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NEWSLETTER

No Coverage for Wrongful Acts in Uninsured Capacity

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In an unreported decision, the United States District Court for the Western District of Oklahoma, applying Texas law, has held a D&O policy did not afford coverage where the insured was not sued in his capacity as an officer or manager of the insured organization. *Kite Family Inv. Co. v. Levings*, 2005 WL 2346995 (W.D. Okla. Sept. 26, 2005).

The insurer issued a D&O policy to a company that provided coverage to insured persons and the insured organization for "wrongful acts." The policy defined "insured person" as "any past, present or future director, officer, managing member, manager or employee of the insured organization." It defined "wrongful acts" as "any . . . actual or alleged act, error, misstatement, misleading statement, omission or breach of duty . . . by an insured person in his . . . capacity as a director, officer, member, manager or employee of the insured organization." The policy also contained an "insured vs. insured" exclusion that prohibited, with certain exceptions, coverage for "loss in connection with a claim . . . brought by or on behalf of, or in the same name or right of . . . any insured person."

In the underlying suit, plaintiffs alleged that the founder of two separate companies, one of them being the insured, orchestrated a corporate reorganization whereby the non-insured company contributed its business assets to the insured company under a contribution agreement, with plaintiffs then purchasing an interest in the insured company. Plaintiffs further alleged that the founder, acting on behalf of the non-insured company, caused it to make misrepresentations in the contribution agreement and that, as a result of plaintiffs' reliance on the agreement, plaintiffs were damaged. The plaintiffs included an investment company, in which a former member of the insured's board of managers was a partner and held an ownership interest, as well as a revocable trust, of which the same former member of the board of managers was the settlor and the sole trustee. The parties eventually settled the underlying suit, resulting in the entrance of consent judgments against the founder, the insured company and the non-insured company. Because none of the defendants could satisfy the judgments, plaintiffs sought payment from the insurer, which denied coverage.

The insurer first argued that the insured vs. insured exclusion precluded coverage since the former manager fell within the definition of an insured person under the policy and since, as a result of his affiliation with the two plaintiffs, the claims were "brought . . . on behalf of, or . . . in the right of" the former manager. The court refused to apply the exclusion, holding that the investment company and the trust were distinct entities from

the manager. According to the court, a "trustee is not the legal equivalent of the trust he administers. Likewise, a Texas partnership is a legal entity separate and distinct from its partners." The court emphasized that "the rights or interests [the investment company and the trust] as . . . sought to vindicate as investors . . . were not the rights or interests" of the former manager and thus were not the rights or interests of an insured person under the policy.

The insurer next argued that coverage was not available because neither the founder, in his capacity as an officer or manager of the insured company, nor the insured organization committed a wrongful act under the policy. The insurer highlighted that the misrepresentation upon which the plaintiffs relied was set forth in the segment of the contribution agreement containing the warranties and representations of the non-insured company. Therefore, any wrongful act committed by the founder was committed in his capacity as an officer, director or manager of the non-insured company, not in his capacity within the insured's company. The court recognized that, while the insured also made misrepresentations in the same contribution agreement, those misrepresentations were not the basis of the complaint that prompted the underlying settlement agreement. The court concluded that "[b]ecause neither an insured organization nor an insured person in his capacity as a director, officer, member or manager of an insured organization committed the wrongful act for which coverage is sought, [the insurer] is not obligated to provide coverage under the policy and is therefore entitled to summary judgment in its favor."

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