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Insurance Coverage Update

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Short-Term Director Is Still a "Director" for Application of IvI Exclusion

A former director, who served on the insured's board for seven months following a merger agreement, resigned from the board when the merger deal soured and sued the insured entity and its directors. The Second Circuit, in an unreported opinion, found that the suit was brought in his "capacity" as a former director, rejected his arguments that the relevant insurance policy's Insured vs. Insured ("IvI") exclusion was ambiguous, and concluded that the directors and officers liability policy did not provide coverage. *Intelligent Digital Systems, LLC, et al. v. Beazley Insurance Co., Inc*., No. 16-3548-CV, 2017 WL 4127540 (2d Cir. Sept. 19, 2017).

Jay Edmond Russ ("Russ") founded and served as the sole officer of Intelligent Digital Systems, LLC ("IDS"), a technology company in the digital recording industry. In January 2008 IDS agreed to sell its assets to Visual Management Systems, Inc. ("VMS"), a now-dissolved company in the video technology business. As part of the sale, VMS agreed to pay IDS $1.5 million over time (and issued a promissory note to that effect), add Russ to its board of directors, and hire him as a consultant. The VMS Board of Directors met and approved the transaction and Russ's appointment, conditioned upon completion of the transaction. VMS's general counsel confirmed to Russ that Russ would be a director as of its May 2008 meeting. Russ participated in three board meetings and was paid for his services as a board member.

Russ resigned from the board in December 2008 and advised of his intent to sue VMS for delinquent payments owed under the promissory note. IDS and Russ, along with IDS' Pension Plan (the "Plaintiffs") sued VMS and its five directors in March 2009. Beazley, VMS's D&O insurer, denied coverage, citing the IvI Exclusion. The underlying action was eventually settled, with the directors agreeing to pay Plaintiffs $75,000, agreeing to the entry of judgments against them in amounts exceeding $2 million, and assigning their rights under the Policy to Plaintiffs in exchange for Plaintiffs' agreement to "unconditionally forbear collection" of the judgments against the five directors.

Beazley's D&O Policy defined "Directors and Officers" to include "all persons who were, now are, or shall be duly elected or appointed directors." The Policy's IvI Exclusion excluded coverage for "any Claim ... by, on behalf of, or at the direction of any of the Insureds, except and to the extent such Claim ... is employment-related and brought by or on behalf of any of the Directors and Officers." The Policy defined "Insureds" as "the Directors and Officers and the Company."

Plaintiffs filed an action against Beazley, seeking indemnification for the unpaid amounts of the judgments. The trial court denied all motions for summary judgment. Beazley prevailed at trial, as a jury determined that Russ was "duly elected or appointed" to the Board of VMS.

In their appeal to the Second Circuit, Plaintiffs argued that the IvI exclusion was ambiguous under applicable Nevada law because it could be read as applying only to claims brought by

directors in their capacities as directors. The Second Circuit disagreed, finding "no such ambiguity exists in the Policy." The IvI exclusion plainly exempted from coverage "any" claim brought by, on behalf of, or at the direction of an insured director. The exclusion was not limited to claims brought by an insured in his "capacity" as a director. As the court noted, "[o]n its face, the exclusion applies to all claims . . . regardless of whether the director brings the claims in an individual or fiduciary capacity." *Id.* at *2. Further, the court found that the employment-related claim exception to the exclusion did not apply because Russ' consultant's agreement specified he was an independent contractor, not an employee.

The Court next rejected Plaintiffs' ambiguity argument with respect to the term "duly elected or appointed" in the Policy's definition of "Directors and Officers". The plain meaning of "duly elected or appointed," according to the Court, meant that directors must be duly selected, by vote or appointment, in accordance with proper procedures. It found nothing in the language of the Policy to support Plaintiffs' argument that the omission of references to "'de facto directors" rendered the otherwise unambiguous language ambiguous.

The Court further found Plaintiffs' reliance on the VMS bylaws was misplaced. They argued that certain provisions of the bylaws required the board to formally vote to expand its membership in addition to voting to appoint Russ as a new director. The Second Circuit was not persuaded.

By voting unanimously to appoint Russ as its sixth director, the board implicitly – if not explicitly – determined that it would increase its membership to six. Additionally, the question of whether Russ was duly elected or appointed as a director was put to the jury, and the jury determined that he was duly elected. That decision was well supported by largely undisputed evidence: all of VMS's five directors were present at the February 26, 2008, board meeting; Russ then began serving as a director and sought confirmation that he was, indeed, covered by the Policy; he attended three board meetings and was paid for his service; and in various filings with government agencies, VMS represented that Russ was a director. All of the parties treated Russ as a duly elected or appointed director.

The Second Circuit, therefore, found Russ was a "duly elected or appointed director[]," the IvI exclusion applied, and Beazley was properly awarded judgment.

Discussion

An IvI exclusion applies regardless of the amount of time that a plaintiff serves as a director; once a director, always a "director." This appears to be a case where both the trial court (aided by a jury's factual finding) and the appellate court applied the plain language of the IvI exclusion in a straightforward manner. Russ' time on the VMS Board, however brief, and his status as a plaintiff in the suit against VMS, precluded his chances of prevailing against Beazley.

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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