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NEWSLETTER

Insured v. Insured Exclusion Applies to Claim Brought by Spouse of Executive

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The United States Court of Appeals for the Eighth Circuit, applying Minnesota law, has determined that a D&O policy's insured versus insured exclusion applied to a claim brought by the spouse of an insured executive against the insured company. *Westchester Fire Ins. Co. v. Wallerich*, 2009 WL 1098684 (8th Cir. April 15, 2009). The court also concluded that, although there was no duty to defend such a lawsuit, the insurer was not entitled to reimbursement for previously advanced defense costs under Minnesota law.

The underlying suit was initiated against the insured company by its Chief Manager and his wife, alleging that the company breached various fiduciary duties. After initially denying coverage, the carrier subsequently agreed to advance defense costs, but also initiated a declaratory judgment action seeking to establish that coverage was barred by the policy's insured versus insured exclusion. It also sought recovery of all defense costs previously advanced. The United States District Court for the District of Minnesota determined that the carrier had no duty to defend the lawsuit because it was brought by an insured individual against the insured company; therefore, the policy's insured v. insured exception applied. However, in doing so, the court determined that, while the Chief Manager was an insured under the policy, his wife was not. It also determined that the insurer was not entitled to recover the defense expenses previously advanced and that the insured was entitled to recover coverage fees it incurred prior to the carrier's agreement to defend the action. Both parties appealed.

The Eighth Circuit first noted that the D&O coverage part of the policy defined "Insured" to include only "the Company and the Directors and Officers." It also noted, however, the policy's General Terms and Conditions section provided that spouses of insured individuals "shall be considered Insureds under this policy . . . ." The court then concluded that the "plain language, common sense interpretation" of the policy necessarily required that the D&O coverage part's definition of "Insured" incorporate the General Terms and Conditions proviso regarding spouses, and thus that the spouse should be treated as an "Insured" under the D&O coverage part. Accordingly, it reversed the lower court's ruling that the exclusion would not apply to a claim brought solely by the spouse.

The court then considered whether the carrier could recover the defense costs it had advanced prior to the district court's coverage determination. Observing that courts are split nationally on whether an insurer may

be reimbursed for defending a claim that is ultimately determined not to be covered, the court decided that no right to reimbursement existed in this situation under Minnesota law. In doing so, it first stated that the insured had rejected the carrier's reservation of rights and that the carrier had nonetheless opted to provide a defense, thus "impliedly agreeing to proceed on the Insureds' terms." It also noted that the policy did not contain an "express provision for such reimbursement."

Finally, the court considered the lower court's award of attorneys' fees to the insureds in connection with their efforts to obtain coverage prior to the insurer's acceptance of the defense in the underlying action. The district court had awarded such fees *sua sponte*, but the insurer contended that, absent a duty to defend, such an award was improper under Minnesota law. Because the court had concluded that the insured v. insured exclusion barred coverage with respect to the insured and his spouse, the court concluded that the insurer never had a duty to defend the underlying action and that the insureds accordingly were not entitled to the award of attorneys' fees.