

Officer Entitled to Coverage under D&O Policy When Sued as Shareholder

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A Massachusetts federal district court, applying Massachusetts law, has held that the president, CEO and majority shareholder of a company insured under a D&O policy was entitled to coverage for a lawsuit that formally named him as a defendant, only in his capacity as a shareholder, on the grounds that a review of the complaint revealed that he was also sued in an insured capacity as a director and officer. *D'Amelio v. Fed. Ins. Co.*, 2004 WL 937328 (D. Mass. Apr. 28, 2004).

The plaintiff in the coverage litigation was the president, CEO and majority shareholder of a sealant and adhesives company. Effective September 17, 1998, the sealant company entered into a stock purchase and sale agreement pursuant to which it sold all of its stock to a third party. As part of the sale, the sealant company made a series of representations and warranties. The sealant company also entered into an escrow agreement whereby \$4 million of the \$130 million purchase price was paid into an escrow account to guarantee the representations and warranties and to fund an earn-out provision securing the sealant company's obligation to meet certain financial targets.

Also effective September 17, 1998, the sealant company purchased a representations and warranties (R&W) policy and a D&O policy. The R&W policy was excess to the D&O policy. The D&O policy defined "Wrongful Act" as "any error, misstatement, misleading statement, act, omission, neglect or breach of duty committed, attempted or allegedly committed or attempted, by an Insured Person, individually or otherwise, in his Insured Capacity, or any other matter claimed against him solely by reason of his serving in such Insured Capacity." It defined "Loss" as "the total amount which any Insured Person becomes legally obligated to pay on account of each Claim...including, but not limited to, damages, judgments, settlements, costs, and Defense Costs."

Following execution of the stock purchase and sale agreement, the purchaser demanded the escrow funds, alleging that the shareholders of the sealant company breached representations made in the agreement. The purchaser and shareholders became embroiled in litigation, and eventually reached a settlement pursuant to which the shareholders paid \$5.7 million in cash to the purchaser and released to the purchaser the entire amount in the escrow account, which totaled \$4.7 million with interest. The former president of the sealant company then filed suit against the insurer under both policies, seeking indemnification for the settlement and the cost of the defense.

The insurer argued that the president was not entitled to coverage because the purchaser sued him in an uninsured capacity as a shareholder, not as an officer or director. The court rejected this argument, explaining that the "formal capacity" in which he was sued was not dispositive as to coverage. According to the court:

The crucial issue is not how a third party (in this case, [the purchaser]) worded its claim, but rather whether [the purchaser's theory of litigation], and the eventual settlement, encompassed allegedly wrongful conduct by [the president] in [his] insured capacity, as defined in the policy. That [the president] acted as a selling shareholder does not defeat coverage.

The court also stated that the complaint by the purchaser contained numerous allegations against the president in his capacity as a director and officer of the company.

The insurer also argued that it had no obligation to fund the payment from the escrow account because that amount did not constitute "loss" under the policy since the company had failed to meet the financial targets necessary to avoid relinquishing the escrow funds. The court noted that although the insureds forfeited their contingent rights to the escrow account as part of the settlement with the purchaser, those contingent rights might have had no value since the earnings targets required to trigger return of the escrow had apparently not been met. However, since the court noted that there was a dispute as to whether the financial targets had in fact been met, it denied the president's motion for summary judgment.

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