

Appeals Court Finds Even the Word “Insured” Can Be Ambiguous In a Directors and Officers Policy

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Corporate mergers and acquisitions often result in the creation of new companies, the disappearance of old companies, the transfer of stock between shareholders, and the creation of boards of directors to effectuate a transaction. These events can have significant insurance consequences if litigation ensues over the transaction. Management and company liability insurance policies and directors and officers liability insurance policies typically contain so-called “insured vs. insured” exclusions barring coverage for claims or lawsuits between “insureds” under the policies. The term “insureds” however, can have a very broad reach, particularly when it is defined to include all of the “past,” the “present,” and the “future” directors or officers of the insured company. Merger and acquisition activity can sweep a large number of individuals into this expansive definition of “insureds” and potentially eliminate coverage in later litigation over the transaction.

The Second Circuit Court of Appeals grappled with this exact problem in a decision issued June 30, 2010 in *Macey v. Carolina Casualty Insurance Company*, 2010 WL 2595299 (2d Cir. June 30, 2010). The claims in the case arose from the complicated corporate history of a homeland security consulting firm called Community Research Associates. The company’s old shareholders, which the court called “Legacy Shareholders,” filed a suit against the later directors of the company for breach of fiduciary duty and obtained a \$3 million settlement. The insurer denied coverage to the later directors because the Legacy Shareholders had served briefly as directors or officers of the company to effectuate the transfer of its stock to its new owners.

The trial court agreed that the “insured vs. insured” exclusion in the policy was clear on its face and barred coverage for the claim. The court of appeals reversed. It found the “insured vs. insured” exclusion to be ambiguous under the facts of the case because two reasonable interpretations existed as to when the company actually came into existence.

The later directors claimed that the company came into existence when the transaction closed and the Legacy Shareholders resigned their positions as directors or officers. The insurer claimed that the company came into existence sometime before closing because, among other things, the Legacy Shareholders had served on the board of directors long enough to allow for the issuance and transfer of the stock to the new shareholders. Additional evidence therefore was required to resolve the dispute as to when the company actually came into existence: “It is the responsibility of the trier of fact, once a

