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Private Equity Practice
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Capacity Exclusions in Directors & Officers Insurance Policies

Goggin v. National Union Fire Insurance Company of Pittsburgh, PA

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In a case with implications for principals of private equity funds, the Delaware Superior Court recently denied two former directors coverage under a D&O insurance policy. In *Goggin v. National Union Fire Insurance Company of Pittsburgh, PA*, the Court, on a Motion for Judgment on the Pleadings, construed a "capacity" exclusion in the policy to exclude coverage of an underlying claim that arose out of the directors' positions as investors in the company, despite the fact that their alleged misconduct was a breach of their duties as directors and thus on its face eligible for coverage.

Goggin and Goodwin were investors in U.S. Coal Corporation beginning in 2007 and 2008, becoming directors in 2009 and remaining in that position until their resignations in 2014 and 2012, respectively. During their terms as directors, in an attempt to reinvigorate the failing U.S. Coal via debt repurchases and other recapitalization activities, they formed two investment vehicles for which they acted as manager or investor. Shortly after U.S. Coal entered bankruptcy in 2014, suit was brought alleging that Goodwin and Goggin breached their fiduciary duties and committed other acts for their own personal benefit.

Goggin and Goodwin sought coverage under a D&O Policy issued by National Union to U.S. Coal. Although National Union acknowledged that Goggin and Goodwin were "Insured Individuals" under the policy, it invoked the "capacity" exclusion in the policy to deny coverage. The "capacity" exclusion states:

> The Insurer shall not be liable to make any payment for Loss in connection with any Claim made against an insured…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 an Executive or Employee of a Company…. (emphasis added).

Noting that courts in other jurisdictions have applied the "but-for" test to construe a D&O policy's exclusionary clause, the Court determined that "but for" Goggin and Goodwin's roles as members/managers of the investment vehicles, the breach of fiduciary duty claims would fail. Thus, in the Court's view, whether the misconduct was related to Goggin and Goodwin's duties as directors of U.S. Coal was irrelevant because the alleged misconduct arose out of their roles as members/managers of the investment vehicles.

As a result of this decision, sponsors with principals serving as directors of portfolio companies should consider a review of their current D&O policies to determine whether such exclusions exist. In particular, firms investing in portfolio companies facing "down rounds" or other distressed situations should be aware of any capacity exclusion in the company's D&O policy and take care to avoid conduct that may fall outside of the scope of coverage as a result of any such exclusion.

For more information on the matters discussed in this *Locke Lord QuickStudy*, please contact the authors.

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