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NEWSLETTER

I v. I Exclusion Does Not Bar Coverage for Claim against CFO; Court Addresses Allocation

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A New Jersey appellate court has held that an insurer had a duty to pay defense costs incurred by the CFO of a hospital in defending a lawsuit brought by the hospital because the I v. I exclusion in the applicable D&O policy barred coverage for suits by other directors and officers, but not the hospital. *Hebela v. Healthcare Ins. Co.*, 2004 WL 1431733 (N.J. Super. Ct. App. Div. June 28, 2004). The court also provided substantial guidance on how the trial court should allocate defense costs between covered and uncovered allegations.

The insurer issued a D&O policy to an incorporated hospital. The policy provided coverage "on behalf of an 'insured person' because of any claim made against an 'insured person' for a 'wrongful act....'" "Wrongful act" was defined as "any actual or alleged error or misstatement or misleading statement or act or omission or neglect or breach of duty." "Insured person" was defined as any "past, present or future director, officer or trustee" of the hospital. The policy also contained an I v. I exclusion precluding coverage for claims "made against any director, officer, or trustee by any other director, officer or trustee whether directly or derivatively."

The former CFO of the hospital brought suit against the hospital, alleging wrongful termination. The hospital counterclaimed, alleging that the CFO was negligent in the performance of his duties. The CFO sought coverage for defense of the counterclaim from the D&O insurer, but the insurer denied coverage based on the I v. I exclusion. Ultimately, the counterclaim was dismissed on summary judgment.

The appellate court held that the policy covered the hospital's counterclaim. The court explained that the language of the policy's insuring clause "amply encompassed" the basis for the counterclaim, an allegation of negligence against the insured director. The court also found that the I v. I exclusion was inapplicable because "the policy does not exclude a claim brought against a director or officer by the corporation, as here, although it does exclude claims brought against a director or officer by another director or officer."

The court then addressed the apportionment between the covered costs incurred by the CFO in defending against the counterclaim and the uncovered costs he incurred in bringing his wrongful termination suit. Although the invoices of the CFO's attorney contained little specification supporting whether the costs related to defense of the counterclaim or prosecution of the original case, the trial court had "summarily concluded"

that the CFO was entitled to 50 percent of his attorneys' fees. The appellate court held that a more rigorous analysis was required. The court pointed to the decision of the New Jersey Supreme Court in *SL Industries, Inc., v. American Motorists Insurance Co.,* 607 A.2d 1266 (1992), in which the court addressed apportionment between covered and uncovered claims and stated "[w]e recognize that insurers, insureds, and courts will rarely be able to determine allocation of defense costs with scientific certainty. However, the lack of scientific certainty does not justify imposing all of the costs on the insurer by default. The legal system frequently resolves issues involving considerable uncertainty." The appellate court therefore remanded the allocation question back to the trial court to determine the proper allocation of fees.

In so doing, the appellate court provided some guidance as to how the trial court should allocate defense costs. The court explained that the trial court: (1) should allow for the submission of all evidence which might bear on the issue and utilize its own legal experience and understanding of the case; and (2) must consider the reasonableness of the costs incurred, lest an opportunity be provided for insureds that have been wrongfully denied a defense to generate excessive fees. However, the court rejected the insurer's argument that the defense costs were implicitly unreasonable because the CFO's counsel could have more economically and expeditiously defended the counterclaim, finding that the insurer could not, after denying a defense, complain about the manner in which a defense was provided. The court noted that the judgment of defense counsel should not be second guessed, but simply that the reasonableness of billable hours and time expended should be reviewed.

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