

Prior Acts Exclusion Held Not Dependent on Identity of Prior Actor

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The United States District Court for the District of Nevada has held that a prior acts exclusion in a D&O policy would bar coverage for directors who committed a Wrongful Act prior to June 30, 2004, as well as those who committed a Wrongful Act after that date if their Wrongful Act related to a pre-June 30, 2004 Wrongful Act of another. *Carolina Cas. Ins. Co. v. McGhan, et al.*, No. 2:07-cv-00949 (D. Nev. Mar. 12, 2008). In so holding, the court rejected the insureds' argument that such a ruling was inconsistent with the policy's non-imputation provision.

In the underlying action, certain directors are alleged to have conspired prior to June 30, 2004 to steal the assets of a company in which the plaintiffs had a financial interest. Other directors allegedly knew or should have known about the improper diversion of funds after June 30, 2004. These latter directors argued that the insurer's denial of coverage was improper as to them because they committed no pre-June 30, 2004 Wrongful Acts and the acts of others could not be imputed to them.

The prior acts exclusion at issue barred coverage for loss in connection with a claim based upon, arising out of, or directly or indirectly resulting from: "1. any Wrongful Act which occurred on or before June 30, 2004, or 2. any Wrongful Act occurring on or subsequent to June 30, 2004, which, together with a Wrongful Act occurring prior to such date, would constitute a Related Wrongful Act." "Related Wrongful Act" was defined as a Wrongful Act that is "logically or causally connected by reason of any common fact, circumstance, situation, transaction, casualty, event or decision." The policy also included an endorsement stating that "the Wrongful Act of a Director or Officer shall not be imputed to any other Director or Officer for the purpose of determining the applicability of any Exclusion."

The court held that the prior acts exclusion could apply to bar coverage for directors who did not commit Wrongful Acts before June 30, 2004 if their Wrongful Acts were related to another Wrongful Act that occurred prior to June 30, 2004. The court noted that "the Past Acts Exclusion does not base the exclusion on who committed the Wrongful Act." Therefore, the court concluded that "so long as the particular insured seeking coverage committed any Wrongful Act that relates to 'a' Wrongful Act that occurred prior to June 30, 2004, the prior acts exclusion applies regardless of the identity of who committed the pre-June 30, 2004 Wrongful Act."

The court further held that the non-imputation endorsement was not akin to a severability clause and did not require application of the policy to each insured separately. According to the court, the non-imputation endorsement "does not alter the Past Act Exclusion's language that a Related Wrongful Act constitutes 'any' Wrongful Act related to 'a' prior Wrongful Act without limitation as to the identity of the actor who committed the pre-June 30, 2004 Wrongful Act. Such an interpretation does not run afoul of the Imputation Endorsement because each officer and director must have committed either a pre-June 2004 Wrongful Act or a post-June 30, 2004 Related Wrongful Act of his own to be excluded from coverage." The court also rejected the directors' contention that this interpretation rendered coverage illusory because the policy still afforded coverage for Wrongful Acts a director may commit from July 1, 2004 through the policy period, so long as they are not related to a pre-June 30, 2004 Wrongful Act.

The court, however, found that the policy was ambiguous as to whether the prior acts exclusion would apply to "alleged," as opposed to "actual," Wrongful Acts. As such, construing the ambiguity in favor of the directors, the court held that the prior acts exclusion applied only to "actual" and not "alleged" Wrongful Acts. The court then denied the parties' cross-motions for summary judgment "[b]ecause neither party . . . presented evidence demonstrating no genuine issue of material fact remain[ed] regarding whether Defendants in fact engaged in Wrongful Acts or Related Wrongful Acts."

In a subsequent decision, the court denied the insureds' motion to certify the prior acts exclusion issues to the Nevada Supreme Court.