ARONBERG GOLDGEHN

Insurance Coverage Update

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No D&O Coverage for Accused Embezzler Sued By Condo Association's Fidelity Insurer

An Insured-versus-Insured (IvI) exclusion in a condominium association's D&O policy applies to preclude a defense for a former treasurer sued by the association's fidelity insurer for reimbursement of allegedly misappropriated funds, according to the Texas Supreme Court. *Great American Insurance Co. v. Robert Primo*, 2017 WL 749870 (Tex. Feb. 24, 2017).

The IvI exclusion in the D&O policy issued to Briar Green Condominium Association precluded coverage for "any Claim made against any Insured...by, or for the benefit of, or at the behest of the Organization or ... any person or entity which succeeds to the interest of the Organization." The policy defined the "Organization" as Briar Green and "Insured" to include past and present directors and officers of Briar Green.

A former director and treasurer of Briar Green allegedly wrote checks to himself from Briar Green's account. Briar Green filed a claim on a fidelity bond to recover losses from the alleged misappropriation. After the fidelity insurer paid Briar Green $115,558.77, Briar Green assigned the fidelity insurer all of its claims and rights against the former treasurer.

Seeking to recover the amount paid to Briar Green under the bond, the fidelity insurer sued the treasurer, alleging that it had been "assigned all rights to this matter" by Briar Green, and that it had "stepped into the shoes of [Briar Green]."

The treasurer requested that Briar Green's D&O insurer pay for his defense costs in the fidelity insurer's suit. The D&O insurer denied coverage based upon the policy's IvI exclusion, which precluded coverage for any claims brought by one insured (or an entity that "succeeds to the interest" of that insured) against another insured. Because the fidelity insurer had been assigned all of Briar Green's rights against the treasurer, the fidelity insurer brought the suit as a successor to the association's interest.

Alleging it had breached its bylaws by failing to indemnify him for his defense costs incurred in the action brought by the fidelity insurer, the treasurer filed suit against Briar Green and was awarded $107,846.02. During the pendency of this suit, the treasurer also sued Briar Green's D&O insurer seeking reimbursement for his defense costs in the fidelity insurer's suit against him.

The D&O insurer filed a motion for summary judgment arguing, among other issues, that the treasurer's claims were barred by the IvI exclusion in the policy. The Trial Court granted the motion for summary judgment and signed a take-nothing judgment on the treasurer's claims.

The Court of Appeals reversed the judgment, finding the IvI exclusion did not apply to the fidelity insurer's claims as an assignee of Briar Green because there was insufficient evidence "to prove as a matter of law that [the fidelity insurer] was a successor to the interest of Briar Green." The Court declined to consider the portion of the IvI exclusion that applied to claims made "by, or for the benefit of, or at the behest of [Briar Green]."

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The D&O insurer argued before the Texas Supreme Court that the Appellate Court erroneously concluded that the IvI exclusion did not apply to the claims made against the treasurer. The D&O insurer argued that in reaching this conclusion, the Appellate Court "judicially rewrote the unambiguous exclusion (changing the phrase "succeeds to the interest of" to the distinct legal term "successor in interest") under the guise of construction, and also failed to consider all language within the exclusion (the "by, or for the benefit of, or at the behest of" portion) which was preserved on appeal."

Agreeing with the D&O insurer, the Texas Supreme Court ruled that the Appellate Court had erred in defining "successor in interest" in the same manner as is used in corporate transactions when interpreting the IvI exclusion. The Texas high court held that the Appellate Court ignored the context and intent of the exclusion, which is to "prevent both collusive suits between business organizations and their directors and officers as well as actions arising out of the 'bitter disputes that erupt when members of a corporate…family have a falling out.'"

The Supreme Court further opined that such an interpretation of the exclusion makes collusive suits more likely rather than less, stating, "under the court of appeals' interpretation, an insured under a D&O policy need only assign its rights in any claim against another insured to a third party and the exclusion no longer applies." The Supreme Court went on to hold that "because Great American has shown as a matter of law that the Insured-versus-Insured Exclusion in the D&O Policy applies in this instance, the policy provides no coverage…."

Comment

The Texas Supreme Court decision is significant because it appropriately recognized the entire IvI exclusion, including "at the behest of" language, and preserved established Texas precedent prohibiting a court from rewriting an unambiguous contractual provision. The high court also underscored and enforced what it concluded was the intent of IvI exclusions in D&O policies.

If you have any questions about this Update, please contact the author listed below or the Aronberg Goldgehn attorney with whom you normally consult:

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