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NEWSLETTER

I v. I Exclusion Does Not Apply to Suit by Individual Who Was Officer of Subsidiary Prior to Acquisition by Insured Entity

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The United State District Court for the District of Oregon, applying Oregon law, has held that an insured versus insured exclusion in a D&O policy does not bar coverage for a claim brought by a shareholder who formerly served as a director and officer of two subsidiaries prior to the subsidiaries being acquired by the insured entity. *Kollman v. Nat'l Union Ins. Co. of Pittsburgh*, 2007 WL 865679 (D. Or. Mar. 15, 2007). The court also rejected the insurer's late notice defense and its argument that the policyholder made material misrepresentations and omissions in its application.

This coverage litigation arose after a shareholder of the policyholder corporation was awarded a judgment in a breach-of-fiduciary-duty action against two officers and directors of the corporation and sued the insurer to recover under the policy issued to the corporation. The shareholder had previously served as an officer and director of two companies that became subsidiaries of the corporation in a reverse merger. After the merger, the shareholder was no longer an officer or director of either of the entities, but served as an employee and later as a consultant to the corporation.

The policy contained an I v. I exclusion that, with certain exceptions, applied to any claim:

which is brought by or on behalf of an Organization or any Insured Person, other than an Employee of an Organization; or which is brought by any security holder or member of an Organization, whether directly or derivatively, unless such security holder's or member's 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 Executive of an Organization or any Organization.

The policy's definition of "Organization" included "each Subsidiary." The policy also contained a prior acts exclusion for subsidiaries that provided, in pertinent part, as follows:

[I]t is hereby understood and agreed that the term Subsidiary shall be amended to included [sic] the entity (ies) listed below abut [sic] only for Wrongful Act [sic] committed by such entity(ies) and/or any Insureds,

thereof which occurred subsequent to such entity's respective acquisition/creation date listed below or prior to the time that Named Entity no longer maintains Management Control of such entity(ies), respectively, either directly or indirectly through one or more other Subsidiaries. . . .

The insurer argued that the shareholder was an insured under the policy because he had been an officer and director of the subsidiaries and was an employee and later a consultant to the corporation, and, therefore, the I v. I exclusion barred coverage. The court found that the shareholder was not an officer or director for purposes of the exclusion because he had only been a director and officer of the subsidiary prior to the "acquisition/creation date" in the policy.

The court held that the I v. I exclusion did not apply to the shareholder as a consultant since the policy did not define "insured" to include consultants. The court also noted that, even if it did, the shareholder was not a consultant during the policy period. Although the shareholder was an employee, the court held that the exclusion did not preclude the shareholder's claim because the exclusion contained a carve-out for claims brought by employees.

The court also rejected the argument that coverage for the claim was barred because the plaintiff was a shareholder. The court pointed out that the exclusion contained a carve-out for shareholder claims instigated without the participation of the corporation or an executive, and that the shareholder did not collude with the corporation or an executive in bringing the claim.

The insurer also argued that notice of the claim was untimely because of letters that the shareholder had sent to the directors and officers two years before filing suit, in which he expressed certain grievances. The policy defined "claim" to include "a written demand for monetary, non-monetary or injunctive relief."

For purposes of the summary judgment motion, the court assumed that the letters were nonmonetary claims. However, the court noted that while the lawsuit centered on a purported breach of fiduciary duty in connection with an investment, those allegations were not at issue in the letters. It therefore concluded that the insured corporation provided timely notice by promptly tendering the suit.

The insurer also asserted that the corporation had made material misrepresentations in its original application. When the corporation submitted the application, it stated that it was not aware of any "claims, or acts, errors or omissions that might give rise to a claim." This was a material misrepresentation, the insurer argued, because the shareholder had already sent one of the letters at the time of the application. However, the court held that the letters were not material given information that the insurer already had from other sources regarding the hostility between the shareholder and the principals of the corporation.

The court also rejected the insurer's defense regarding the renewal of the policy. Almost two months before the shareholder filed the fiduciary duty lawsuit, the insurer issued the policy but reserved its right to review and approve certain outstanding additional information from the corporation. The shareholder filed the

fiduciary suit, and the corporation submitted the additional information shortly thereafter, but the corporation did not disclose the existence of the lawsuit until an additional few weeks had elapsed. The insurer argued that it would not have issued the renewal policy had it known of the lawsuit. However, the court held that the insurer could not have relied upon the corporation's non-disclosure because the insurer had issued the policy almost two months before the lawsuit was served on the company.