

Eleventh Circuit Holds No Duty to Defend Directors Serving in Mixed Capacities



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On June 22, 2015, the 11th Circuit affirmed a Georgia federal court decision that there was no coverage under a director's and officer's (D&O) insurance policy for claims asserted by beneficiaries of a family trust against a closely held corporation and two of its directors and officers. The beneficiaries claimed that the directors and officers, who also served in dual capacities as trustees, had lied and schemed to convince the beneficiaries to sell their shares back to the corporation for less than they were worth. Looking to the fact allegations in the complaint against the insureds, the court found that but for the individual actions as trustees there would be no claim against any insured entity. As a result, based on an exclusion in the D&O policy for alleged misconduct committed in a capacity other than as a corporate officer or director, there was no duty to defend.

Plaintiff-appellant, The Langdale Company (TLC), is a holding company for several subsidiaries conducting business across a number of different industries. A family trust owned approximately 25 percent of TLC's shares, and the remaining shares were owned by individual family members, including the CEO Johnny Langdale, and his uncle Harley Langdale, a director. In addition to their corporate roles, Johnny and Harley Langdale (collectively, Langdales) were also the trustees for the family trust.

The trust beneficiaries claimed that the Langdales embarked on a scheme to consolidate their control by making misstatements about the trust termination date, value and liquidity, inducing the trust beneficiaries to sell their shares back to TLC at a fraction of their real value. Johnny Langdale ultimately resigned as a trustee and the next day signed a Redemption Agreement in his capacity as CEO, allowing TLC to purchase the trust's shares. Harley Langdale signed the agreement on behalf of the trust, in his capacity as trustee. This effectively allowed the Langdales to control two-thirds of the shares instead of their original 50 percent.

The trust beneficiaries brought a state court action against TLC and the Langdales, asserting the following causes of action: breach of trust, breach of fiduciary duty to trust beneficiaries, and breach of fiduciary duty as directors of TLC to the company's minority shareholders. Thereafter, TLC filed a declaratory judgment action against the trust beneficiaries, seeking a declaration that TLC held clear title to the repurchased stock. The trust beneficiaries counterclaimed, asserting TLC's *respondeat superior* liability for its officers' misconduct, as well as other counts, including fraud, conspiracy and tortious interference with fiduciary duties. The two lawsuits were ultimately consolidated into one underlying action.

TLC held an insurance policy from National Union Fire Insurance Company of Pittsburgh (National Union), which provided D&O coverage, including defense costs, for the corporation and its individual employees and executives. The trust was not an insured, nor were the Langdales in their capacities as trustees. TLC demanded a defense under this policy for the claims made against it in both lawsuits, arguing that the claims arose out of the corporation's actions — and the Langdales' acts as directors and officers — based on two counts that explicitly referenced officer misconduct: "breach of fiduciary duty as directors of TLC to minority shareholders" and "*respondeat superior* liability for officer misconduct" counts.

National Union denied coverage based on Exclusion 4(g), which provides:

The Insurer shall not be liable to make any payment for Loss in connection with any Claim made against an Insured:

(g) alleging, arising out of, based upon or attributable to any actual or alleged act or omission

of an Individual Insured serving in any capacity, other than as Executive or Employee of a Company, or as an Outside Entity Executive of an Outside Entity.

TLC brought an action against National Union seeking a defense and arguing that Exclusion 4(g) did not bar coverage. Applying Georgia law, the district court granted summary judgment to National Union, finding that the “genesis of the underlying plaintiffs’ claims involves the acts of the trustees,” as opposed to the acts of TLC’s directors or officers. Because the claims against TLC and the Langdales would not have occurred but for the trustees’ actions, the exclusion applied to bar coverage for the entire underlying action. The district court addressed the two counts that specifically addressed officer wrongdoing and found that there was no duty to defend even these claims, as “the facts that gave rise to these causes of action arose out of the trustee’s alleged wrongful actions.”

On appeal, the 11th Circuit affirmed, noting that when the phrase “arising out of” is found in an exclusionary clause of an insurance policy, Georgia applies a “but for” test. “The exclusionary clause is focused solely on the genesis of the underlying plaintiff’s claims — if those claims arise out of the excluded acts then coverage need not be provided. Claims arise out of the excluded conduct when ‘but for’ that conduct, there could be no claim against the insured.”

Both the cause of action for breach of fiduciary duty owed by the Langdales as TLC directors, and the cause of action to hold TLC vicariously liable for its officers’ misconduct, alleged that the Langdales had deliberately concealed critical information and had induced the trust beneficiaries to grant them rights to their detriment and to the Langdales’ individual benefit. The court found that the allegations of self-dealing and misrepresentation arose out of the Langdales alleged breaches of their duties as trustees, rather than as directors and officers.

The allegations are of acts and omissions that would not have occurred had Johnny and Harley Langdale not breached their duties as trustees by using the redemption mechanism to consolidate control over TLC without having to purchase the Trust beneficiaries’ TLC shares themselves. The allegations of officer and director misconduct arose out of the allegations of misconduct as trustees ...

Because these causes of action could not have existed without the claim of trustee misconduct, Exclusion 4(g) applied.

Conclusion

The 11th Circuit’s decision settles that, at least under Georgia law, courts must carefully evaluate the substance of the allegations made against insureds, rather than merely referencing the form of the pleadings. When the genesis of the claim lies in acts in an uninsured capacity, and when the claim would not exist but for the uninsured activity, the mere fact that there is a nexus or relation to some covered capacity will not negate the plain effect of an exclusionary clause.

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 Angelo Savino at (212) 908-1248 or asavino@cozen.com or Laura Dowgin at (212) 453-3775 or ldowgin@cozen.com.