DIRECTORS AND OFFICERS INSURANCE COVERAGE: RECENT DEVELOPMENTS IN THE UNITED STATES

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I. INTRODUCTION.

The recent worldwide financial crisis has presented new issues and challenges both for the liability of directors and officers of corporations as well as traditional Directors and Officers Liability Insurance. This paper will briefly outline the structure of the typical Directors and Officers Liability Insurance Policy as used in the United States and discuss some of the recent legal issues that have arisen under those policies, primarily following the financial crisis. For the most part, the issues are not "new" as the sole result of the financial crisis, but represent the ongoing development of policy coverage terms and exclusions as the policies are interpreted by the courts in the context of evolving issues regarding the legal liability and related coverage issues for directors and officers of publically traded companies.

II. STRUCTURE OF A TYPICAL AMERICAN DIRECTORS AND OFFICERS LIABILITY INSURANCE POLICY.

Historically, American Directors and Officers Liability Insurance Coverage ("D&O Coverage") provides insurance coverage for the directors and officers of the corporation and not the corporate entity itself. Current typical coverage forms of D&O Coverage provided three distinct types of insurance coverage. The types are referred to colloquially as Side "A" Coverage, Side "B" Coverage and Side "C" Coverage. Side "A" provides insurance coverage for the insured directors and offices; Side "B" provides coverage for the corporation for actions and damages caused by directors and officers for which the corporation is obligated to indemnify either by state or federal law, or the bylaws of the corporation; and, Side "C" provides corporate or "entity" coverage for the corporation for the actions of the directors and officers. All three "Sides" have their own insuring agreement language – that is, what actions and damages are covered; defined terms, exclusions from coverage and conditions to coverage, typically post-loss conditions.

III. AREAS OF RECENT CASE LAW DEVELOPMENT IN THE UNITED STATES.

Recent developments in case law consider issues that arise under the insuring agreement and certain exclusions from coverage. American courts have recently addressed the question of what is a covered "loss" as defined in the insuring agreement. These decisions address whether a contractual obligation is a "loss", when attorney's fees in a corporate derivative suit are "loss", and whether public policy prevents a loss from being covered, primarily because of fraud.

Generally to be covered, the director or officer must be sued for actions taken in his "insured capacity." Recent cases discuss when the insured is acting in his insured or some other capacity. Like virtually all liability insurance policies, for the insurer of directors and officers to have liability, its insureds must be "legally obligated to pay" for a loss or damages as those terms are used in the policy. Thus, absent a legal obligation of an insured to pay damages, the insurer either does not have liability or may be relieved from liability. A question that frequently arises, because of creative settlements seeking to shift all liability to the insurer, is whether the settlement not only eliminates the legal exposure of the insured, but may also eliminate any obligation of the insurer to pay. This issue has long presented hurdles and traps to settling parties in all types of insurance coverage disputes and recent cases have addressed that issue in the context of D&O Coverage. Further, with the significant costs associated with Securities and Exchange Commission ("SEC") investigations, recent cases have considered when costs of responding to SEC investigations are covered defense costs.

Courts have recently addressed issues with respect to when and what actions are excluded by the "Wrongful Act Exclusion," as well as the application of other exclusions. Finally, with the potential massive litigation associated with large financial losses, and insureds making claims against other insureds, recent cases discuss what types of claims are excluded from coverage by the longstanding "Insured vs. Insured Exclusion" designed to prevent coverage for claims, sometimes collusive, between covered insureds.

1. WHAT CONSTITUTES A "LOSS" UNDER INSURING AGREEMENTS.

Recent decisions have analyzed what constitutes a "loss" under insuring agreements in D&O cases. Courts have determined that (1) breaches of contractual agreements do not constitute a loss; (2) attorney fee awards in derivative actions do constitute a loss; and, (3) restitution paid as a result of fraud or other activities contrary to public policy do not constitute a loss. The following cases highlight some of the more significant cases addressing these issues.

a. Breach of a Contractual Obligation is not a Loss

Courts have recently addressed the issue of whether a breach of a contractual obligation constitutes a loss under an insuring agreement. In *Sauter v. Houston Casualty Co.*, 168 Wn App 348, 276 P3d 358, *as amended* 2012 Wash. App LEXIS 1135 (2012), the Washington Court of Appeals held that amounts paid in satisfaction of a contractual obligation did not constitute "Loss" as defined by the D&O policy. In addressing this issue, the court analyzed the insuring agreement requirement that the Loss resulted from a claim for a wrongful act, and concluded that there was no coverage for the CEO's guaranty obligation.

The *Sauter* court cited *August Entertainment, Inc. v. Philadelphia Indem. Ins. Co.*, 146 Cal App 4th 565, 52 Cal Rptr 3d 908 (2007) with approval. In *August*

Entertainment, the court reasoned that a breach of a contractual obligation cannot give rise to a "Loss" because the breach of contract is not a "Wrongful Act" and simply requires the corporation to pay an amount it was contractually obligated to pay. *Id*. at 568-69. The court added that, had it found that the breach constituted a covered loss within the meaning of the policy, it "would create a moral hazard problem, encouraging corporations to risk a breach of their contractual obligations, knowing that, in the event of a breach, the D&O insurer would ultimately be responsible for paying the debt." *Id*. at 582.

In *Am. Cas. Co. of Reading, Pa. v. Hotel & Rest. Emps. & Bartenders Int'l Union Welfare Fund*, 942 P2d 172 (1997), the Nevada Supreme Court held that an insurance policy did not provide coverage for liability arising from a contractual obligation under a merger agreement because the liability did not constitute a loss resulting from any "Wrongful Act." There, the International Welfare Fund ("International Fund") entered into a merger agreement with the Southern Nevada Local Welfare Fund ("Local Fund"), wherein the International Fund agreed to indemnify the Local Fund for certain losses and damages. The International Fund ultimately breached the agreement and, after settling with the Local Fund, sued American Casualty for indemnification of its settlement costs. Applying the same analysis as *August Entertainment*, the Court determined that the judgment against the International Fund was not a loss resulting from any wrongful act of the insured, and held that the policy did not provide coverage. *Id*. at 176-177. *See Waste Corp. of Am., Inc. v. Genesis Ins. Co.,* 382 F Supp 2d 1349 (S.D. Fl 2005) (contractual obligations not covered by policy).

Most recently, in *Screen Actors Guild, Inc. v. Fed. Ins. Co.*, 2013 U.S. Dist. LEXIS 100638 (C.D. Cal, July 11, 2013), Federal Insurance Company ("Federal") issued a policy to the Screen Actors Guild ("SAG") providing coverage for losses, including losses resulting from wrongful acts. The policy defined "Loss" as "the amount that any Insured becomes legally obligated to pay on account of any covered Claim, including but not limited to…settlements; [and]…Defense Costs". *Id*. at 3. In 2007, an actor filed a class action against SAG alleging claims of conversion and unjust enrichment, among others. In September 2010, SAG entered into a settlement agreement to resolve the action against it and tendered the settlement judgment to Federal, requesting reimbursement. Federal argued, in part, that there was no coverage for a claim seeking unpaid benefits that the insured had contractually agreed to pay. The court noted that a "claim alleging breach of contract is not covered under a professional liability policy because there is no 'Wrongful Act' and no 'Loss' since the insured is simply being required to pay an amount it agreed to pay". *Id*. at 15-16. The court further reasoned that "if a contracting party fails to pay amounts due under a lawful contract and is sued for that failure to pay, it cannot then obtain a windfall by having its payments covered by an insurance policy covering only 'wrongful acts'." *Id.* at 16. The court concluded there was no coverage for the claim.

b. Attorney Fees Constitute a Loss in Derivative Actions

In *XL Specialty Ins. Co., et al., v. Loral Space & Comm., Inc.*, 82 A.D. 3d 108, 918 N.Y.S. 2d 57 (2011), the New York Appellate Division held that attorney fee awards constitute a "Loss" resulting from a securities claim for a "Company Wrongful Act." There, the policy's definition of "Loss" covered "other amounts" the insured became "legally obligated" to pay. Because the insured was legally obligated to pay an attorney fee award out of its own pocket, the situation fit squarely within the broad definition of "Loss". *Id.* at 113. S*ee Safeway Stores, Inc. v. National Union Fire Ins. Co. of Pittsburgh, Pa.*, 64 F3d 1282, 1287 (9th Cir 1995) (holding that plaintiff's attorneys' fees constituted an "actual out-of-pocket loss" under the insurance policy because "[t]he lawyers got the money, not the shareholders").

c. Payments For Fraud and Other Acts Against Public Policy Do Not Constitute Losses

In *Ryerson Inc. v. Fed. Ins. Co.*, 676 F3d 610 (7th Cir 2012), the court determined that a covered "loss" did not include restitution paid by an insured as a result of the insured's fraudulent conduct. In that case, the insured paid millions of dollars to settle fraud claims against it and sought reimbursement from its insurance company for the money paid out. The court held that, "[i]f Ryerson can obtain reimbursement of that amount from the insurance company, it will have gotten away with fraud." *Id*. at 612. It added, "If disgorging such proceeds is included within the policy's definition of 'loss,' thieves could buy insurance against having to return money they stole. No one writes such insurance." *Id*. at 612-13.

Other courts have likewise refused to apply the definition of "Loss" to entitle an insured to obtain coverage for ill-gotten gains. In *OneBeacon Am. Ins. Co. v. City of Granite City*, 2013 U.S. Dist LEXIS 19475 (S.D. Ill, Feb 13, 2013), the insurer sought summary judgment in a declaratory judgment action on the grounds that the policy insured defendants against damages, and not against restoration of money wrongfully obtained. The Seventh Circuit, citing *Ryerson*, held that restitution of money wrongfully taken does not constitute damages within the meaning of an insurance policy. *Id*. at 8. *See In re TransTexas Gas Corp.*, 597 F3d 298, 308-11 (5th Cir 2010) (payments for fraudulent transfers did not constitute "loss" under policy).

2. ACTING IN AN INSURED CAPACITY

D&O policies only provide coverage for the acts or omissions of directors or officers performed in their capacity as directors and officers. In analyzing whether a particular individual is acting in an insured capacity, the specific policy language must be reviewed, including the definitions of "Named Insured", "Insured Person", and "Wrongful Acts". Further, liability and coverage issues are inextricably linked to, and depend on, the corporate and tort law of the jurisdiction involved, and the unique duties of corporate directors and officers. In resolving coverage issues, courts attempt to distinguish between acts performed in an official capacity from acts performed in a personal capacity.

In *Sauter v. Houston Casualty Co.,* 168 Wn App 348, 276 P3d 358, *as amended* 2012 Wash App LEXIS 1135 (2012), the court addressed the distinction between acts performed in an official capacity from acts performed in a personal capacity. The court held that a "guaranty executed by a corporate officer that secures the indebtedness of the corporation is not executed in the officer's official capacity. Such a circumstance would result in the corporation itself guaranteeing its own indebtedness, thus negating the very purpose of the guaranty." *Id.* at 349. The insured argued that he was acting in his capacity as an officer when he executed the guaranty, and thus, his conduct met the capacity requirement of a "Wrongful Act" pursuant to the policy. Pursuant to the policy, an act by an "Insured Person" constitutes a "Wrongful Act" only when that person commits the act "while acting in his or her capacity as … such on behalf of the Insured Organization". The court examined the transaction at issue and noted that the individual CEO executed the guaranty in his personal capacity, provided personally owned properties to secure the guaranty, and perhaps most significantly, a corporation cannot be the guarantor of its own debts. Because the CEO was acting in his personal capacity when he signed the guaranty, the CEO committed no "Wrongful Act" as defined by the D&O policy and thus, the policy did not provide coverage for his financial obligation to the bank. *Id.* at 363. *See August Entertainment, Inc. v. Philadelphia Indem Ins. Co.*, 146 Cal App 4th 565, 582, 52 Cal Rptr 3d 908 (2007) (individual acting in his capacity as an officer, cannot be held liable for breach of a corporate contract. If the individual was acting in his individual capacity in breaching the contract, the D&O insurance did not cover any of his acts or omissions).

In contrast, in *Goerner v. Axis Reinsurance Co.*, 2010 US App LEXIS 21624 (9th Cir. October 20, 2010), the court held that there was a duty to defend a CEO under the D&O policy at issue. In *Goerner*, the complaint did not specifically allege that the individual had acted in his capacity as the CEO of the corporation. Rather, the complaint simply asserted that the individual acted on behalf of two other companies in the same industry. The court construed the defense obligation in a broad manner and held that the insured would reasonably expect coverage for actions taken in the capacity of director or officer of an insured company, whether or not that capacity was alleged by the third-party plaintiff. The court determined that the individual CEO had created a factual issue regarding capacity by showing that the insured entity had business dealings, or potential dealings, with all the individuals and companies at issue in the underlying complaint, and therefore, there was a duty to defend. *Id.* at 4.

3. LEGAL OBLIGATION TO PAY

The typical D&O policy requires the insurer to pay for "Loss" or damage that the insured becomes legally obligated to pay as the result of a covered claim. Further, the policy may exclude an insurer's indemnity obligation because a director or officer is absolved from liability by reason of a settlement agreement, covenant, or court order. Insureds frequently attempt to assign any claims regarding their policies to the plaintiff and avoid personal liability. Some courts construing such agreements have determined that an insurer is not required to indemnify an insured because the insured is not "legally obligated to pay" damages. It is critical to review the individual law of the

jurisdiction at issue addressing direct actions against insurers and the assignment of insurance claims.

In *Jones v. Golden Eagle Ins. Corp.*, 201 Cal App 4th, 139, 133 Cal Rptr 3d 874 (Cal Ct App 2011), a personal injury plaintiff was assigned the right to pursue a judgment against the company's insurer pursuant to a reorganization plan. As part of the assignment, the plaintiff could not enforce the judgment against the insured itself. In denying the recovery of any insurance proceeds, the court held that the plaintiff's lawsuits presented no "potential for indemnity" under the policies because there was no possibility that the insured would suffer a "loss" requiring reimbursement from its insurers.

Similarly, in *United States National Ass'n v. Federal Ins. Co.*, 664 F3d 693 (8th Circ. 2011), the trustee for creditors sought to collect against several director and officer insurance policies that named an insured who caused the corporation to lose money and file for bankruptcy. The corporation assigned its claims against the officers to the trust. The creditors agreed to seek satisfaction of any judgment against the officer only from the insurance policies, and not from the insured's personal assets. The court held that, because the assignment agreement which transferred to the trust the limited right to sue the officer for insurance proceeds *absolved the officer from payment*, the judgment that was obtained was not a "Loss" as required by the plain language of the policy. *Id*. at 700.

Conversely, in *Hrobuchak v. Fed. Ins. Co.*, 2013 U.S. Dist. LEXIS 74160 (M.D. PA, May 24, 2013), the court addressed a bankruptcy court judgment that provided that the creditors "may immediately proceed to enforce the Judgment against the Debtors insurance policy pursuant to, and as limited by, the First Amended Plan of Liquidation". The insurer argued that it had no duty to indemnify under the policy, because the liquidation plan absolved the insured from having to pay the judgment and, as such, there was no "Loss" under the policy. The court, after noting that the plaintiff had standing to bring the action under Pennsylvania's direct action statute, determined that the agreement was not designed to absolve the insured of liability, financial or otherwise, from the underlying conduct. Citing Pennsylvania law, the court interpreted the agreement to not release liability, but to allow the recovery of an agreed debt from a specific asset. As such, the court held that coverage was not barred by the "absolved from payment" provision of the policy. *Id.* at 33.

Other courts have also determined that a "Loss" has in fact occurred even if the insureds personal assets are not at risk *See Pengill Masonry, Inc. v. Aspen Ins. UK Ltd*, 674 F Supp 2d 1150, 1158 (E.D. Cal 2009) (court recognized that "a covenant not to execute is not the same as release as it may have adverse effects for the insured, including impairment of future credit."); *Pruyn v. Agric. Ins. Co*., 36 Cal App 4th 500 (1995) (rejecting insurers argument that it was absolved of the responsibility because the insured "no longer has a legal obligation in view of the covenant."); *National Union Fire Ins. Co. of Pittsburgh, Pa. v. Puget Plastics Corp.*, 649 F Supp 2d 613, 625 (S.D. Tex 2009) (*aff'd* 454 F App'x, 291 5th Cir. 2011) (where a judgment resulted from the

settlement between an insured in and an underlying claimant, the claimant may pursue a claim against the insurer despite a covenant not to execute the judgment against the insured).

To circumvent these issues, states have enacted legislation providing for the assignment of claims by insureds against their insurers. These statutes must be carefully reviewed to determine that the provisions of the statute have been strictly adhered to in drafting any stipulated judgment and assignment. For example, under Oregon law an insured may assign a claim against an insurer pursuant to ORS 31.285 as follows:

> **Assignment of cause of action against insurer**. A defendant in a tort action against whom a judgment has been rendered may assign any cause of action that defendant has against the defendant's insurer as a result of the judgment to the plaintiff in whose favor the judgment has been entered. That assignment and any release or covenant given for the assignment shall not extinguish the cause of action against the insurer unless the assignment specifically so provides.

ORS 31.825 provides that a defendant in a tort action may assign any cause that the defendant has against its insurer to the plaintiff "in whose favor the judgment has been entered." In *Brownstone Homes Condo Ass'n v. Brownstone Forest Heights, LLC*, 255 Or App 390, 298 P3d 1228 (2013), *rev. allowed*, 2013 Ore. LEXIS 557 (July 26, 2013), the Oregon appellate court addressed whether an assignee could garnish the proceeds of an insurance policy issued to an insured whom had assigned claims pursuant to ORS 31.825. The court specifically analyzed the timing element of the statute and concluded that the statute preserves assigned rights against an insurer that "result from a judgment" that "has been entered" prior to the assignment. *Id*. at 398. In analyzing the propriety of the garnishment proceeding, the court stated that a garnishment gives the judgment creditor plaintiff no greater rights against the garnishee than the judgment debtor defendant has. Since the assignment in the settlement agreement predated the stipulated judgment and because the judgment had not "been entered" at the time of the assignment, the insurer was not obligated to pay pursuant to ORS 31.825. *Id*. at 400. Therefore, the assignment, without the entry of a judgment against the insured, did not give the assignee rights to proceed against the insured's insurance policy.

4. AVAILABILITY OF INSURANCE COVERAGE FOR SEC OR OTHER INVESTIGATION COSTS.

The question of whether coverage is available for costs associated with certain governmental investigations turns on the specific policy language and the nature of the costs incurred. Where a policy broadly defines a claim, to include a formal investigation, costs incurred in responding to a subpoena or inquiry are clearly covered. On the other hand, if the policy clearly requires a formal complaint or claim, the policy simply does not extend coverage to investigation costs. The most liberal case

discussed below is the *Gateway* case from California, finding coverage perhaps only because the court concluded that it was reasonable for the insured to expect coverage for investigation costs even where no actual claim was made.

In *Gateway, Inc. v. Gulf Ins. Co*., 2011 U.S. Dist. LEXIS 91063 (S.D. Cal. August 15, 2011) the SEC made securities claims against the company, certain individual directors and officers, and investigated, but did not make claims against other directors and officers. The insurer conceded that the costs associated with the entity and the directors and officers against whom the SEC made a claim were covered costs. The question was whether the costs of responding on behalf of only the investigated directors and officers were covered.

The insured claimed Side "B" coverage for the costs of the employees who were only investigated by the SEC. The corporate insured contended that it was obligated to indemnify the employees for the investigation expenses and that a subpoena constituted a "claim." The policy defined "claim" as a formal demand for damages or "formal investigatory proceeding before the Securities and Exchange System." The insurer argued that no formal claim had been made against the employees and thus it was not obligated to reimburse the insured entity for expenses it was obligated to indemnify. The court found an ambiguity in the definition of claim – whether formal included a subpoena investigation procedure – and that coverage for such subpoena response costs was within the "objectively reasonable expectations of the insured." The insurer was ordered to pay the attorney's fees incurred in responding to the subpoena.

In *Office Depot, Inc. v. National Union Fire Ins. Co.,* 453 Fed Appx 871, U.S. Dist. LEXIS 20759 (11th Cir. October 13, 2011), the Eleventh Circuit Court of Appeals reached a different and more coverage restrictive result than the US District Court in California reached in *Gateway*. In July 2007, the SEC sent Office Depot a letter "advising it that the Commission would begin conducting an inquiry into Office Depot to determine whether Office Depot had violated securities laws." In January 2008, the SEC issued a formal order of investigation and in December 2009, the SEC filed a formal complaint and the parties announced a settlement. The question was which, if any, attorney's fees from the 2007 letter to the formal investigation and later complaint and settlement were covered.

The Office Depot policy defined a "claim" as "a civil, criminal … proceeding … is commenced" by a complaint, an indictment or other notice of formal charges. The policy covered the insured investigation expenses after such a claim had been made. The court restricted available investigation response costs concluding: that the policy "does not cover the costs incurred between the filing of the initial notice of circumstances and the time a Claim is made against an Insured. Nothing in the language of [the policy] indicates that it extends coverage to defense costs incurred after a notice is filed but before a claim actually exists." *Id.* at 16.

In *MBIA, Inc. v. Fed. Ins. Co*., 652 F 3d 152 (2nd Cir 2011), the coverage grant was much broader and the court found coverage for extensive investigation costs after

issuance of only a subpoena. The Insuring Agreement covered "Securities Claims" including "a formal or informal administrative or regulatory proceeding or inquiry commenced by the filing of a notice of charges, formal or informal investigative order or similar document." The policy also covered defense costs "incurred in defending or investigating Securities Claims." Since the definition of claim included an informal inquiry, the court had no difficulty finding coverage for the insured's costs in responding to a subpoena.

Other courts in areas of regulation outside of the SEC have reached similar results. For example, in *Employers' Fire Ins. Co. v. Pro-Medica Health Systems Inc.*, U.S. Dist. LEXIS 150225 (N.D. Ohio December 31, 2011), the policy defined a claim to include "a written demand for monetary, non-monetary or injunctive relief" and covered investigation expenses. The court concluded that because a claim had been made, but not reported to the insurer before the policy inception, the investigation expenses associated with an anti-trust investigation, were not covered.

5. WRONGFUL ACT EXCLUSION

The "wrongful act exclusion" bars coverage for losses arising from any wrongful act or acts of the insured. Although many insurance policies contain wrongful act exclusions, the enforceability of such exclusions is questionable, and courts will often refuse to enforce the exclusions due to ambiguity. Even if the exclusion is deemed to be unambiguous, an insurer often must defend the insured until it is determined that the insured is liable for a wrongful act falling within the exclusion.

In *Pendergest-Holt v. Certain Underwriters at Lloyd's of London*, 600 F3d 562 (5th Cir 2010), the court analyzed a Money Laundering exclusion which barred coverage for losses (including defense costs) arising "directly or indirectly as a result of or in connection with any act or acts (or alleged act or acts) of Money Laundering." The policy addressed the applicability of the exclusion as follows:

> Notwithstanding the foregoing Exclusion, Underwriters shall pay Costs, Charges and Expenses in the event of an alleged act or alleged acts *until such time that it is determined that the alleged act or alleged acts did in fact occur*. In such event the Directors and Officers and the Company will reimburse Underwriters for such Costs, Charges and Expenses paid on their behalf. *Id.* at 567 *(emphasis added)*.

Underwriters sent a letter advising the executives that they would no longer provide coverage under the D&O policy because Underwriters had determined, based on evidence available to them at that point, that money laundering had occurred. *Id*. at 567-68. The court analyzed the term "in fact" and determined that the term was ambiguous; therefore, absent language pointing to Underwriters as decision makers, a determination of the facts required a judicial act. *Id*. at 573-74. The court reasoned that because the executives had not been found liable of money laundering in a separate

proceeding, Underwriters were required to continue paying all costs, charges and expenses, as required by the policy. *Id*. at 574.

Similarly, in *Wintermute v. Kan. Bankers Sur. Co.*, 630 F3d 1063 (8th Cir 2011), the court also analyzed the term "in fact," and concluded that an insurer could not deny a defense based solely on the allegations in the complaint, unless the facts were uncontested. *Id*. at 1072. Because factual issues existed regarding whether the insured had received a personal gain to which she was not entitled (a "Wrongful Act"), the court remanded the case to the district court for further proceedings. *Id*. at 1073. S*ee Homebank of Ark. v. Kan. Bankers Sur. Co.*, 2008 US Dist. LEXIS 51767, 3-4 (E.D. Ark, July 7, 2008) (insurer had a duty to defend a bank president against fraud claims because there was "a possibility, however remote, that the to-be-established facts will show that the personal profit and dishonesty exclusions do not apply").

In *Am. Home Assur. Co. v. Pope*, 591 F3d 992 (8th Cir 2010), the district court had determined that the insured's conduct was knowingly wrongful within the language of the insurance policy. The Eighth Circuit Court of Appeals held that the policy exclusion was ambiguous and reversed the decision of the lower court. The policy provision at issue excluded coverage for "any wrongful act committed with knowledge that it was a wrongful act." The policy defined a "Wrongful Act" as "any actual or alleged negligent act, error, or omission, or any actual or alleged defamation." American Home alleged that because the insured knew he had a duty to report a situation and failed to do so, he committed a knowingly wrongful act. *Id*. at 1000. A jury, however, determined that the insured's conduct was negligent, and thus, the court held that the exclusion did not apply. *Id.*

6. INSURED VERSUS INSURED EXCLUSION

D&O policies often contain exclusions for claims brought by one insured against another insured. Unlike the Wrongful Acts Exclusion discussed above, courts are often willing to uphold insured versus insured exclusions because allowing such claims would arguably transform liability insurance into "business-loss insurance" because "the company would be able to collect from the insurance company for its own mistakes." *Biltmore Assocs., LLC v. Twin City Fire Ins. Co.*, 572 F3d 663, 669 (9th Cir 2009); *see Township of Center v. First Mercury Syndicate, Inc.*, 117 F3d 115, 119 (3rd Cir 1997) (insured versus insured exclusions arose to "prevent collusive suits in which an insured company might seek to force its insurer to pay for the poor business decisions of its officers or managers").

In *Miller v. St. Paul Mercury Ins. Co.*, 683 F3d 871, 872 (7th Cir 2012), the court noted that the exclusion only applies to those plaintiffs who are insureds. There, the insured defendants were sued by a group of plaintiffs, some were insureds and some not insureds. The court held that St. Paul had no duty to defend or indemnify the claims brought by the three insured plaintiffs, but had to defend and indemnify the claims brought by the two non-insured plaintiffs. *Id*. at 873.

Determining whether a plaintiff is an insured or not is not always an easy task. In *Wojtunik v. Kealy*, 2011 US Dist LEXIS 36229 (U.S. Dist. Ariz, March 31, 2011), the insured versus insured exclusion stated, in relevant part:

> The insurer shall not be liable to make any payment for Loss in connection with a Claim made against any Insured:
>
> * * *
>
> F. ….by any of the Directors and Officers…

The policy also defined Directors and Officers as those being "duly elected or appointed." Because the plaintiff was only designated as president in an employment agreement and not "duly elected or appointed" as defined by the policy, plaintiff did not meet the definition of an insured, and the court held that the exclusion was inapplicable. *Id*. at 16.

In *Macey v. Carolina Cas. Ins. Co.*, 674 F3d 125 (2nd Cir 2010) the court also addressed the "duly elected or appointed" language. In *Macey*, the plaintiff shareholders lost all ownership interest in a company after a merger. After the shareholders filed a lawsuit alleging breach of fiduciary duty surrounding the merger, the insurer denied coverage, citing the insured versus insured exclusion. The court held that because the policy did not indicate when the shareholders ceased to be duly elected or appointed directors or officers, the policy was ambiguous and could be "understood in more than one way." *Id*. at 130. As a result of the ambiguity, the policy was construed against the insurer and determined to provide coverage.

IV. CONCLUSION

The recent financial crisis has presented American Courts with the opportunity to further develop insurance coverage concepts in the area of Directors and Officers Liability Insurance. While few broad conclusions can be drawn, given the application of the law of many different jurisdictions, the exposures are increasing and insurers should evolve coverage language to anticipate the increasing exposures of Directors and Officers of corporations.