

ALERT

Insured's Corporate Parent Not a Proper Party to Coverage Action

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The United States District Court for the Northern District of Illinois has held that the corporate parent of the named insured on a directors and officers liability policy was not a proper party to a coverage action initiated by the insurer where the corporate parent had not yet acquired the named insured at the time the policy was issued and the corporate parent was not an insured under the policy. *Carolina Cas. Ins. Co. v. Merge Healthcare Inc.*, 2011 WL 3921412 (N.D. Ill. Sept. 6, 2011).

The insurer filed a declaratory judgment action seeking a determination as to the availability of coverage for the named insured with respect to an award of enhanced attorneys' fees in an underlying shareholders action. The insurer's complaint named both the named insured and its corporate parent, which had acquired the named insured after the entry of the award against it. The corporate parent filed a motion to dismiss the coverage action, arguing that it was not a proper party to the coverage dispute because, while it may have had a financial interest in the outcome, it was not a party to the contract between the named insured and the insurer. The court granted the motion.

According to the court, because the corporate parent did not have a "legal interest" in the outcome, the insurer's claims for declaratory relief against it could not be sustained. In reaching this conclusion, the court rejected the corporate parent's position that the dispositive issue was whether the corporate parent was a party to the insurance contract. The court noted the possibility that an action on a contract may be maintained against a non-party where there are proper grounds to pierce the corporate veil. Here, however, the court found that the corporate parent did not have a legal interest in the action

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because it had no grounds to compel performance and recover under the policy.

The court compared the situation to one in which the corporate parent might seek to intervene as a "necessary" party. In this regard, the court noted that the corporate parent would have to demonstrate a "direct, significant, and legally protectable" interest in the outcome of the litigation and that a mere financial interest does not suffice. The court also noted that the standard for such intervention would not be met in this case because the corporate parent's interests were adequately represented by an existing party - namely, the named insured. Thus, according to the court, because the corporate parent could not have intervened in the coverage action, it could not be compelled to remain a defendant in lawsuit in which it had no protectable legal interest.