

# Insured v. Insured Exclusion Precludes Coverage for Suit Brought by Insured in any Capacity

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The United States District Court for the District of Minnesota, applying Minnesota law, held that there was no duty to defend claims under a D&O policy brought against the insured entity and some of its directors and officers by an insured manager-director acting as a trustee and derivative claimant. *Thomas Engineering Co. v. Twin City Fire Ins. Co.*, 2010 WL 4979106 (D. Minn. Dec. 2, 2010). The court held that the insured v. insured exclusion precluded coverage for all claims by the insured director despite a carve-back for derivative suits because the policy specifically excluded claims brought by an insured "in any capacity."

The insured company was owned by two shareholders, one of whom held the majority interest while the other, a trust, held the remaining 36% of the company stock. The plaintiff in the underlying suit was the trustee, grantor and sole beneficiary of the trust with complete authority to modify, amend or revoke the trust at any time. The plaintiff in his capacity as trustee and derivatively on behalf of the company brought a purported "minority shareholder and derivative action" against the company for a statutory violation, breach of duties, unjust enrichment, conspiracy, breach of contract and defamation. The policyholder tendered the defense to the insurer, which denied coverage based on the policy's insured v. insured exclusion. After settling the underlying suit, the company brought the instant action against the insurer for breach of contract. The insurer counterclaimed, seeking a declaration that there was no coverage under the policy. The parties both agreed that the underlying plaintiff also was an insured under the policy.

The policy's insured v. insured exclusion, as amended by endorsement, provided that:

The Insurer shall not pay Loss for any Claim . . . brought or maintained by or on behalf of any Insureds (in any capacity), provided that this exclusion shall not apply to any Claim . . . that is a Derivative Action or a Derivative Demand.

The policy's definition of "Derivative Action" and "Derivative Demand" limited those terms to claims "made without the assistance, participation, or solicitation of any [Insured]."

The company first argued that the trust was a shareholder and not an insured and thus the claims asserted on its behalf were not barred by the exclusion. The court found this argument flawed for two reasons. First it noted that, in at least some circumstances, "the grantor of a revocable trust is treated as the owner of the trust corpus." According to the court, this cast doubt on whether the trust could be treated as a legally distinct entity from the trustee. Second, the court held that, because the exclusion applied to "claims brought by an Insured 'in any capacity,'" the claims brought by the plaintiff on behalf of the trust were excluded even if the trust were treated as a separate legal entity, so long as the insured plaintiff brought the action on its behalf.

The policyholder argued that the derivative action was not excluded due to the derivative action carve-back contained in the exception to the exclusion. The court rejected this argument, holding that the policy language excluding coverage for any suit brought by any insured "in any capacity" included a suit brought by an insured derivatively on behalf of the company. Additionally, the court held that the plaintiff's argument failed because the derivative suits were "brought with [the plaintiff's] assistance and participation" in violation of the definition of covered Derivative Actions.

With respect to the policyholder's argument that the purpose of the insured v. insured exception is to prevent collusion and that, absent such collusion, the exclusion should not be enforced, the court held that "where such exclusions are clear and susceptible to only one fair interpretation, courts generally apply them pursuant to their plain terms."

The insured also argued that "an allocation clause in the Policy creates ambiguity" and worked to limit the exclusion's applicability. The court noted that in all cases where other courts had refused to apply or limited the exclusion for this reason, the claims were "mixed" in that at least some of the "plaintiffs were clearly non-Insureds." The court concluded that no ambiguity existed in this case and that it must "fastidiously guard against the invitation to create ambiguities where none exist."

Finally, the policyholder argued that the exclusion, as interpreted, would render coverage for derivative actions illusory because the company had no shareholders who were not also insureds. The court noted that the "illusory-coverage doctrine disfavors interpretation of insurance policies resulting in the denial of all coverage," but held that such doctrine is applicable "only when part of the premium is specifically allocated to a particular type or period of coverage." The court held that no such specific allocation had been shown and thus the illusory-coverage doctrine was inapplicable. For these reasons the court concluded that the insurer did not owe any duty to defend and had not otherwise breached the policy.