers@haynesboone.com](mailto:werner.powers@haynesboone.com)

[David Taubenfeld](#)

214.651.5531

[david.taubenfeld@haynesboone.com](mailto:david.taubenfeld@haynesboone.com)