

# Insured v. Insured Exclusion Held Ambiguous Where Fact-Finding Was Necessary To Determine Correct Application of Exclusion

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The United States Court of Appeals for the Second Circuit, applying Virginia law, has held that an "insured versus insured" exclusion was ambiguous because extrinsic evidence was required to determine how the parties intended the exclusion to apply in the context of certain individuals who were directors of the insured before, but not after, the entity officially came into being through a merger. *Macey v. Carolina Cas. Ins. Co.*, 2010 WL 2595299 (2d Cir. June 30, 2010).

An insurer issued a D&O policy to a company that had been formed through a corporate merger and stock sale. As part of the merger transaction, certain prior owners and directors of the merged entity (the Legacy Shareholders) became directors of the surviving entity, but only for purposes of approving the corporate reorganization. They then resigned from the board in order to close the merger and were replaced by directors chosen by the entity that purchased the majority of the surviving entity's stock. Approximately one year later, the Legacy Shareholders sued the directors who had replaced them for taking subsequent actions that divested the Legacy Shareholders of the minority ownership interests they had retained after the merger and stock sale. Those directors sought coverage under the D&O policy.

The insurer denied coverage based on an exclusion that barred coverage for claims "by, on behalf of, or in the right of the Insured Entity, or by any Directors or Officers." The policy defined Directors and Officers to include "any past, present or future duly elected or appointed directors or officers of the Insured Entity."

In the ensuing litigation, the insureds argued that the Legacy Shareholders could not have been "duly elected or appointed" directors or officers of the surviving entity because the entity did not exist until the merger closed, by which time the Legacy Shareholders had resigned from the board. The insurer argued that the Legacy Shareholders served as directors or officers of the surviving entity long enough to pass resolutions approving the merger and therefore properly were considered former directors or officers of the surviving entity.

The court noted that the policy incorporated the application, in which the surviving entity explained the transaction by which it was formed and stated that the Legacy Shareholders were no longer participants on the board. Reading the policy and the application as a whole, the court determined that the policy was ambiguous because it was not clear whether the parties intended to encompass pre-merger directors and officers of the surviving entity within the definition of Directors and Officers. The court found that both parties' arguments regarding when the surviving entity came into existence were reasonable and that, at a minimum, "the question should have gone to a jury to determine whether [the surviving entity] existed prior to the merger or, if it did, whether it was the same entity that existed after the merger for purposes of policy coverage." The court declined to consider extrinsic evidence and remanded the action to the district court for additional fact finding.