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NEWSLETTER

Court Refuses to Apply I v. I Exclusion Where Officers Who Provided Information to Plaintiffs Did Not Do So to Obtain an "Economic Benefit"

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The United States District Court for the Northern District of California, applying California law, has held that a D&O insurer could not deny coverage based on the I v. I exclusion even though two officers of the company had provided information to the underlying plaintiffs because the officers had not sought to obtain an "economic benefit" by providing the information. *Harris, et al. v. Gulf Ins. Co.*, 2003 WL 23110387 (N.D. Cal. Dec. 15, 2003).

The insurer issued a D&O policy that provided coverage for claims made against directors and officers for "Wrongful Acts." The policy defined "Wrongful Act" as "any error, misstatement, misleading statement, act, omission, neglect, or breach of duty committed or attempted, or allegedly committed or attempted, by one or more Directors or Officers, individually or collectively, in their respective capacities as such." The policy also contained an I v. I exclusion barring coverage for actions "brought or maintained by or on behalf of...any security holder of the Insured Company whether directly or derivatively except...a Claim that is brought and maintained by security holders who are acting totally independently of, and totally without the solicitation, assistance, participation, or intervention of any Director or Officer of the Insured Company."

The company and a number of its directors and officers were named as defendants in class action securities lawsuits. After the insurer discovered from reviewing the consolidated amended complaint that two officers of the company, who were not named in the securities lawsuit, had provided information to the plaintiffs in the underlying action, it stopped advancing defense expenses based on the I v. I exclusion. Two individual defendants in the securities litigation then filed a declaratory judgment action challenging the applicability of the I v. I exclusion.

The court held that the I v. I exclusion did not apply in these circumstances. Relying on *MacKinnon v. Truck Insurance Co.*, 31 Cal. 4th 635 (2003), the court opined that "insurance coverage is interpreted broadly so as to afford the greatest possible protection to the insured, whereas exclusionary clauses are interpreted narrowly against the insurer." The court pointed to the definition of "Wrongful Act" and reasoned that "[t]his

coverage language is quite broad, establishing a reasonable expectation that the insured will be covered for making misleading statements."

The court then held that the I v. I exclusion did not "conspicuously, plainly and clearly" apprise the officers that coverage was unavailable, notwithstanding the insurer's argument that the exclusion applied since other officers had provided "assistance." In so holding, the court rejected the insurer's effort to rely on a dictionary definition of "assistance," explaining that California law disfavors resorting to a dictionary definition in lieu of relying on how the policy language at issue would be interpreted by a reasonable layperson. The court reasoned that the insurer's interpretation would lead to absurd results, such as loss of coverage if a director of the company was subpoenaed to testify in the underlying action or was duped into making a statement advantageous to the underlying plaintiffs. The court also reasoned that adopting the insurer's interpretation of the exclusion would "tread dangerously close to violating the public policy of the State of California." Specifically, the court stated that the insurer admitted at oral argument that its interpretation of the policy language could provide an incentive for policyholder companies and directors to agree to suppress evidence, which is against public policy. Finally, the court held that adopting the insurer's interpretation of the exclusion would render coverage under the policy illusory because coverage or non-coverage would turn on chance events outside of a director's or officer's control.

Ultimately, the court held that "the [I v. I] exclusion bars coverage for securities fraud claims only if a director or officer actively and voluntarily provided substantial aid or help to a securities fraud plaintiff with the intent to aid the prosecution of the lawsuit in order to obtain economic benefit." Applying this standard, the court held that, although the stipulated facts indicated that two officers of the company had provided information that allowed the consolidated amended complaint to survive a motion to dismiss, there was no evidence the officers had acted to obtain an "economic benefit".

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