When You Agree to Buy Out Partner Upon Death and Fail to Do So Don’t Expect Your Insurer to Defend You

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A Directors and Officers (“D&O”) insurance policy provides coverage for a multitude of actions by corporate officers. D&O policies, however, come with many exclusions to void coverage for intentional acts and other actions founded on contracts and other instruments. Many corporate officers, especially in smaller companies, look to D&O policies to defend and indemnify them for all sorts of deeds, only to find out that exclusions strip them of the protection they thought they had. That circumstance was made clear by the Eighth Circuit in a recent case.

In *Russell v. Liberty Insurance Underwriters, Inc.*, No. 18-2984 (8th Cir. Feb. 19, 2020), the three shareholders of a business entered into stock agreements that provided for the company to purchase life insurance for each shareholder and if one died the company would use the insurance proceeds to buy the deceased shareholder’s stock. This plan was prompted by the cancer diagnosis of one of the shareholders. When the shareholder died, the company deposited the life insurance proceeds in its account, but never bought the deceased shareholder’s stock from his widow. She sued and received a judgment against the president of the company for breach of fiduciary duty.

The two remaining shareholders thought that the company’s D&O and Fiduciary
Liability Coverage carrier would defend them, but the insurance company disclaimed once the widow sued. The shareholders sued the insurance company in state court and the case was removed to federal court. The opinion spends time on jurisdiction and if you are interested in that, please read the opinion. The district court granted summary judgment to the insurance company and the shareholders appealed. The circuit court affirmed.

In affirming the grant of summary judgment to the insurer, the court agreed with the district court that the Fiduciary Liability Coverage did not apply to the claim because the stock agreements were not a Plan administered by the shareholders as fiduciaries. The court also found that the policy applied to misdeeds done in the discharge of their duties as fiduciaries of any plan, but the breach of fiduciary duty they were sued for was in their capacity of fiduciaries of the company and its shareholders, not for their duties as employee benefit plain fiduciaries.

As to D&O coverage, the policy excluded coverage for liability or defense costs based on any actual or alleged liability under or in breach of any contract or agreement. Because the company broke its promise to the widow that the life insurance proceeds would be used to buy out the deceased shareholder’s stock, it appeared to the court that the insurance company had no duty to cover the surviving shareholders or to defend them.

The court rejected the shareholder’s argument that under Kansas law, if the insured’s liability is based on a separate and distinct legal theory from the liability excluded from the policy, there could be coverage. The court found that the exception was very narrow if it even survived later case law, and that applying it to a breach of contract case would result in an unintended windfall. Thus, held the court, the D&O policy did not cover the surviving shareholders and summary judgment in favor of the insurance company was properly granted.

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