

No Coverage for Directors and Officers of Insured Entity Where Conduct “Inextricably Intertwined” with Conduct on Behalf of Non-Insured Entity

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In an unreported decision, a federal district court in Pennsylvania, applying Pennsylvania law, has determined that no coverage is available for directors and officers of an insured company where the alleged conduct was "inextricably intertwined" with their conduct as directors and officers of an entity that was not insured. *Continental Cas. Co. v. Adams*, 2003 WL 22162379 (M.D. Pa. Sept. 12, 2003).

The insurer issued a health care executive liability insurance policy to a non-profit corporation. The policy contained an outside directorship exclusion that barred coverage for "any loss in connection with any claim...involving any actual or alleged conduct by the individual insureds in the discharge of their duties as directors, officers, trustees, employees or volunteers of any entity other than the [insured] Entity..." The directors and officers also worked for an uninsured for-profit corporation.

One of the employees of the non-profit corporation, who later served as the chief financial officer of the for-profit corporation, was alleged to have been involved in a check-kiting scheme. According to the underlying complaint, the scheme involved writing checks from the for-profit corporation's account and depositing the checks in the non-profit corporation's account, only to draw on the account to write a check to deposit back in the for-profit corporation's account. Neither of the accounts had sufficient funds, and the officer treated these transactions as inter-company loans. The underlying complaint also alleged that had the other insured officers read the daily or monthly reports of the non-profit, insured corporation, the scheme would have failed. The complaint further alleged that the directors and officers acted negligently in their capacities as directors and officers of the for-profit, uninsured corporation and thereby "facilitated the scheme."

The district court held that no coverage was available under the policy. Emphasizing the language of the outside directorship exclusion, the court first noted that the scheme "could only be effectuated by actions taken by individual insureds in the discharge of their duties as directors and officers of both the insured entity and the uninsured entity." The court further observed that the underlying complaint alleged that the negligent conduct of the individuals in their capacities as directors and officers of the for-profit company facilitated the

check-kiting scheme. Therefore, the court determined that the allegations in the underlying complaint "plainly show [the directors and officers] acting simultaneously in dual capacities: as officers and directors of both the insured and uninsured corporations." Because the complaint did not distinguish upon which company's behalf the negligent conduct was undertaken, the court concluded that the "negligence claims plainly have the requisite nexus to the activities of [the directors and officers] on behalf of [the for-profit, uninsured corporation] to fall within the scope" of the outside directorship exclusion. The court explained that "an otherwise covered claim of negligence of a named insured is excluded where that claim is closely connected to the named insured's activities as an agent of an entity other than the named insured." Since the claims against the directors and officers were "inextricably intertwined with their actions" on behalf of the uninsured corporation, the court determined that the exclusion applied to bar coverage for the underlying litigation.

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