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# New Jersey Appellate Court Enforces Capacity Exclusion in D&O Policy

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In a matter of first impression, CMG secured a victory for its insurer-client in New Jersey's intermediate appellate court. The decision, *Mist Pharmaceuticals LLC v. Berkley Insurance Company*, was handed down on July 9, 2024 and holds that a capacity exclusion in a Directors and Officers liability insurance policy precluded coverage for a claim in which the director of the insured entity was acting in a "dual capacity" based upon his role with a non-insured entity. The decision represents a significant ruling for the insurance industry in New Jersey and manifests the New Jersey Court system's willingness to uphold unambiguous restrictions in coverage.

One of the indispensable elements to implicate coverage under a D&O policy is the requirement that the alleged wrongful act giving rise to the claim be committed by an insured person in an insured capacity. In Mist, the director at issue had roles at the insured entity as well as a role at a number of related, uninsured entities. The D&O policy at issue included capacity restrictions in its definition of "wrongful act" as well as in its "capacity exclusion." The claim involved alleged self-dealing by the director of the insured entity by improperly inserting various entities that he controlled, including the insured entity, as "middleman" in certain transactions, resulting in the alleged diversion of assets from a non-insured entity in which he was also a director.

The New Jersey appellate court held that the capacity exclusion was clear and unambiguous, and adopted the 11th Circuit's reasoning from *Langdale Co. v National Union Fire Insurance Co. of Pittsburgh*, 609 Fed.Appx. 578 (11th Cir. 2015), that if the claim would not exist "but for" the insured person's status with a non-insured entity, the exclusion applies. Specifically, the New Jersey court held that the claim against the insured entity arose from and could not have existed but for the director's conduct in his capacity as a director of the non-insured entity. Accordingly, the Court held that there was a sufficient basis to implicate the capacity exclusion and concluded that there was no coverage obligation under the D&O policy for the claim at issue.

This decision is significant for insurers underwriting corporate entities in New Jersey. Numerous claims address situations where an individual director or officer is acting in multiple capacities. The *Mist* decision clearly reflects that, under New Jersey law, the insurance provided by a D&O policy is

only involved when the insured’s liability arises from situations in which an insured person is acting in his or her capacity as a director or officer of the insured company, not when their actions arise from the insured person’s capacity for a noninsured entity.