

Oregon District Court Interprets I v. I Exclusion Based on Collusive "Rationale" of Exclusion

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The United States District Court for the District of Oregon, applying Oregon law, has held that a D&O policy's I v. I exclusion did not bar coverage for a shareholder derivative suit even though two of the six shareholder plaintiffs were former directors and officers of the insured organization. *Megavail v. Illinois Union Ins. Co.*, 2006 WL 2045862 (D. Or. July 19, 2006).

The insurer issued a D&O policy to the insured. The policy contained an I v. I exclusion. The I v. I exclusion contained an exception for "independent, derivative shareholder actions." The policy also contained an allocation clause, requiring allocation between covered and uncovered losses.

In the underlying dispute, six shareholders of the insured organization, two of whom were former directors and officers, sued the organization and some of its current directors and officers. The insured organization tendered defense of the suit to its insurer. The insurer refused to defend the organization in the dispute, relying on the policy's I v. I exclusion to deny coverage. The policyholder subsequently filed suit against the insurer.

The court first observed that, for the I v. I exclusion to apply, the insurer had to establish that "the allegations of the complaint place the claims squarely within the language of the exclusion." The court noted a split between courts applying the I v. I exclusion, with some courts refusing to apply the exclusionary clause when the underlying action was not demonstrably collusive and other courts relying solely on the text of the exclusion. After taking into account the reasoning of the relevant case law, the court concluded that, based on Oregon law requiring strict construction of policy exclusions and recognizing a broad duty to defend, it would join the courts that "look[ed] to the nature of the underlying suit and the rationale behind the exclusionary clause to determine whether the clause is applicable." The court then concluded that there was no evidence that the underlying suit was collusive in nature and thus the rationale behind the I v. I exclusion did not apply. Therefore, the court held that the insurer had a duty to defend the underlying suit.

The court then noted that, even if the exclusion were applicable in the first instance, the exception providing coverage for independent, derivative shareholder actions would also apply since "any one of the four uninsured plaintiffs in the underlying case could have been acting independently of the others." Recognizing that Oregon law provides that an "insurer has a duty to defend if the complaint provides *any basis* for which the insurer provides coverage," the court further observed that, since four of the six plaintiffs in the underlying

suit were uninsured shareholders, the insured had a duty to defend the underlying dispute. Additionally, the court relied on *Level 3 Communications, Inc. v. Federal Insurance Co.*, 168 F.3d 956 (7th Cir. 1999), to conclude that, even if the I v. I exclusion applied, the policy's allocation clause "establishes the method for addressing claims involving both insured and uninsured plaintiffs," so coverage would still be available as a result of the uninsured parties.