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NEWSLETTER

D&O Policy Affords No Coverage for Officer's Personal Contractual Obligation

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A Washington appellate court has held that a D&O policy did not provide coverage for losses incurred by an officer in his or her personal capacity and that a guaranty executed by a corporate officer that secured the corporation's debt was not executed in the officer's official capacity. *Sauter v. Houston Cas. Co.*, 2012 WL 1699447 (Wash. Ct. App. May 14, 2012). The appellate court also concluded that amounts paid in satisfaction of that contractual obligation did not constitute "Loss" as defined by the D&O policy.

An insurer issued a D&O liability policy to a corporation. The corporation received a loan from a bank, and the corporation's CEO signed the loan agreement in his official capacity on behalf of the corporation. Pursuant to a requirement in the loan agreement, the CEO also executed a guaranty of the loan, which was secured by seven deeds of trust on real property that the CEO owned jointly with his spouse. The corporation failed to repay the loan, and the bank demanded payment in full on the CEO's guaranty. The CEO in turn demanded indemnification from the corporation. Although the corporation's members agreed that the corporation should indemnify the CEO, the corporation was insolvent. The corporation then tendered the bank's demand on the guaranty to the insurer.

The D&O policy afforded coverage for Loss resulting from a Claim against Insured Persons for a Wrongful Act. The policy defined "Wrongful Act," in relevant part, as "any actual or alleged act, misstatement, error, omission, misleading statement, neglect, breach of duty or act by . . . any of the Insured Persons, while acting in their capacity as . . . such on behalf of the Insured Organization." The definition of "Loss" carved out "matters deemed uninsurable under the law pursuant to which this Policy shall be construed." The insurer denied coverage and argued that that no act by the CEO constituted a "Wrongful Act" and that the CEO suffered no "Loss." In the ensuing coverage litigation, the trial court granted summary judgment in favor of the insurer.

On appeal, the court examined the definitions of "Wrongful Act" and "Insured Person" and concluded that no coverage would be available unless the CEO's purported loss resulted from a claim made against him for an act that he committed "while acting in [his] capacity as [CEO] on behalf of" the corporation. The court then determined that the CEO was acting in his personal capacity when he executed (and later defaulted on) the guaranty, citing the facts that his signature on the guaranty did not note his position at the corporation, in contrast to his signature on the loan agreement, and that the guaranty was secured by the CEO's personal

real estate. The court also reasoned that "the very nature of the guaranty indicates that [the CEO] was acting in his personal capacity in executing the guaranty" because, as a matter of law, "an entity cannot be a guarantor of its own obligations." Accordingly, the appellate court concluded that the Claim did not allege a "Wrongful Act" by the CEO, and the policy afforded no coverage.

The insurer also argued on appeal that "the repayment of a loan does not constitute a 'Loss' and that . . . liability insurance is not intended to insure against such an obligation." The court observed that Washington courts had not previously addressed whether satisfaction of a voluntary contractual obligation constituted insurable "Loss." The court concluded that it need not look beyond the policy language, however, to decide whether the amounts sought by the CEO were covered "Loss." The court focused on the insuring agreement requirement that the Loss *result from* a Claim for a Wrongful Act. The court explained that, in this case, the CEO incurred the obligation to pay the corporation's debt by executing the guaranty and that his obligation was not the result of a Claim, or the bank's demand on the guaranty.

The court therefore affirmed summary judgment in favor of the insurer.