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NEWSLETTER

I v. I Exclusion Bars Coverage Where Security Holder Assisted by an Insured

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The United States District Court for the District of Massachusetts, applying Massachusetts law, has held that the insured vs. insured exclusion in a D&O policy precludes coverage for a lawsuit brought by a former security holder of the insured company with the assistance of a director of the company where the security holder owned stock and warrants at the time the operative claim was first made. *Strange v. Genesis Ins. Co.*, 2008 WL 583815 (D. Mass. Mar. 3, 2008). Wiley Rein LLP represented the insurer.

The plaintiff in this coverage litigation was a former officer of a defunct company. A second company (the "Investor") that had acquired stock and warrants of the defunct company filed suit against the former officer, alleging breach of fiduciary duty and misconduct on the part of the former officer. A member of the company's board who was appointed by the Investor (the "Board Member") gave deposition testimony, signed interrogatory responses and consulted with the Investor's counsel in connection with the underlying lawsuit. After the insurer denied coverage based on the I v. I exclusion in the policy, the former officer ultimately settled the underlying litigation. He then sued the insurer seeking coverage for his costs of defense and settlement.

The policy's I v. I exclusion precluded coverage for any claim against an insured brought by "any security holder of the COMPANY, whether directly or derivatively, unless such claim is instigated and continued totally independent of, and totally without the solicitation of, or assistance of, or active participation of, or intervention of, any DIRECTOR or OFFICER." The plaintiff contended that the I v. I exclusion did not bar coverage for his claim because (1) the policy's definition of "security holder" encompassed only holders of secured interests, such as notes, not holders of stock or warrants; (2) the Investor was no longer a security holder at the time the lawsuit was filed because the company had been liquidated in bankruptcy, and (3) the Board Member's role in the underlying litigation did not rise to the degree of assistance or participation required to invoke the exclusion.

The court ruled in the insurer's favor on all three points. First, the court held that the policy's definition of "security holder" unambiguously included holders of securities of all kinds, including stock, notes and warrants. The court stated that the officer's "narrow reading is undermined by, among other things," the fact that the term "security holder" was followed immediately by the words "whether directly or derivatively," which clearly

indicated that the exclusion contemplated actions brought by shareholders of the company. According to the court, "[i]n order for the 'derivative' term to have meaning and effect, a 'security holder' cannot merely be the holder of a security interest in the company's assets. Rather, the term 'security holder' must, at the very least, also include stockholders."

The court then concluded that the Investor was a security holder in the company at the relevant time, which was when the claim was first made. The policy had expired by the time the underlying litigation was filed, but the officer sought coverage on the grounds that the claim related back to an adversary proceeding that was reported to the insurer during the policy period. The officer argued that "properly read, the [I v. I] exclusion does not apply unless the security holder maintains its status as a security holder at all times relevant to the claim, including throughout the pendency of the underlying litigation." The court rejected the officer's interpretation because it would give him "the benefit of coverage of an otherwise untimely claim, by predicating coverage on its relation to a timely claim, without acknowledging that the timely claim was limited by the exclusion. It cannot reasonably be supposed that the Policy should be read to mean that if [the officer] had made a claim within the policy period, coverage would have been precluded, but having made a claim after the policy period, he would have coverage."

Finally, the court concluded that the underlying litigation was not continued "totally without the solicitation of, or assistance of, or active participation of" the Board Member. The court noted that the Board Member testified as a corporate designee for the Investor in the underlying litigation, participated in the preparation of and signed interrogatory responses on behalf of the Investor, discussed case strategy with the Investor's attorneys, and testified that he had the second-greatest level of interaction (after the general counsel) with the Investor's lawyers regarding the underlying litigation. The court found that these facts left "no question" that "the full force and effect of the [I v. I] exclusion applies."