

By Ilan Goldberg and Paula Rodrigues (*)

A discussion on directors and officers (D&O) insurance coverage arose surprisingly and unexpectedly during a recent judgment of the 1st Private Commercial Chamber of Sao Paulo's State Court of Appeals. The actual matter under analysis was whether parties of a D&O policy, Galvao Participacoes S.A. (Galpar), as contracting party, and Fairfax Brasil Seguros Corporativos S.A., as insurer, had agreed to refer their disputes to arbitration. Galpar filed a lawsuit against Fairfax alleging that the policy had an open arbitration clause and, therefore, requested that the insurance company was obliged to sign an arbitration commitment, as per article 7, section 2 of the Brazilian Arbitration Act. Galpar was willing to challenge, in the arbitration, Fairfax's decision to reject coverage for the defence costs of Galpar's director, Eduardo de Queiroz Galvao, in a criminal action related to Operation 'Car Wash'.

Galpar's request was granted in the first instance, which delimited the arbitration commitment, and, due to an appeal filed by Fairfax, the case was taken to the State Court of Appeals of Sao Paulo and was distributed to the 1st Private Commercial Chamber for judgment.

The panel of three judges which received the appeal disagreed on whether an arbitral agreement existed in the policy, with one judge upholding the first instance decision and two overruling it. Therefore, the other two judges of the Chamber were called to take part in the judgment, as provided for by article 942, section 2 of the Brazilian Civil Procedural Code (CPC).

During this extended judgment, the last judge to vote, Cesar Ciampolini, a former corporate lawyer, decided to take a step back and see what was behind the discussion on arbitration, essentially, the possibility of enforcement of the D&O policy vis-à-vis the act of the claimant's director. He stated that Galpar could not claim coverage neither before a State Court nor an arbitral tribunal as there was no legitimate right to be claimed.

In order to reach such a conclusion, the judge made a deep analysis of the constitutional guarantee of access to justice versus the abuse of the right to litigate and concluded that by balancing two such standards, the constitutional right to go to court would not be jeopardised by the summary dismissal of a claim of which the object is illicit or illegitimate.

After this procedural introduction, he dived into the heart of the case, by stating that the D&O coverage exists to protect D&Os from damages arising unintentionally from the legitimate exercise of management acts. However, such coverage could not be extended to reach illicit acts, intentionally performed to obtain unlawful benefits, which often have nothing to do with the administration of the company, but aim to gain a personal advantage, particularly when such acts are qualified as crimes by the law.

The exclusion of coverage for criminal acts, although unnecessary as the law prevents coverage in these situations (article 762 of the Brazilian Civil Code states that "the contract to guarantee risk arising from the wilful act of the insured, the beneficiary, or the representative of one or the other shall be null and void"), was expressly provided for in clause 12 of the policy.

According to the judge, Galpar presented a brief notice of claim to the insurance company related to the action of its directors connected to 'Operation Car Wash'. The insurance company, in turn, rejected the notice of claim and coverage by means of a comprehensive letter, clarifying that the notice of claim was related to a criminal action, in which one of the directors of Galpar confessed to the payment of bribes to the officers of Brazilian state oil company Petrobras, in order to obtain illegal advantages in construction contracts.

The judge added that the director of the company who confessed to paying bribes had been already convicted for criminal action and signed a plea bargain with public prosecutors.

The indemnification of the defence costs related to such criminal action was the goal behind the request for the institution of the arbitral tribunal presented by Galpar, which was under analysis before the appeal court..

Finally, the judge made reference to the recent judgment of the Special Appeal n. 1,601,555, which denied coverage under a D&O policy to a director accused of insider trading.

After a long vote, and based on the abuse of the right to litigate, the judge stated that, more than simply refusing the request for institution of arbitration, Galpar's claim should be summarily dismissed based on the impossibility of enforcement of the D&O policy by concluding that the object of the claim – coverage for defence costs of a criminal action in which an illegal act was confessed – was illegitimate, as the D&O policy was not created to protect criminal offences and illicit acts.

In light of procedural issues, more precisely, the impossibility of a surprising decision (as the actual D&O coverage was not under discussion in the appeal), the Appeal Chamber decided just to overcome the first instance decision and reject Galpar's request of arbitration, concluding that there was no agreement on arbitration in the policy, just a chance that the parties may refer their disputes to arbitration, should both parties agree to do so.

In any case, the judgment and the winning vote of judge Ciampolini, together with some decisions handed down from other courts, sent a strong message to the market, that courts will not tolerate claims for coverage, under D&O policies, connected to corruption scandals.

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