

The Eighth Circuit Applies Insured vs. Insured Exclusion to Non-Insured Co-Plaintiffs

In a significant decision interpreting one of the most frequently litigated exclusions in the world of D&O insurance, the Eighth Circuit recently ruled that an Insured vs. Insured exclusion applied to an insured director's entire lawsuit, even though other non-insured shareholders were also plaintiffs in the suit. See *Jerry's Enterprises, Inc. v. U.S. Specialty Ins. Co.*, 845 F.3d 883 (8th Cir. 2017). Because the policy defined "Claim" as a "civil proceeding," the court held that the exclusion of a "Claim" referred to that entire proceeding, and not just to individual plaintiffs or issues — regardless of the policy's allocation provision. This holding potentially has far-reaching implications, not only with respect to the Insured vs. Insured exclusion but also regarding other exclusions and other types of claims-made policies.

The D&O policy in *Jerry's Enterprises* was issued to a closely held corporation that operated a chain of retail and grocery stores in the upper Midwest and Florida. The founder gifted non-voting shares to three of his daughters, as well as a smaller number of shares to two of his granddaughters. Subsequently, the founder died. Under his will, the daughters were appointed as directors of the corporation until their shares were redeemed. One of those daughters disagreed with the valuation placed on her shares by the other directors. After her shares (comprising 28 percent of the outstanding shares) had been redeemed, she and her two daughters (who had owned 2.4 percent and 1.2 percent, respectively) sued the corporation for various acts of misconduct relating to the valuation of their shares.

After several months, the litigants reached a confidential settlement. When the corporation sought reimbursement of its defense costs and the settlement, its D&O insurer denied coverage. Coverage litigation ensued in the U.S. District Court for the District of Minnesota. The District Court held that the Insured vs. Insured exclusion precluded coverage for the suit in its entirety and that the policy's allocation provision did not restore any coverage.

The insured corporation appealed, but the Eighth Circuit affirmed the District Court's ruling. First, the court held that the exclusion — which applied to any "Claim brought by ... any Insured Person" — applied to the entire underlying lawsuit. The court observed that the definition of Claim included a "civil proceeding commenced by service of a complaint." Because the Claim here was the civil proceeding, and that proceeding was brought by an insured person, the entire lawsuit was excluded. The inclusion of the granddaughters in the complaint did not create distinct covered Claims, as defined in the policy.

Second, the court held that the allocation provision did not restore any coverage. There were two significant factors supporting this aspect of the opinion. The first was that the director/daughter — who owned 28 percent of the company — was the driving force behind the entire lawsuit. On this point, the court distinguished a Seventh Circuit case that reached a contrary result: *Level 3 Communications, Inc. v. Federal Ins. Co.*, 168 F.3d 956 (7th Cir. 1999). In *Level 3*, the court expressed concern that under a literal application of the exclusion, a minor shareholder who qualified as an insured could sign on to a larger lawsuit with numerous other shareholders and thereby vitiate coverage for the entire suit. By contrast, in *Jerry's Enterprises*, it was the daughter who truly brought and controlled the suit, and the granddaughters owned far smaller shares in the corporation. The second factor was that the exclusion in *Jerry's Enterprises* contained an exception for Claims "brought independently by, and without the solicitation, assistance or active participation of ... any Insured Person." Under this language, if an insured had merely signed onto a larger lawsuit brought on behalf of other shareholders, the exception would have applied. Thus, when the exclusion contains the "active participation" exception, it can be applied literally without the absurd result that concerned the *Level 3* court.



Jonathan Toren

Co-Chair,
Casualty &
Specialty Lines
Coverage

jtoren@cozen.com
Phone: (206) 224-1260
Fax: (206) 621-8783

Related Practice Areas

- Insurance Coverage
- Professional Liability Insurance Coverage

As noted above, the most significant takeaway from *Jerry's Enterprises* is that when an exclusion applies to a Claim, and Claim is defined as a civil proceeding, the entire lawsuit should be excluded. Moreover, when the exclusion applies only to a proceeding brought with the active participation of an insured, and that is what occurs, the policy's allocation provision will not restore any coverage for claims brought by non-insureds. This is particularly true when the allegedly covered aspects of the suit are secondary and less significant. The civil proceeding prong of the Claim definition is often discussed in connection with when a claim was first "made." However, *Jerry's Enterprises* shows that this provision can be significant to other aspects of coverage, as well.

To discuss any questions you may have regarding the issues discussed in this Alert, or how they may apply to your particular circumstances, please contact Jonathan Toren at jtoren@cozen.com or (206) 224-1260.