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NEWSLETTER

Alleged Misconduct in Personal Capacity Not Covered Wrongful Act Under Nonprofit Policy

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The United States District Court for the District of Minnesota, applying Minnesota law, has granted an insurer's motion to dismiss a coverage action because wrongful conduct alleged in the underlying lawsuit did not arise solely out of the discharge of the insured's duties on behalf of the policyholder entity. *Carlson v. Twin City Fire Ins. Co.*, 2009 WL 1793887 (D. Minn. June 23, 2009). The court therefore held that the insurer had no duty to indemnify or defend.

The insurer issued a Nonprofit Directors and Officers Liability Insurance Policy to a non-profit association established to advance the interests of dealers of postal equipment produced by a certain manufacturer. One such dealer served on a committee of the association tasked with responding to some of the manufacturer's initiatives. The manufacturer decided to establish a new committee for this purpose, which it called the Presidential Advisory Council, and which was composed of management of the manufacturer and representative dealers. The insured dealer was allegedly appointed to the Presidential Advisory Council because of his committee membership in the policyholder association and because he had represented that he would never sell his company to the manufacturer's chief competitor. While serving on the Council, the dealer allegedly negotiated an agreement to sell his company to the competitor in order to distribute their competing equipment. The manufacturer sued the dealer in connection with his participation on the Council, alleging breach of fiduciary duty, misrepresentation and use of the manufacturer's confidential information in breach of contract. The dealer notified the insurer of the litigation and sought coverage for his defense, which was denied. After the underlying litigation settled, the insured sued the insurer, seeking coverage for his defense and damages for breach of contract and breach of the duty of good faith and fair dealing.

The policy provided coverage for "any CLAIM(s) first made against the INSURED for a WRONGFUL ACT(s) which arise solely out of the discharge of an INDIVIDUAL INSURED's duties on behalf of [the association]." "INDIVIDUAL INSURED" was defined as "[a]ny past, present or future director, officer, trustee employee, volunteer or member of any duly constituted committee of [the association], but only with regard to WRONGFUL ACTS which arise solely out of the discharge of the INDIVIDUAL INSURED'S duties on behalf of [the association]." The dealer asserted that the underlying litigation was covered by the policy because he reported to the policyholder association on his activities with the Council. The court rejected the argument that, because the dealer was discharging a duty to the association by serving on the Council, he was covered for all wrongful conduct done during that service.

The court determined that the conduct alleged in the underlying action did not constitute Wrongful Acts because the dealer's wrongful conduct arose out of his own personal business dealings and not out of out of the discharge of duties on behalf of the policyholder association. The court determined further that, even if the alleged wrongful conduct arose in part out of the dealer's discharge of his duties to the association, the conduct was not covered because it did not arise *solely* out of the discharge of those duties. The court quoted the dictionary definition of "solely," defining it to mean "to the exclusion of alternate or competing things." Because the dealer acted at least in part on his own company's behalf, his conduct was not covered under the policy.

The court distinguished *McAninch v. Wintermute*, 491 F.3d 759 (8th Cir. 2007), which held that criminal conduct by a shareholder and director of a bank was covered under a D&O policy that covered Wrongful Acts done solely in her capacity as a director. The court determined that, unlike in *McAninch*, the claims here were asserted against the dealer in his individual capacity, not in his capacity as a representative of the policyholder association. In addition, in *McAninch*, the fact that the insured acted as both a director and a shareholder did not facilitate her wrongful conduct. Here, the dealer's dual capacity as a representative of the association and as the owner of his business facilitated the charged wrongdoing.

The court also determined that the insurer had no duty to defend because the pleadings could not give rise to a claim arguably within the scope of coverage. Moreover, the court dismissed the dealer's claims under the doctrine of illusory coverage and reasonable expectations, determining that there are numerous scenarios under which the policy could provide coverage and that there was no reasonable expectation of coverage given the policy's unambiguous language.