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11 U.S.C. § 541 AND D&O INSURANCE: AN ANALYSIS OF THE “INSURED VERSUS INSURED” EXCLUSION IN A BANKRUPTCY CONTEXT FOLLOWING INDIAN HARBOR

ABSTRACT

Directors and Officers insurance has been a mainstay for most corporations for years. Included in most D&O insurance policies is what is referred to as an “insured versus insured” exclusion which prohibits an insured from filing suit against another insured. Section 541 of the Bankruptcy Code’s creation of an estate has created a dichotomy amongst courts plagued with determining whether claims filed by a post-petition debtor or on a post-petition debtor’s behalf by a trustee or trust should be covered under a D&O policy including an “insured versus insured” exclusion. The ones most effected by such a trend are not the fortune 500s of the world, but startups and emerging companies which will face stiffer costs leading to a greater likelihood of failure. Basing premiums on the risk a particular insured poses, insurance providers are likely to increase premiums in an uncertain legal environment. Couple this with the likelihood of an economic correction on the horizon, and a trend of increased premiums is ever more likely.

*This Comment first looks at the history of D&O insurance and the emergence of “insured versus insured” exclusions. Next, this Comment offers a microcosm of the current dichotomy amongst courts, by examining the majority and dissenting opinions of *Indian Harbor Ins. Co. v. Zucker*. Second, this Comment analyzes exceptions to “insured versus insured” exclusions that have been making their way into D&O insurance policies and how courts have historically treated claims brought by debtors in possession compared to claims brought by trustees. This Comment concludes by proposing a four step approach courts should take when tasked with determining an “insured versus insured” exclusion’s applicability. Step four of the approach includes a recommended “Modified Factors Test,” which builds on a similar concept first suggested years ago by Michael D. Sousa.*

INTRODUCTION

Directors and Officers liability insurance, often referred to as D&O insurance, covers director and officers for claims against them during their time serving on a board of directors or as a corporate officer. D&O insurance continues to be a mainstay for most corporations in the aftermath of the 2008 financial crisis and beyond. With the frequency of securities class action lawsuits increasing steadily from 2011 through 2015, the likelihood of a corporation facing such a suit is the highest it has ever been.¹ Corporations in the life sciences and technology industries have felt the brunt of these suits.² With a greater likelihood of corporations facing a lawsuit, inconsistency amongst courts as to how to treat certain provisions within a D&O policy (in this case following a bankruptcy filing by the insured company), comes with inconsistency in determining the risk of litigation a particular company poses. Without a more consistent approach, insurance companies will likely raise premiums on corporations taking out D&O insurance policies. Companies operating at low margins, most notably, startups and smaller organizations, will face the greatest impact. Increased premiums which cause these companies to forego D&O insurance due to fiscal concerns could result in qualified individuals becoming reluctant to accept directors, officers, or board positions out of fear of being personally liable down the line. Such reluctance could result in a chilling effect—slowing startup growth and stifling innovation.

The concept of D&O insurance began in the 1930s in the wake of the Great Depression, following the inception of the U.S. Securities Act and the Investment Company Act.³ However, it was not until the 1970s that D&O insurance became commonplace, a consequence of increased litigation against the boards of corporations in the late 1960s.⁴ D&O’s “fundamental purpose [being] to shift by contract to an independent third party—the insurance carrier—a portion of the risk arising out of actions taken both by the corporation’s officers and directors in their official capacity and by the corporation itself in connection with securities law matters.”⁵

¹ Kevin LaCroix, *D&O Liability: More Litigation Globally against a Broader Range of Defendants*, THE D&O DIARY (Sept. 12, 2016), <https://www.dandodiary.com/2016/09/articles/international-d-o/do-liability-more-litigation-globally-against-a-broader-range-of-defendants-2>.

² *Id.*

³ Kristopher Marsh, *A Short History of D&O Insurance*, DISCOVER D&O (June 8, 2015), <https://www.discoverdando.com/a-short-history-of-dando-insurance>.

⁴ *Id.*

⁵ 1 GILLIAN MCPHEE, CORPORATE GOVERNANCE: LAW AND PRACTICE §5.04(2) (2005).

Commonplace within a D&O insurance policy is what is known as an “insured versus insured” exclusion.⁶ “[A]n ‘insured versus insured’ exclusion bars coverage [by an insurer under an insurance policy] for claims made by one insured under the policy, for example, the corporation, against another insured under the same policy, for example, the corporation’s directors and officers.”⁷ Although questions surrounding the applicability of the “insured versus insured” exclusion typically arise in the context of derivative suits,⁸ so too can it become an issue in bankruptcy.⁹ To this point, a circuit split exists regarding the issue of whether a lawsuit brought against a corporation’s former or current directors and officers brought by a debtor in possession, trustee, creditors’ committee, court-appointed trustee, or post confirmation liquidating trustee, triggers the “insured versus insured” exclusion in a D&O insurance policy held by a corporation. The Third, Fourth, Sixth, Eighth, and Ninth Circuits concluded that an “insured versus insured” exclusion bars coverage when a post-petition entity files suit against directors and officers covered under a corporation’s D&O insurance policy.¹⁰ In contrast, the First, Second, Fifth, and Eleventh Circuits concluded that an “insured versus insured” exclusion is not applicable in the aforementioned circumstances.¹¹ The Seventh Circuit declined to rule on the issue;¹² the Tenth Circuit has yet to be tasked with the issue.

⁶ *Murray v. Loewen Grp.*, 133 F. Supp. 2d 1110, 1117 (E.D. Wis. 2001) (citing *Level 3 Commc’ns, Inc. v. Fed. Ins. Co.*, 168 F.3d 956, 958 (7th Cir. 1999)).

⁷ Michael D. Sousa, *Making Sense of the Bramble-Filled Thicket: The “Insured vs. Insured” Exclusion in the Bankruptcy Context*, 23 EMORY BANKR. DEV. J. 365, 368–69 (2007).

⁸ *See, e.g.*, *FDIC v. BancInsure, Inc.*, 675 F. App’x 666, 669 (9th Cir. 2017); *Voluntary Hosps. of Am. v. National Union Fire Ins. Co.*, 859 F. Supp. 260, 263 (N.D. Tex. 1993) (interpreting the plain language of the insured versus insured clause to exclude a derivative shareholder suit assisted by a former officer).

⁹ *See, e.g.*, *Biltmore Assocs., LLC v. Twin City Fire Ins. Co.*, 572 F.3d 663 (9th Cir. 2009).

¹⁰ *See Indian Harbor Ins. Co. v. Zucker*, 860 F.3d 373, 378 (6th Cir. 2017); *Redmond v. Ace Am. Ins. Co.*, 614 F. App’x 77, 80 (3d Cir. 2015); *Biltmore Assocs., LLC*, 572 F.3d at 668; *Terry v. Fed. Ins. Co. (In re R.J. Reynolds–Patrick Cty. Mem’l Hosp., Inc.)*, 315 B.R. 674, 682 (Bankr. W.D. Va. 2003); *Reliance Ins. Co. v. Weis*, 148 B.R. 575, 583 (E.D. Mo. 1992).

¹¹ *See Certain Underwriters at Lloyd’s of London v. FDIC*, 723 F. App’x 764, 766 (11th Cir. 2018); *Segner v. Admiral Ins. Co. (In re Palmaz Sci., Inc.)*, Nos. 16-50552-CAG, 17-05027-CAG, 2018 Bankr. LEXIS 1659, *38 (Bankr. W.D. Tex. June 4, 2018); *Cohen v. Nat’l Union Fire Ins. Co. (In re County Seat Stores, Inc.)*, 280 B.R. 319, 329 (Bankr. S.D.N.Y. 2002); *Phila. Indem. Ins. Co. v. Providence Cmty. Action Program, Inc.*, No. 15-388 S, 2017 U.S. Dist. LEXIS 9345, *11 (D.R.I. Jan. 24, 2017) (determining that, although relying on split precedent within the First Circuit, under the circumstances, a Rhode Island receiver is not working “on behalf of: the prepetition entity, and therefore not subject to the insured-versus-insured exclusion).

¹² *See Ha 2003, Inc. v. Fed. Ins. Co. (In re HA 2003, Inc.)*, 310 B.R. 710, 714–15 (Bankr. N.D. Ill. 2004) (failing to rule on this issue directly with the only applicable case relating to a D&O insurance policy which expressly included an exclusion to the insured versus insured exclusion for bankruptcy purposes, therefore rendering the issue mute).

Representing a microcosm of the current split is the 2017 Sixth Circuit case *Indian Harbor Ins. Co. v. Zucker*.¹³ In reaching a split decision, the majority and dissent in *Indian Harbor* argue that contradicting applications of 11 U.S.C. § 541(a) exist when determining whether the creation of an estate under bankruptcy law should constitute a wholly separate entity for purposes of an “insured versus insured” exclusion.¹⁴ *Indian Harbor* will be explored in greater detail *infra*.¹⁵

For purposes of an “insured versus insured” exclusion’s application to bankruptcy law, it must first be established whether language in the applicable D&O insurance policy includes an “insured versus insured” exclusion and if such inclusion includes any expressly stated exceptions. If the D&O insurance policy contains an “insured versus insured” exclusion and does not contain an express exception for post-bankruptcy entities or trustees, then it is important to determine whether a debtor in possession or a trustee is bringing the suit. As will be discussed, courts seem to agree that if a debtor in possession is bringing the suit, too strong a potential for collusion is present, barring the suit under the “insured versus insured” exclusion. However, the same level of agreement amongst courts is not present when a trustee is bringing suit. As such, when a trustee brings suit, a case-by-case analysis must be conducted to determine if a trustee is acting on behalf of the prepetition debtor to such an extent that would warrant the exclusion’s applicability.

Part I of this Comment will provide an overview of D&O insurance and how it came to be commonplace from its creation in the 1930’s to its usage today. Part II will provide a background on the “insured versus insured” exclusion and its controversial past. Part III will provide an overview of *Indian Harbor*, describing the background to the case and both the majority and dissenting opinions. Part IV analyzes what must be considered when determining the applicability of an “insured versus insured” exclusion in the bankruptcy context, including the differing approaches when express language is provided in a D&O insurance policy and the differing treatments of suits brought by debtors-in-possession and trustees. Finally, Part V reinforces the multi-factor approach suggested by Michael D. Sousa in his 2007 Comment for the *Emory Bankruptcy Developments Journal*, “Making Sense of the Bramble-Filled Thicket: The Insured vs. Insured Exclusion in the Bankruptcy Context” with some additional recommendations based on twelve additional years of case law.

¹³ *Indian Harbor Ins. Co.*, 860 F.3d at 378.

¹⁴ *Id.*

¹⁵ See *infra* notes 44–107 and accompanying text.

I. AN OVERVIEW OF DIRECTORS & OFFICERS INSURANCE

Directors & Officers insurance, or D&O insurance for short, has been a way for businesses to “shift by contract to an independent third party—the insurance carrier—a portion of the risk arising out of actions taken both by the corporation’s officers and directors in their official capacity and by the corporation itself in connection with securities law matters.”¹⁶ D&O insurance policies have typically helped shield organizations from claims against its directors and officers for things such as fraud, mergers, breaches of fiduciary duties,¹⁷ and inadequate or inaccurate disclosures. In fact, it has been said that “D&O insurance plays an important role in corporate governance in America” because “[u]nless directors can rely on the protections given by D&O policies, good and competent men and women will be reluctant to serve on corporate boards.”¹⁸ This role is ever more important in filling in the gaps when indemnification is unavailable.¹⁹

A typical D&O insurance policy consists of two types of coverage, Side A and Side B.²⁰ Side B coverage provides the protection for the corporation.²¹ Side B coverage “compensates a corporation for expenses that it incurs as a result of indemnifying directors and officers and that, in the absence of insurance, would have to be paid out of corporate funds.”²² Side B coverage’s relevance to the “insured versus insured” exclusion is that it makes the corporation an insured under the policy, filling out either the left or right side of the “versus.”

¹⁶ MCPHEE, *supra* note 5.

¹⁷ Following default corporate law rules, director and officers owe shareholders the fiduciary duties of care and loyalty. *See* MCPHEE, *supra* note 5. The fiduciary duty of care requires the use of “the amount of care which ordinarily careful and prudent men [and women] would use in similar circumstances and consider all material information reasonably available in making business decisions.” *Boles v. Filipowski (In re Enivid, Inc.)*, 345 B.R. 426, 450 (Bankr. D. Mass. 2006) (alteration added) (internal citations omitted). The fiduciary duty of loyalty requires “that directors act in good faith and in the honest belief that the action taken is in the best interests of the corporation, and that directors be both disinterested and independent.” 1 STEVEN M. HAAS, CORPORATE GOVERNANCE: LAW AND PRACTICE §4.03(2) (2005) (“The essence of the duty of loyalty is that ‘[c]orporate officers and directors are not permitted to use their position of trust and confidence to further their private interests . . . [A]n undivided and unselfish loyalty to the corporation demands that there shall be no conflict between duty and self-interest.”).

¹⁸ MCPHEE, *supra* note 5 at § 5.04(1) (citing *In re WorldCom, Inc. Sec. Litig.*, 354 F. Supp. 2d 455, 469 (S.D.N.Y. 2005)).

¹⁹ *Id.* (Stating that indemnification may not be available in situation such as after a corporation has filed for bankruptcy or following a change in control when a new board of directors is unwilling to authorize indemnification of outgoing directors or officers).

²⁰ *See id.* (D&O insurance policies can also have three coverage types: direct coverage to directors and officers, reimbursement for indemnification payments made by the corporation, and entity coverage. For purposes of the “insured versus insured” exclusion, the inclusion of the third type of coverage is unnecessary).

²¹ *Id.*

²² *Id.*

While Side B coverage has its place, Side A coverage is more important in the context of the “insured versus insured” exclusion. This side provides protection for the executives as “standard ‘Side A’ portion of a primary D&O policy protects insured directors and officers against certain types of losses against which the corporation does not or cannot indemnify them.”²³ While D&O insurance is subject to public policy limitations, it still typically provides an alternative source of payment for corporations when indemnification is unavailable. However, D&O insurance policies generally include exclusions, one of which is the basis for this Comment. As previously stated, D&O insurance helps fill the gap when indemnification is unavailable, and Side A coverage is how this is achieved.²⁴ In 2008, this need increased in *Schoon v. Troy*, where a Delaware court decided that nothing barred a corporation from revising their bylaws in the future.²⁵ This decision set the precedent that corporations could revise their bylaws to the detriment of former directors and officers, potentially putting them at personal risk due to a lack of indemnification.²⁶ This personal risk could be mitigated by a D&O policy as its coverage extends for future lawsuits against those insured.²⁷ For this reason, according to a Towers Watson Director and Officers Liability Survey, Side A coverage is the most widely purchased component of a D&O insurance policy by organizations.²⁸

II. THE INSURED VERSUS INSURED EXCLUSION

A. General History

Most directors’ and officers’ liability insurance policies contain an “insured versus insured” exclusion, which “precludes coverage for claims brought by or on behalf of or at the direction of any of the insureds”²⁹ For example, a

²³ *Id.*

²⁴ *Id.* (stating that indemnification may not be available in situations such as after a corporation has filed for bankruptcy or following a change in control when a new board of directors is unwilling to authorize indemnification of outgoing directors or officers).

²⁵ See *Schoon v. Troy*, 948 A.2d 1157 (Del. Ch. 2008).

²⁶ *Id.*

²⁷ Jeanne Oronzio Wermuth, *Why Purchase Side ‘A’ Directors & Officers Liability Coverage?* INS. JOURNAL (June 18, 2012), <https://www.insurancejournal.com/magazines/mag-features/2012/06/18/251462.htm>.

²⁸ *Id.* (“Of its 401 survey respondents (public, private and nonprofit), 86 percent purchased side ‘A’ coverage, either on its own or in addition to either side ‘B’ (coverage for the organization’s indemnification of its directors, officers or members) or side ‘B’ and side ‘C’ (coverage for suits brought directly against the organization); 57 percent purchased excess side ‘A’ or side ‘A’ DIC policies. The vast majority of organizations cited the breadth of the coverage under the excess/DIC side ‘A’ policies as their main reason for making that purchase. These percentages increase each year.”).

²⁹ Larry P. Schiffer, *Insured v. Insured Exclusion in Directors and Officers Policies*, INS. AND

corporation filing suit against one of its former directors for a case arising during his/her term on the corporation's board of directors cannot then claim coverage under its D&O insurance policy to receive a payout. Since the early 2000s, "insured versus insured" exclusions have typically been modified to provide coverage carve-backs for certain claims, such as derivative claims and employment practice claims.³⁰

As a result of the savings and loans crisis in the 1980s, the federal banking regulators actively pursued claims against many of the failed institutions' former officials. Many of these claims implicated the "insured versus insured" exclusion.³¹ In particular, the cases *Bank of America v. Powers* and *National Union Fire Insurance Co. v. Seafirst Corp.* served a defining role in the now common practice of insurance companies' inclusion of such exclusions in D&O insurance policies.³²

In *Bank of America v. Powers*, Bank of America filed suit against a group of its corporate officers based on purported "wrongful and negligent performance of their duties and responsibilities as bank officers and employees in connection with a series of mortgage-backed securities transactions initiated by National Mortgage Equity Corporation."³³ Furthermore, "Bank of America also sued Employers Insurance of Wausau and First State Insurance Company, who issued directors and officers liability insurance policies to [the bank]."³⁴ "[I]n its own right," Bank of America filed claims for indemnity, negligence, gross negligence, and breach of fiduciary duty against its director and officers.³⁵ Claiming the insurance companies' liability under its policies terms, Bank of America also filed indemnity claims against the aforementioned insurance companies.³⁶ Ultimately settling, Bank of America received \$8.2 million from its insurers.³⁷

REINSURANCE DISP. BLOG (Oct. 11, 2017), <https://www.inredisputesblog.com/2017/10/insured-v-insured-exclusion-in-directors-and-officers-policies>.

³⁰ Kevin LaCroix, *D&O Insurance: The "Insured v. Insured" Exclusion*, INS. AND REINSURANCE DISP. BLOG (Aug. 3, 2008), <https://www.dandodiary.com/2008/08/articles/d-o-insurance/do-insurance-the-insured-v-insured-exclusion>.

³¹ *Id.*

³² See *supra* note 7 (referencing *Bank of Am. v. Powers*, No. C 536-776 (Cal. Super. Ct. filed Mar. 1, 1985), reprinted in David W. Ichel & Sharon O. Thompson, *Directors' and Officers' Insurance Coverage: An Overview and Current Issues*, 1 SEC. LITIG. 257, 378 (Sept.–Oct. 1987)).

³³ Sousa, *supra* note 7, at 387.

³⁴ *Id.*

³⁵ *Id.*

³⁶ *Id.*

³⁷ Melanie K. Palmore, "Insured v. Insured" Exclusions in Director and Officer Liability Insurance Policies: Is Coverage Available When Chapter 11 Trustees and Debtors-in-Possession Sue Former Directors

In *National Union Fire Insurance Co. v. Seafirst Corp.*, National Union Fire Insurance Company of Pittsburgh issued an insurance policy to Seafirst Corporation and its subsidiary, Seattle-First National Bank in 1982.³⁸ A shareholder derivative suit was filed in 1983 purporting negligent mismanagement in connection with the previous year's losses by Seafirst's former directors and officers; Seafirst, after court approval, took over the shareholder derivative action and pursued it as direct actions against the former directors and officers.³⁹ National Union Fire Insurance Company subsequently argued that the policy "was not intended to and does not cover claims brought by Seafirst itself against former officers and directors of Seafirst," in filing for declaratory judgement.⁴⁰ Seafirst's argument was unsuccessful, however, as the court disagreed:

[a]fter carefully reviewing the language of the policy, the court concludes that the policy plainly and unambiguously covers direct actions by Seafirst itself against its own directors and officers. According to the policy terms, National Union must pay for loss suffered as a result of 'any claim or claims' against the directors and officers. The phrase 'any claim or claims' clearly includes direct actions, and no other provision in the policy purports to limit the scope of the phrase so as to exclude them from coverage.⁴¹

Not surprisingly, the outcomes of *Bank of America* and *Seafirst* caused a change in many policies, explicitly barring coverage for claims commenced by the insured company itself against its own directors and officers⁴² in the hopes of preventing collusion or "friendly" lawsuits "in which an insured [company] would in essence 'force' its insurer to pay for the poor business decisions of its officers or directors."⁴³

and Officers?, 9 Bankr. Dev. J. 101, 111 n.47 (1992) (citing Peter Waldman, *Bank of America Settles Suits Tied to Losses, Posts Gain on Sale of Bank-Firm Stake*, WALL ST. J., Jan. 5, 1988, at 12.

³⁸ *National Union Fire Ins. Co. v. Seafirst Corp.*, No. C85-396R, 1986 U.S. Dist. LEXIS 28065 at *1 (W.D. Wash. Mar. 19, 1986).

³⁹ *Id.* at *3-*4.

⁴⁰ *Id.* at *4.

⁴¹ *Id.* at *15.

⁴² See Sousa, *supra* note 7 at 388.

⁴³ *Id.* (referencing *Township of Ctr. v. First Mercury Syndicate, Inc.*, 117 F.3d 115, 119 (3d Cir. 1997).

III. INDIAN HARBOR INS. CO. V. ZUCKER

A. *Background & Case Facts*

In *Indian Harbor Insurance Co. v. Zucker*, Capital Bankcorp, a Michigan holding company, filed for reorganization under chapter 11 in 2012 following three plus years of operating at a loss as a result of the 2008 financial crisis.⁴⁴ Reorganization efforts stalled quickly however, and Capital Bankcorp decided to liquidate under chapter 7 in 2013, submitting three proposed liquidation plans in the process.⁴⁵ Each plan included a provision releasing the company's executives from liability.⁴⁶ The creditors' committee objected this release, and asked the bankruptcy court to grant the committee derivative standing to sue the company's executives for breach of their fiduciary duties to the company.⁴⁷ The court denied their motion.⁴⁸ Negotiations continued, and a liquidation plan was agreed upon in 2014.⁴⁹ The plan "required Capitol to assign all of the company's causes of action to a Liquidating Trust, which could pursue those claims on behalf of creditors."⁵⁰ The plan limited prepetition liability to the amount recovered from Capital Bancorp's existing liability insurance policy, while eliminating any personal liability for conduct occurring post-petition.⁵¹ Capital Bankcorp had taken out a prepetition, one-year management liability insurance policy through Indian Harbor in September 2011; said policy was extended multiple times post-petition.⁵² Per the policy, "Indian Harbor agreed to pay for any 'Loss resulting from a Claim first made against the Insured Persons'—a group that included Capitol's directors, officers, and employees—'during the Policy Period . . . for a Wrongful Act.'"⁵³

Importantly, the policy excluded coverage for "any claim made against an Insured Person . . . by, on behalf of, or in the name or right of, the Company or any Insured Person,' except for derivative suits by independent shareholders and

⁴⁴ *Indian Harbor Ins. Co. v. Zucker*, 860 F.3d 373, 374 (6th Cir. 2017).

⁴⁵ *Id.*

⁴⁶ *Id.*

⁴⁷ *Id.*

⁴⁸ *Id.*

⁴⁹ *Id.*

⁵⁰ *Id.* at 374–75.

⁵¹ *Id.* at 375.

⁵² *Id.*

⁵³ *Id.*

employment claims.”⁵⁴ Such an exclusion is commonly referred to as a “insured-versus-insured exclusion.”⁵⁵

In August 2014, the Liquidation Trustee filed suit against several executives of Capital Bankcorp for \$18.8 million, alleging breaches of fiduciary duty owed to the company.⁵⁶ Indian Harbor, after getting word of the suit, responded by filing a diversity action against the Liquidation Trustee and the executives of Capital Bankcorp, and sought a declaratory judgment which argued they had no obligation to cover damages from the suit because the claim fell within the insured-versus-insured exclusion.⁵⁷ The district court held that the insured-versus-insured exclusion applied.⁵⁸ On appeal, the Sixth Circuit affirmed the district court’s holding via split decision.⁵⁹

B. Majority Opinion

Judge Sutton authored the majority opinion.⁶⁰ Sutton first references the Ninth Circuit case *Biltmore Assocs., LLC v. Twin City Fire Ins. Co.* establishing a limit to a corporation’s reliance on D&O insurance.⁶¹ In referencing *Biltmore*, Sutton notes “[a] company . . . cannot hope to push the costs of mismanagement onto an insurance company just by suing (and perhaps collusively settling with) past officers who made bad business decisions.”⁶²

Sutton begins his analysis by looking at the contract terms in question, and considers a simplified application of including the “insured versus insured” exclusion.⁶³ Sutton notes that “[h]ad Capitol sued the Reids for mismanagement, that would be a claim ‘by’ the Company (an insured person) against its own officers (also insured persons)[,] the exclusion would bar the claim”⁶⁴ In determining the issue in dispute, Sutton compares the simplified application to case’s fact pattern, concluding that while the claim’s objects are equivalent (the officers), the claimant is no longer the Company, but instead the Liquidation Trust which the Company’s rights have been assigned.⁶⁵ Citing *Burkhardt v.*

⁵⁴ *Id.*

⁵⁵ *Id.* Specifics of an “insured versus insured” exclusion are detailed in Section II. *Supra* Section II.

⁵⁶ *Id.*

⁵⁷ *Id.*

⁵⁸ *Id.*

⁵⁹ *Id.* at 378.

⁶⁰ *Id.* at 373.

⁶¹ *Id.* at 375 (citing *Biltmore Assocs., LLC v. Twin City Fire Ins. Co.*, 572 F.3d 663 (9th Cir. 2009)).

⁶² *Indian Harbor Ins. Co.*, 860 F.3d at 375 (citing *Biltmore Assocs., LLC*, 572 F.3d at 670).

⁶³ *Indian Harbor Ins. Co.*, 860 F.3d at 375.

⁶⁴ *Id.*

⁶⁵ *Id.*

Bailey, Sutton concludes that as a voluntary assignee, the Liquidation Trust stands in the shoes of Capitol possesses the same rights that are subject to the same defenses; thus, the “insured versus insured” exclusion covers a lawsuit by the Liquidation Trust “in the right” of Capitol.⁶⁶

Sutton opposes the dissent’s argument, which rested on 11 U.S.C. § 541(a)(1), described *infra*, and disputed said argument’s validity before bankruptcy.⁶⁷ As Sutton says,

Capitol could not have dodged the exclusion by transferring a mismanagement claim to a new company—call it Capitol II—for the purpose of filing a mismanagement claim against the Reids. No matter how legally distinct Capitol II might be, the claim would still be “by, on behalf of, or in the name or right of” Capitol.⁶⁸

The same conclusion must therefore apply to claims filed after a corporation enters bankruptcy because the transferred claim would still have been filed “on behalf of” the prepetition entity.⁶⁹

Furthermore, Sutton argues that the dissent’s reliance on 11 U.S.C. § 541(a)(1) is ill-founded, citing to both *Biltmore* and the 1984 Supreme Court decision in *NLRB v. Bildisco & Bildisco*.⁷⁰ The *Biltmore* court stated that “the debtor in possession is the debtor, and the debtor is the person”—pre-bankruptcy Capitol—“that filed for bankruptcy.”⁷¹ The Court in *NLRB* rejected that a debtor in possession is a “wholly new entity” unbound by the prepetition company’s contractual obligations, further stating that “if the [debtor in possession] were a wholly ‘new entity,’ it would be unnecessary for the Bankruptcy Code to allow it to reject executory contracts, since it would not be bound by such contracts in the first place.”⁷² While the Sixth Circuit previously remarked on the legal distinction between the prepetition entity and the debtor in possession, they further clarify this distinction in stating that “[t]he debtor and the debtor-in-possession is one and the same person, although ‘wearing two hats’—representing its own interests as well as the interests of the bankruptcy estate—and held that district courts should not appoint separate counsel.”⁷³

⁶⁶ *Id.* at 375–76 (citing *Burkhardt v. Bailey*, 260 Mich. App. 636, 680 N.W.2d 453, 462 (Mich. Ct. App. 2004)).

⁶⁷ *Id.* at 376.

⁶⁸ *Id.*

⁶⁹ *Id.*

⁷⁰ *Id.* (citing *NLRB v. Bildisco & Bildisco*, 465 U.S. 513, 528 (1984)).

⁷¹ *Biltmore Assocs., LLC v. Twin City Fire Ins. Co.*, 572 F.3d 663, 671 (9th Cir. 2009).

⁷² *NLRB*, 465 U.S. at 528.

⁷³ *Cle-Ware Indus., Inc. v. Sokolsky*, 493 F.2d 863, 871 (6th Cir. 1974). *See also* *Gordon Sel-Way v.*

Ultimately, Sutton agrees with the dissent that Capitol’s bankruptcy created a new legal entity distinct from Capital itself, via the creation of the bankruptcy estate under 11 U.S.C. § 541(a)(1).⁷⁴ However, Sutton’s agreement ends there as he further states that “[t]he bankruptcy estate is a nominal entity that cannot act on its own; it needs a debtor in possession or trustee to sue on its behalf.”⁷⁵ So, just as the “insured versus insured” exclusion would bar a claim brought on behalf of Capital, so too does it bar a suit brought by the Trust.⁷⁶

C. *Dissenting Opinion*

Judge Bernice B. Donald authored the dissenting opinion.⁷⁷ Donald argues contrary to the majority stating that “[t]he assigned trustee in this case should have the same right to be exempt from the insured-versus-insured exclusion as a court-appointed trustee . . . [b]ecause [the majority’s] decision makes it harder for companies to emerge . . . from bankruptcy with a consensual plan of reorganization”⁷⁸ Quoting a 2007 comment from the *Emory Bankruptcy Developments Journal*, Donald notes:

The primary intent of the development of the “insured versus insured” exclusion was to prevent collusive lawsuits in which an insured corporation would in essence “force” its insurer to pay for the poor business decisions of its officers and directors by the corporation filing an action against its own officers and directors.⁷⁹

Donald further notes that “there is a split among ‘federal courts on the issue of whether a lawsuit against a corporation’s former directors and officers brought by a debtor in possession, trustee, creditors’ committee, or post confirmation liquidating trustee triggers the ‘insured versus insured’ exclusion in a directors and officers liability insurance policy[,]” and that functionally, there is no “distinction between an assigned trustee that a bankruptcy court has determined is independent and does not pose a risk of collusion, and one that is appointed by a bankruptcy court and is by nature of that appointment independent.”⁸⁰

United States, 270 F.3d 280, 290 (6th Cir. 2001) (remarking on the legal distinction between a prepetition entity and the resulting debtor in possession).

⁷⁴ *Indian Harbor Ins. Co.*, 860 F.3d at 377.

⁷⁵ *Id.* (citing *In re Lucre, Inc.*, 434 B.R. 807, 832 n.57 (Bankr. W.D. Mich. 2010)).

⁷⁶ *Indian Harbor Ins. Co.*, 860 F.3d at 377.

⁷⁷ *Id.* at 378.

⁷⁸ *Id.*

⁷⁹ *Id.* at 379 (quoting Sousa, *supra* note 7, at 370).

⁸⁰ *Indian Harbor Ins. Co.*, 860 F.3d at 379.

Donald then points to a recent trend: some courts have found that a plain language examination of the “insured versus insured” exclusion should not extend to successors or assignees, including claims by a trustee in bankruptcy.⁸¹ Donald emphasizes such claims “are not the same claims brought ‘by’ the Debtor under the exclusionary provision.”⁸² Donald then looks to the “insured versus insured” exclusion within the Insurance Policy at issue, which states “[t]he Insurer shall not be liable to make any payment for Loss in connection with any claim made against an Insured Person . . . (G) by, on behalf of, or in the name or right of, the Company or any Insured Person”⁸³ Discrediting the notion that the suit brought by the Liquidation Trustee against Capitol’s officers was made “by the Company” or on “behalf of an Insured Person,” Donald believes the only remaining question is whether the suit was brought in the “name or right of the Company.”⁸⁴

Donald again looks to the plain language of the Insurance Policy for the definition of the term “Company,” determining that it only includes “Capitol Bancorp, its Subsidiaries, and 216 entities affiliated with Capitol Bancorp, including community banks, real estate holding companies, and trust companies[,]” and not a debtor in possession or other estate representatives.⁸⁵

Donald then points to Sixth Circuit precedent which determined that the bankruptcy estate and a debtor are separate legal entities.⁸⁶ Attempting to discredit the majority’s argument, Donald argues that said precedent comports with fundamental principles of bankruptcy law, stating that it is “precisely the point” that the “new-entity” argument would not work before bankruptcy since a new entity gets formed when entering bankruptcy.⁸⁷

Discrediting any arguments of fairness, Donald notes that the “new-entity” argument is precisely the reason why many companies file for bankruptcy: in bankruptcy, companies receive certain rights, including contractual rights, that they would not be entitled to outside of bankruptcy.⁸⁸ An example of this is the treatment of ambiguous anti-assignment clauses in an insurance contract within

⁸¹ *Id.* (internal citations omitted).

⁸² *Id.* (internal citations omitted).

⁸³ *Id.* at 380.

⁸⁴ *Id.*

⁸⁵ *Id.*

⁸⁶ *Id.* (citing *Sel-Way v. United States*, 270 F.3d 280, 290 (6th Cir. 2001); *Frank v. Mich. State Unemployment Agency*, 252 F.3d 852, 853 (6th Cir. 2007); *Mgmt. Inv’rs v. United Mine Workers*, 610 F.2d 384, 392 (6th Cir. 1979)).

⁸⁷ *Id.* at 380–81 (citing 11 U.S.C. § 541).

⁸⁸ *Indian Harbor Ins. Co.*, 860 F.3d at 381.

bankruptcy law.⁸⁹ In fact, within the underlying bankruptcy case of *Indian Harbor*, the court notes distinguish the debtor and the trust as separate legal entities, stating:

It appears to this Court that movants are confused about the relationship between the Debtor and the Liquidating Trust. The Liquidating Trust was created by the Plan and the order confirming the Plan. Debtor and the [Liquidating] Trust are separate legal entities, separate counsel, separate assets and separate duties. To the extent movants here have a claim for indemnification, it would be against Debtors and not the [L]iquidating Trustee.⁹⁰

Donald argues that under the majority decision, under which only court-appointed trustees are exempt from the “insured versus insured” exclusion, “creditors would be required to reject any plan and instead seek appointment of a trustee in order to preserve the ability to obtain an insurance recovery[,]” and “the insurance company would be no better off as it would be left in the same position, having to defend the directors’ claims.”⁹¹ While agreeing some case law supports the majority’s notion that court-appointed trustees are exempt from the “insured versus insured” exclusion, Donald disagrees that silence on the issue means assignee trustees are not given the same treatment.⁹²

According to Donald, if the majority’s decision becomes precedent, its effect would be detrimental to a court’s efficiency in chapter 11 proceedings as it:

Send[s] a clear message to creditors in chapter 11 proceedings that if claims against directors and officers are deemed to be of significant value and the plan proposes to put those claims into a trust, the creditors must not agree to a plan proposed or even agreed to by the debtor-in-possession. Instead creditors will be required to seek the appointment of a bankruptcy trustee, where appropriate, or they will have to defeat the debtor-in-possession’s plan and propose their own disclosure statement and plan⁹³

⁸⁹ See, e.g., *In re Federal-Mogul Global Inc.*, 684 F.3d 355, 365–66 (3d Cir. 2012) (holding that insurance proceeds were assignable despite anti-assignment provisions in subject insurance policies).

⁹⁰ *Indian Harbor Ins. Co.*, 860 F.3d at 381 (quoting *Indemnification Hearing Transcript*, R. 35-21, Page ID #1205-06).

⁹¹ *Id.*

⁹² *Id.* Donald furthers this notion by pointing to the fact that while the majority states a distinction between an assignee trustee and a court-appointed trustee, this distinction is without merit as the majority failed to provide supporting case law. *Id.* at 381–82.

⁹³ *Id.* at 382.

Additionally, the costs would significantly outweigh the lack of benefits from this type of approach, because insurance companies still would be required to defend applicable claims.⁹⁴

On the topic of possible collusion issues, Donald points not to the majority's decision for guidance, but instead argues for evaluation of the trustee's independence on a case-by-case basis;⁹⁵ this is similar to bankruptcy court's evaluation in this case when it determined the claims were made in good faith.⁹⁶ Given the lack of collusion, Donald finally argues "there is no reason that the assigned trustee in this case should trigger the insured-versus-insured exclusion."⁹⁷

IV. ANALYSIS

In examining the circuit split on the "insured versus insured" exclusion's applicability in the bankruptcy context, it is important to flesh out areas where the courts are unified in their approach. First, one must look at the text of the exclusion itself to determine if the drafting of the D&O insurance policy can dictate how a court should rule. Finally, one must look at differences between how courts approach whether a debtor in possession or a trustee is the party bringing suit.

A. *Exceptions within the Exclusion*

The "insured versus insured" exclusion is one of the most heavily litigated provisions of D&O policies.⁹⁸ Because of this, insurance policies are more insured-friendly, carving back coverage for certain instances that are expressly stated within the policy. One important carve-out in the bankruptcy context is an exception for successors-in-interest.⁹⁹ By expressly stating that an "insured versus insured" exclusion does not apply to, for example, bankruptcy trustees, the carve-back eliminates any question as to how a court will rule if litigation follows. This is true unless the terms are ambiguous.¹⁰⁰

⁹⁴ *Id.* at 381.

⁹⁵ *Id.* (citing Sousa, *supra* note 7, at 371).

⁹⁶ *Indian Harbor Ins. Co.*, 860 F.3d at 381.

⁹⁷ *Id.*

⁹⁸ *How to Soften the Insured vs. Insured Exclusion in Your Clients's D&O Insurance Policy*, AMWINS GROUP, INC. (Dec. 10, 2015), http://www.amwins.com/insights/article/how-to-soften-the-insured-vs.-insured-exclusion-in-your-client's-d-o-insurance-policy_12-15.

⁹⁹ *Id.*

¹⁰⁰ *Id.*

When an insurer relies on a policy exclusion, it carries the burden of proving such an exception’s applicability.¹⁰¹ The interpretation of an exclusion’s language within a D&O insurance policy presents a question of law.¹⁰² This interpretation follows three guiding principles:

- (1) an insurance contract, like other contracts, is to be construed according to the fair and reasonable meaning of its words . . . (2) exclusionary clauses must be strictly construed against the insurer so as not to defeat any intended coverage or diminish the protection purchased by the insured . . . and (3) doubts created by any ambiguous words or provisions are to be resolved against the insurer¹⁰³

However, “where the terms of [the] exclusionary clause are plain and free from ambiguity, the words [will be] construed in their ‘usual and ordinary sense’ and not strictly against the insurer.”¹⁰⁴

As one can tell, contract law plays a vital part in the interpretation of insurance policies, because an insurance policy is a contract. As such, a “court’s duty is to ascertain the intent of the parties [at the time of contracting] as manifested in the language of the agreement.”¹⁰⁵ Additionally, the “reasonable expectations” doctrine plays a role, furthering the importance of party intent at the time of drafting the contract when determining the applicability of certain exclusions within a policy.¹⁰⁶ In fact, in 1998, the Supreme Court of Iowa described the application of the “reasonable expectations” doctrine when dealing with an exclusionary clause, stating:

In a fundamental sense, of course, [withdrawing with the policy’s left hand what is given with its right] is the proper function of any exclusion clause in an insurance policy. The reasonable expectations doctrine does no violence to this proper function by its limited intrusion into it. The doctrine means only that when, within its metes and bounds definition, an exclusion acts in technical ways to withdraw

¹⁰¹ Great Sw. Fire Ins. Co. v. Hercules Bldg. & Wrecking Co., 619 N.E.2d 353, 356 (Mass. App. Ct. 1993).

¹⁰² Camp Dresser & McKee, Inc. v. Home Ins. Co., 568 N.E.2d 631, 633 (Mass. App. Ct. 1991).

¹⁰³ *Id.*

¹⁰⁴ Farm Family Mut. Ins. Co. v. Whelpley, 767 N.E.2d 1101, 1103 (Mass. App. Ct. 2002).

¹⁰⁵ E. Associated Coal Corp. v. Aetna Cas. & Sur. Co., 632 F.2d 1068, 1075 (3d Cir. 1980) (internal citations omitted).

¹⁰⁶ *See, e.g.*, Righttime Econometrics, Inc. v. Fed. Ins. Co., No. Civ. A. 05-1880, 2006 LEXIS 8621, *3 (E.D. Pa. Mar. 6, 2006) (“Taking the factual allegations in RTE’s complaint as true . . . I cannot conclude that RTE’s expectation of D&O coverage for the Putnam claims is unreasonable as a matter of law. While it is not easy to suppose that RTE could have reasonable expected coverage under the D&O clause in the absence of a claim against an RTE officer or director, RTE’s well-pled allegation that Federal consistently represented as much to RTE and thereby induced RTE to purchase the policy raises at least a possibility that RTE can prove its reasonable expectations theory.”).

a promised coverage, it must do so forthrightly, with words that are, if not flashing, at least sufficient to assure that a reasonable policy purchaser will not be caught unawares.

The reasonable expectations doctrine is a recognition that insurance policies are sold on the basis of the coverage they promise. When later exclusions work to eat up all, or even substantially all, of a vital coverage, they cannot rest on technical wording, obscure to the average insurance purchaser. At some point fairness demands that the coverage clause itself be self-limiting.¹⁰⁷

When coupling the “reasonable expectations” doctrine with the propensity for construing exclusionary clauses narrowly against the insurer, it is clear that only an unambiguously drafted exclusionary clause demonstrating party intent at the time of drafting the policy that is bound by such exclusion will help an insurer meet its burden of proving such exclusion’s applicability.

B. Debtor in Possession v. Trustee

Sections 1106 and 1107 of the Bankruptcy Code define the duties of a trustee and a debtor in possession respectively.¹⁰⁸ Although Sections 1101(1) and 1116 seem to treat debtors-in-possession and trustees as equals, further analysis of Sections 1106 and 1107 together prove otherwise, especially for purposes of the “insured-versus-insured exclusion’s” applicability in bankruptcy.¹⁰⁹

Section 1106(a) lists the duties of a trustee appointed under Section 1101(1).¹¹⁰ While Section 1107(a) references Section 1106(a) when listing the duties of a debtor in possession, it does so with specific limitations.¹¹¹ Other than disallowing a debtor in possession the right to compensation, Section 1106(a) disallows a debtor in possession from performing the duties set forth under Sections 1106(a)(2), (3), and (4).¹¹² Sections 1106(a)(3) and (4) relate to the investigation of the debtor’s business and the subsequent filing and transmitting of a statement of such investigation.¹¹³ Section 1106(a)(2) is only applicable if the debtor had previously failed to file the list, schedule, and statement required

¹⁰⁷ Clark-Peterson Co. v. Indep. Ins. Assoc., Ltd., 492 N.W.2d 675, 679 (Iowa 1992).

¹⁰⁸ 11 U.S.C. §§ 1106, § 1107 (2019).

¹⁰⁹ 11 U.S.C. § 1101(1) (2019) (defining debtor in possession as the debtor except when a trustee has been appointed); §1106 (equating a debtor in possession and trustee in small business cases by giving them identical duties).

¹¹⁰ § 1106(a).

¹¹¹ § 1107(a).

¹¹² *Id.*

¹¹³ § 1106(a)(3)–(4).

under Section 521(a)(1).¹¹⁴ Although a debtor in possession becomes a separate entity, distinct from the prepetition debtor under Section 1107(a), this new separate entity bears little uniqueness from its prepetition self.¹¹⁵ As such, there exists the potential for conflicts of interest to discredit any self-reporting that would be conducted if a debtor in possession were allowed to investigate and report findings under Sections 1106(3) and (4).¹¹⁶

Cases regarding a suit brought by a debtor in possession in a bankruptcy proceeding against the prepetition debtor's directors and officers with the existence of D&O insurance policy containing an "insured versus insured" exclusion have been scarce. However, courts have seemed to gravitate towards a consensus as to how to treat the situation, disallowing claims brought by a debtor in possession.

In 1997, the District Court of Idaho faced a question concerning the "insured versus insured" exclusion's applicability in the bankruptcy context in *Cigna Ins. Co. v. Gulf United States Corp.*¹¹⁷ In *Cigna*, Gulf United States Corp. (Gulf) initiated, in its capacity as debtor in possession, an adversary proceeding against several of its directors and officers following a filing for chapter 11 relief.¹¹⁸ Gulf had insurance policies with Continental, Fidelity, National Union, and multiple policies with Cigna each containing an "insured versus insured" exclusion.¹¹⁹ The Continental Policy stated, in relevant part, that the "company shall not be liable to make any payment in connection with any claim . . . brought against one or more past, present or future directors and officers, by the corporation, its subsidiaries or successors."¹²⁰ The Fidelity Policy stated, in relevant part, that the "Underwriter shall not be liable to make any payment for Loss in connection with any Claim made against any of the Insured Directors and Officers: . . . by or on behalf of the Company."¹²¹ The National Union Policy excluded coverage for "any claim or claims made against the Directors or Officers: . . . which are brought by any Insured or the

¹¹⁴ § 1106(a)(2).

¹¹⁵ See *Bank of New England, N.A. v. Klein*, 86 B.R. 897 (S.D. Tex. 1988).

¹¹⁶ Although self-reporting can lead to conflicts of interest, the bankruptcy court can prescribe such actions at its discretion. See *In re Blue Stone Real Estate, Constr. & Dev. Corp.*, 392 B.R. 897, 902 (Bankr. M.D. Fla. 2008).

¹¹⁷ *Cigna Ins. Co. v. Gulf United States Corp.*, Case No. CV 97-250-N-EJL, 1997 U.S. Dist. LEXIS 23816 (D. Idaho Sept. 11, 1997).

¹¹⁸ *Id.* at *3.

¹¹⁹ *Id.*

¹²⁰ *Id.*

¹²¹ *Id.*

Company.”¹²² The Cigna Policies each contained generic adaptations of “insured versus insured” exclusions.¹²³ Each insurer denied coverage, arguing that the aforementioned “insured versus insured” exclusions barred Gulf’s ability to file suit as a debtor in possession.¹²⁴

Gulf subsequently transferred the claims to a litigation trust formed “for the purpose of prosecuting the [director and officer] claims on behalf, and for the sole benefit of creditors designated in the plan of reorganization. The Trust agreement specifically excluded Gulf as a beneficiary of the Trust.”¹²⁵ The court, speaking to the claims initially brought by Gulf as the debtor in possession, stated that “once Gulf entered bankruptcy, and assumed its status as a debtor-in-possession, its relationship to its creditors and shareholders was subject to a different set of legal obligations.”¹²⁶ Additionally, the court noted that “[t]he primary focus of the [‘insured versus insured’] exclusion is to *prevent collusive suits in which an insured company might seek to force its insurer to pay for poor business decisions of its officers or managers*,”¹²⁷ and that the “insured versus insured” exclusion did not apply where “it is clear that the underlying action is not collusive.”¹²⁸ In doing so, the court sided with Gulf, concluding that the “insured versus insured” exclusions did not apply.¹²⁹

In 2004, the United States District Court for the District of Massachusetts decided *Stratton v. Nat’l Union Fire Ins. Co.* where the court determined whether a successor company, acting as debtor in possession, could be considered an insured for purposes of the “insured versus insured” exclusion.¹³⁰ In *Stratton*, Mariner Health Group, Inc. (“MHG”), a post-acute trauma healthcare company, purchased a \$10,000,000 D&O insurance policy from National Union for coverage from 1997 through 2000.¹³¹ The policy contained the following “insured versus insured” exclusion:

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

(i) which is brought by any Insured or by the [Company, Paragon

¹²² *Id.*

¹²³ *Id.* at *3 –*4.

¹²⁴ *Id.* at *4.

¹²⁵ *Id.* at *2 (quoting *Twp. of Ctr. v. First Mercury Syndicate*, 117 F.3d 115, 119 (3d Cir. 1997).

¹²⁶ *Id.* at *4.

¹²⁷ *Id.* at *18 (emphasis added).

¹²⁸ *Id.*

¹²⁹ *Id.* at *5.

¹³⁰ *Stratton v. Nat’l Union Fire Ins. Co.*, No. 03-CV-12018-RGS, 2004 LEXIS 17613 (D. Mass. Sept. 3, 2004).

¹³¹ *Id.* at *6. Arthur Stratton was the founder of MHG which was acquired by Paragon Post Acute Network, Inc. (Paragon) in 1998. *Id.* at *4.

Health Network, Inc. or Mariner Post-Acute Network, Inc. or successor company thereof or any Subsidiary or affiliate thereof]; or which is brought by any security holder of the Company . . . or successor company thereof . . . , whether directly or derivatively, unless such security holder's Claim(s) is instigated and continued totally independent of, and totally without the solicitation of, or assistance of, or active participation of, or intervention of, any Insured or the Company . . . or successor company thereof¹³²

The court noted that “[t]he policy defined an ‘Insured’ as any past, present or future duly elected or appointed directors or officers of the Company . . . or successor company thereof”¹³³

Mariner Post-Acute Network, Inc. (“MPAN”), the company resulting from an acquisition of MHG by Paragon Post Acute Network, Inc., took out its own D&O insurance policy which provided coverage from 2001 through 2002.¹³⁴ Having a similar “insured versus insured” exclusion, this policy also included a section which defined the term “Company” to include “the Named Corporation that emerges from Bankruptcy.”¹³⁵ MPAN and MHG filed for chapter 11 bankruptcy in 2000.¹³⁶

Following the filing, a lawsuit was brought against four officers and directors of MHG which National Union refused to cover, claiming that MHC is the successor to MHG and MPAN.¹³⁷ Looking at the D&O policy, the District Court of Massachusetts examined the rationale behind “insured versus insured” exclusions, determining that it is “to protect insurers from collusive lawsuits by corporations trying to recoup corporate losses by attributing them to the wrongdoing of directors and officers who, if insured, have nothing to lose by taking the blame.”¹³⁸ The District Court of Massachusetts further noted that because MHC was an ongoing enterprise, any recovery would be paid to MHC, thus creating an absence of truly adverse parties.¹³⁹ As such, the District Court of Massachusetts determined that the successor company constituted an insured based on the policy and therefore coverage was excluded.¹⁴⁰

¹³² *Id.* at *6.

¹³³ *Id.* at *7.

¹³⁴ *Id.*

¹³⁵ *Id.* at *8.

¹³⁶ *Id.* at *7–8.

¹³⁷ *Id.* at *11.

¹³⁸ *Id.* at *17.

¹³⁹ *Id.* at *18.

¹⁴⁰ *Id.* at * 21–23.

In 2008, the United States Court of Appeals for the Ninth Circuit decided *Biltmore Assocs., LLC v. Twin City Fire Ins. Co.*¹⁴¹ In *Biltmore*, Visitalk.com, Inc. (Visitalk) filed for chapter 11 relief.¹⁴² Prior to filing, Visitalk had purchased D&O insurance policies from Reliance Insurance Company and Twin City Fire Insurance Company.¹⁴³ Each policy contained the following “insured versus insured” exclusion:

The Insurer shall not be liable to make any payment for Loss in connection with any Claim made against the Directors and Officers . . . :

(D) brought or maintained by or on behalf of an Insured in any capacity or by an security holder of the company except:

(1) a Claim, including, but not limited to, a security holder class or derivative action that is instigated and continued totally independent of, and totally without the solicitation of, or assistance of, or active participation of, or intervention of an Insured;

(2) an Employment Practice Claim by a former Director or a present or former Officer;

(3) a claim for contribution or indemnity if the Claim directly results from another Claim that is otherwise covered under this Policy; or

(4) a claim by any employee(s) of the Company described in IV.(D)(2) of the Policy.¹⁴⁴

The aforementioned exclusion came into play when Visitalk, acting as debtor in possession, sued a handful of its recently discharged directors and officers for breaches of fiduciary duty.¹⁴⁵ Biltmore Associates, who had been appointed as a trustee within Visitalk’s bankruptcy, then filed a lawsuit against the insurance companies after the companies refused to cover the claims brought by Visitalk against its former directors and officers.¹⁴⁶ Since none of the listed exceptions to the exclusion were at play, the Ninth Circuit looked beyond the

¹⁴¹ *Biltmore Assocs., LLC v. Twin City Fire Ins. Co.*, 572 F.3d 663 (9th Cir. 2009).

¹⁴² *Id.* at 666.

¹⁴³ *Id.* at 665.

¹⁴⁴ *Id.* at 666.

¹⁴⁵ *Id.*

¹⁴⁶ *Id.* at 667.

four corners of the policy, and instead looked to rationale behind the “insured versus insured” exclusion.

In discussing the rationale behind the usage of “insured versus insured” exclusion in D&O policies, the Ninth Circuit stated:

Because risks such as collusion and moral hazard are much greater for claims by one insured against another insured on the same policy than for claims by strangers, liability policies typically exclude them from coverage. Allowing such claims would turn liability insurance into casualty insurance, because the company would be able to collect from the insurance company for its own mistakes, since it acts through its directors and officers.¹⁴⁷

Elaborating further, the Ninth Circuit explained that “[t]he exclusion protects of course against collusion, and also against the risk of selling liability insurance for what amounts to a fidelity bond.”¹⁴⁸

Additionally, the Ninth Circuit Court discussed whether Biltmore’s argument that Visitalk, the debtor in possession, and Visitalk, the insured corporation, were not the same entity. The Ninth Circuit ultimately concluded that “for purposes of the insured versus insured exclusion, the pre-filing company and the company as debtor in possession in chapter 11 are the same entity.”¹⁴⁹ The Ninth Circuit cited the Supreme Court’s decision in *NLRB v. Bildisco & Bildisco* as support for their conclusion.¹⁵⁰ In *Bildisco*, the Supreme Court decided, in the labor law context that “it is sensible to view the debtor-in-possession as the same ‘entity’ which existed before the filing of the bankruptcy petition”¹⁵¹ The Supreme Court also noted that “[o]bviously, if the [debtor in possession] were a wholly ‘new entity,’ it would be unnecessary for the Bankruptcy Code to allow it to reject executory contracts, since it would not be bound by such contracts in the first place.”¹⁵²

Assuming no expressly contrasting language in an applicable D&O insurance policy, the applicable case law bars an entity acting as a debtor in possession from bringing suit against the prepetition debtor’s former directors and officers when such former directors and officers were covered by a D&O insurance policy containing an “insured versus insured” exclusion. After

¹⁴⁷ *Id.* at 669.

¹⁴⁸ *Id.*

¹⁴⁹ *Id.* at 671.

¹⁵⁰ *Id.* at 671–72.

¹⁵¹ *NLRB v. Bildisco & Bildisco*, 465 U.S. 513 (1984).

¹⁵² *Id.* at 528.

originally being deemed allowed in the 1990s, courts barred claims brought by a debtor in possession against former directors and officers covered by an existing D&O insurance policy that included a “insured versus insured” exclusion.¹⁵³ Although 11 U.S.C. §541(a) creates an estate separate to the debtor, 11 U.S.C. § 1101(1) defines debtor in possession as a debtor except when a trustee is appointed. Given that a debtor in possession is a debtor, the name debtor in possession acts as no more than a mere pseudonym created by the Bankruptcy Code in the context of the “insured versus insured” exclusion, thus barring claims brought by a debtor in possession.

But what about when a trustee is the party bringing suit? This is where the true circuit split lies. In fact, in 2017 and 2018, courts have both barred and allowed claims brought by trustees.¹⁵⁴

It was not until 1992 that the first court decision addressing the “insured versus insured” exclusion in the bankruptcy context was reported.¹⁵⁵ In *Reliance Insurance Co. v. Weiss*, Reliance Insurance Company of Illinois (Reliance) issued D&O insurance to Bank Building and Equipment Corporation (BBC) containing the following “insured versus insured” exclusion:

The Insurer shall not be liable to make any payment for loss in connection with any claim made against the Directors and Officers by or on behalf of a Director and/or Officer or by or on behalf of the Company, except for stockholder(s) derivative actions brought by a shareholder(s) of the Company other than a Director and/or Officer.¹⁵⁶

BBC subsequently filed a liquidating chapter 11 plan.¹⁵⁷ The Plan Committee, who had previously been organized to implement the plan, filed a cause of action against the former directors and officers of BBC, alleging breach of fiduciary duty and negligence in the company management.¹⁵⁸ Reliance denied coverage, filing for declaratory judgment on the notion that the aforementioned “insured versus insured” exclusion barred the suit brought by the Plan Committee.¹⁵⁹

¹⁵³ See *Biltmore Assocs., LLC*, 572 F.3d at 668, *Dynasty Oil & Gas, LLC v. Citizens Bank (In re United Operating, LLC)*, 540 F.3d 351 (5th Cir. 2008); *Stratton v. Nat'l Union Fire Ins. Co.*, No. 03-CV-12018-RGS, 2004 LEXIS 17613 (D. Mass. Sept. 3, 2004). *But see* *Cohen et al. v Nat'l Union Fire Ins. Co. et al (In re County Seat Stores, Inc.)*, 280 B.R. 319, 326 (Bankr. S.D.N.Y. 2002).

¹⁵⁴ See *Indian Harbor Ins. Co. v. Zucker*, 860 F.3d 373, 374 (6th Cir. 2017) (barring a claim by a trustee). *But see* *Segner v. Admiral Ins. Co. (In re Palmaz Sci., Inc.)*, Nos. 16-50552-CAG, 17-05027-CAG, 2018 Bankr. LEXIS 1659 at *41 (Bankr. W.D. Tex. June 4, 2018) (allowing a claim by a trustee).

¹⁵⁵ See *Reliance Insurance Co. v. Weis*, 148 B.R. 575 (E.D. Mo. 1992).

¹⁵⁶ *Id.* at 577.

¹⁵⁷ *Id.*

¹⁵⁸ *Id.* at 578.

¹⁵⁹ *Id.* at 580.

The court ultimately sided with Reliance, concluding there was no “significant legal distinction between BBC and its bankruptcy estate, and the action initiated by the Plan Committee was in fact brought ‘on behalf of’ BBC. Therefore the ‘insured versus insured’ exclusion prohibited coverage under the terms of the policy.”¹⁶⁰ The court’s finding was based on the following notions: (1) “the bankruptcy estate’s legal and equitable interests in property . . . rose no higher than those of the debtor;” and (2) “the Plan Committee was specifically authorized to ‘take whatever legal actions were necessary in the name of and on behalf of the . . . Debtors’” by the liquidating plan and disclosure statement.¹⁶¹

Conversely, in *Pintlar Corp. v. Fid. & Cas. Co.*, Pintlar Gulf USA Corporation (Gulf), filed an adversary proceeding against its former directors and officers as one of the debtors-in-possession.¹⁶² Gulf subsequently demanded coverage for this claim under their existing D&O policy, and the insurance carrier denied coverage, claiming the included “insured versus insured” exclusion barred such coverage.¹⁶³ Subsequently, the collective debtors-in-possession entered into a trust agreement that included the assignment of their claims against the former directors and officers to the president of Pintlar.¹⁶⁴ The trust agreement included a provision excluding Gulf, Pintlar, or any of their respective surviving or successor entities from receiving any potential benefit from the trust including those from the prosecution of the claims against the former directors and officers.¹⁶⁵

Regarding the aforementioned claims, both parties filed for summary judgment, with the insurers arguing that the claims were barred by the “insured versus insured” exclusion because “the alter ego of Gulf and Pintlar for the purpose of the exclusion, and that the transfer of the causes of action [was] nothing more than an assignment to avoid the exclusion.”¹⁶⁶ The court disagreed with the insured, holding that the claims now belonged to the creditors, “acting through the litigation trustees . . . [,] [*t*]he litigation Trustees are not acting for the benefit of the corporation, but for the benefit of the corporation’s creditors, including the shareholders.”¹⁶⁷

¹⁶⁰ Sousa, *supra* note 7, at 399 (citing *Weis*, 148 B.R. at 583) (emphasis added).

¹⁶¹ *Id.*

¹⁶² *Pintlar Corp. v. Fid. & Cas. Co. (In re Pintlar Corp.)*, 205 B.R. 945, 946 (Bankr. D. Idaho 1997).

¹⁶³ *Id.*

¹⁶⁴ *Id.*

¹⁶⁵ *Id.*

¹⁶⁶ *Id.* at 947.

¹⁶⁷ Sousa, *supra* note 7, at 399 (quoting *In re Pintlar Corp.*, 205 B.R. at 948 (emphasis added)).

In 2002, the Southern District of New York determined the applicability of the “insured versus insured” exclusion after Alan Cohen, acting as trustee, commenced an adversary proceeding against seven former directors and officers of County Seat, Inc. (County Seat) for breaches of fiduciary duty, fraudulent conveyance, corporate waste, and mismanagement.¹⁶⁸ National Union Fire Insurance Company of Pittsburg (National Union), whom County Seat had an existing D&O policy with, denied coverage for the claims, arguing that the claims brought by the trustee were being “asserted on behalf of County Seat” and therefore the trustee must be barred from bringing such claims under the “insured versus insured” exclusion included in the D&O policy.¹⁶⁹

The “insured versus insured” exclusion included in the National Union policy contained an exclusion allowing the coverage of claims brought by a security holder against an insured if the claim is “instigated and continued totally independent of, and totally without the . . . assistance of, or active participation of the company.”¹⁷⁰ The term “company” as defined in the National Union policy referred to the “Named Corporation designated in Item 1 of the Declarations and subsidiary thereof.”¹⁷¹ County Seat was the only entity listed in Item 1.¹⁷²

In siding with the trustee, the *Cohen* court noted they agreed with National Union that:

the Trustee is asserting claims that belonged to County Seat as of the date of filing its bankruptcy petition. However, the Court does not agree that by virtue of the trustee asserting claims that at one time belonged to the Debtor, he merely stands in the shoes of the Debtor or has somehow assumed the identity of the Debtor.¹⁷³

In reaching its decision, the *Cohen* court pointed to a bankruptcy trustee’s status as a legal entity separate from the debtor.¹⁷⁴ Further, the *Cohen* court noted that

¹⁶⁸ Cohen v. Nat’l Union Fire Ins. Co. (*In re Cty. Seat Stores, Inc.*), 280 B.R. 319, 321 (Bankr. S.D.N.Y. 2002).

¹⁶⁹ *Id.*

¹⁷⁰ *Id.* at 322 (internal quotation omitted).

¹⁷¹ *Id.*

¹⁷² *Id.*

¹⁷³ *Id.* at 324–25.

¹⁷⁴ *Id.* at 325 (citing Reiser v. Baudendistel (*In re Buckeye Countrymark, Inc.*), 251 B.R. 835, 840 (Bankr. S.D. Ohio 2000)).

a trustee's duty is owed to the bankruptcy estate, not the debtor,¹⁷⁵ and that only the trustee can sue and be sued on behalf of the estate.¹⁷⁶

In June of 2011, the First District Court of Appeals decided *Yessenow v. Exec. Risk Indem., Inc.*¹⁷⁷ In *Yessenow*, Jeffrey Yessenow and Vijay Patel were former directors of iHealthcare, Inc. (iHealthcare) and Illiana Surgery and Medical Center, LLC (Illiana).¹⁷⁸ Illiana later renamed to Heartland Memorial Hospital, LLC (Heartland).¹⁷⁹ iHealthcare was the sole owner of Heartland's equity.¹⁸⁰

iHealthcare purchased a D&O insurance policy from Executive Risk Indemnity, Inc. (Executive) in 2005 that ran through October 2, 2007.¹⁸¹ In January 2007, iHealthcare was brought into involuntary bankruptcy by its creditors, and petitioned for chapter 11 relief in March 2007.¹⁸² In February 2009, the court appointed trustee-filed lawsuits against several former iHealthcare directors, alleging mismanagement and self-dealing.¹⁸³ In April 2009, Executive gave notice of their intention to deny coverage on grounds including the policy's "insured versus insured" exclusion. The exclusion read as follows:

This policy does not apply to:

(E) any Claim by or on behalf of, or in the name or right of, the Company or any Insured Person, except that this EXCLUSION

(E) will not apply to:

(1) any derivative action by a security holder of the Company on behalf of, or in the name or right of, the Company, if such action is brought and maintained independently of, and without the solicitation of, the Company or any Insured Person.

(2) any Claim in the form of a crossclaim, third party claim or other claim for contribution or indemnity by an Insured Person which is part of or results directly from a Claim which is not otherwise excluded by the terms of this Policy; or

¹⁷⁵ *In re Cty. Seat Stores, Inc.*, 280 B.R. at 325 (citing *In re Fidelity America Financial Corporation*, 43 B.R. 74, 77 (Bankr. E.D.N.Y. 1984)).

¹⁷⁶ *In re Cty. Seat Stores, Inc.*, 280 B.R. at 325 (citing 11 U.S.C. § 323).

¹⁷⁷ *Yessenow v. Exec. Risk Indem., Inc.*, 953 N.E.2d 433 (Ill. App. Ct. 2011).

¹⁷⁸ *Id.* at 435.

¹⁷⁹ *Id.*

¹⁸⁰ *Id.*

¹⁸¹ *Id.*

¹⁸² *Id.*

¹⁸³ *Id.* at 435–36.

(3) any Claim for an Employment Practices Wrongful Act.¹⁸⁴

In considering Executive's argument, the trial court quoted *Outboard Marine Corp. v. Liberty Mutual Insurance Co.*, stating that "ambiguities and doubts in insurance policies are resolved in favor of the insured, especially those that appear in exclusionary clauses."¹⁸⁵ Pointing to an additional "bankruptcy exclusion" contained in the policy, the trial court determined that "Executive could have sidestepped any ambiguity by including trustees and debtors-in-possession in either the definition of the 'insured' or the language of the insured versus insured exclusion."¹⁸⁶ Further, the court noted that "[b]ecause it did not write with such specificity, the court interpreted the policy in favor of the insured and held that neither Abrams nor iHealthcare is an insured under the policy and that the insured versus insured exclusion does not preclude coverage."¹⁸⁷ Additionally, pointing to the "insured versus insured" exclusion, the trial court determined that "whether a trustee or debtor-in-possession is an insured for the purposes of an 'Insured v. Insured' exclusion is unsettled law," rendering the provision ambiguous and necessitating the resolution in favor of the insured.¹⁸⁸

On appeal, the *Yessenow* court first agreed with the trial court, finding the "bankruptcy exclusion" to be unenforceable because 11 U.S.C. § 541(c) invalidates contract provisions "that are conditioned on the insolvency or financial condition of the debtor [or] on the commencement of a bankruptcy case."¹⁸⁹ Speaking to the applicability of the "insured versus insured" exclusion, the *Yessenow* court differentiated the case at hand with the *Biltmore* case,

¹⁸⁴ *Id.* at 436.

¹⁸⁵ *Outboard Marine Corp. v. Liberty Mut. Ins. Co.*, 607 N.E.2d 1204, 1218 (Ill. 1992).

¹⁸⁶ *Yessenow v. Exec. Risk Indem., Inc.*, 953 N.E.2d 433, 437 (Ill. App. Ct. 2011). The bankruptcy exclusion stated as follows:

(1) In the event that a bankruptcy or equivalent proceeding is commenced by or against the Company, no coverage will be available under the Policy for any Claim brought by or on behalf of:

(a) the bankruptcy estate or the Company in its capacity as a Debtor in Possession; or

(b) any trustee, examiner, receiver, liquidator, rehabilitator, conservator, or similar official appointed to take control of, supervise, manage or liquidate the Company, or any assignee of any such official (including, but not limited to, any committee or creditors or committee of equity security holders).

(2) For the purposes of this endorsement, the term Debtor in Possession means a debtor under Chapter 11 of the United States Bankruptcy Code unless a person that has qualified under Section 322 of Title 11 of the U.S. Code is serving as trustee of such debtor.

¹⁸⁷ *Id.*

¹⁸⁸ *Id.* at 442.

¹⁸⁹ *Id.* at 441 (quoting 11 U.S.C. §541(c)).

explained *supra*, noting that unlike in the *Biltmore* case where a debtor in possession attempted to bring claims against former directors and officers, a court-appointed trustee was attempting to bring the claims.¹⁹⁰ This court found this distinction crucial, ultimately finding that “*the trustee and the debtor hospital are not the same entity for purposes of the insured versus insured exclusion.*”¹⁹¹ In doing so, the court sided against Executive finding that the “insured versus insured” exclusion did not apply to the claims.

In 2018, the Texas Western Bankruptcy Court decided *Segner v. Admiral Insurance Company (Segner)*, and determined whether an “insured versus insured” exception applied following a chapter 11 filing by Palmaz Scientific Inc. (PSI).¹⁹² PSI, a medical technology company, had taken out a \$20 million D&O insurance policy with an “insured versus insured” exception which read as follows:

[T]he Insurer shall not be liable to make any payment for Loss in connection with a claim made against any Insured:

(F) by, on behalf of, or in the right of any Insured in any capacity, or any security holder of the Insured Entity, provided, however, this exclusion does not apply to:

(1) any Claim by any security holder of the Insured Entity, whether directly or derivatively, but only if such claim is instigated and continued totally independent of, and totally without the solicitation of, or assistance of, or participation of, or intervention of any Insured.¹⁹³

Following the bankruptcy filing, a Litigation Trustee was appointed.¹⁹⁴ The Litigation Trustee subsequently filed suit against several former officers and directors of PSI for breaches of fiduciary duty.¹⁹⁵ Admiral, the insurance provider, denied coverage for the claims under the above “insured versus insured” exception.¹⁹⁶

Looking to the Litigation Trust Agreement, the court noted that although the agreement itself uses assignment language, it “would be remiss to ignore the

¹⁹⁰ *Id.* at 443.

¹⁹¹ *Id.* at 444 (emphasis added).

¹⁹² See generally *Segner v. Admiral Ins. Co. (In re Palmaz Sci., Inc.)*, Nos. 16-50552-CAG, 17-05027-CAG, 2018 Bankr. LEXIS 1659 (Bankr. W.D. Tex. June 4, 2018).

¹⁹³ *Id.* at *6–8.

¹⁹⁴ *Id.* at *5.

¹⁹⁵ *Id.* at *6.

¹⁹⁶ *Id.* at *7–8.

circumstances under which [it was] negotiated.”¹⁹⁷ As such, the court determined that it would not be unreasonable to interpret the “assignment” of rights not as a contractual assignment, but as a vesting of assets in order to accomplish the effect of 11 U.S.C. § 1141(b).¹⁹⁸

Next, the court differentiated *Segner* from *Biltmore*,¹⁹⁹ noting that while the language in the agreements may have been similar, a debtor in possession filed suit in the *Biltmore* case as opposed to a trustee.²⁰⁰

Looking next to *Reliance Ins. Co. v. Weiss*, the court differentiated the Missouri Bankruptcy Court’s case with its own, stating that “the terms of the Plan differ from that of Weis in that the express purpose of this Litigation Trust is to distribute its assets to the Litigation Trust Beneficiaries . . . not to recover assets for Debtors’ estate for distribution to its creditors.”²⁰¹

Further, the court looked to *Indian Harbor*.²⁰² Unpersuaded by the majority’s decision in *Indian Harbor*, the court pointed to various rationales.²⁰³ First, the court differentiated the main questions of the cases, noting that while *Indian Harbor* asked whether “the Company” included a debtor in possession, *Segner* asked whether a trustee constituted an insured.²⁰⁴ Second, the court noted that *Indian Harbor* dismissed the case law holding that a court-appointed trustee was not barred by the “insured versus insured” exclusion.²⁰⁵

Disagreeing with the *Biltmore* and *Indian Harbor* courts, the *Segner* court followed the narrow interpretation of *Bildisco & Bildisco*, stating:

Obviously if the [debtor in possession] were a wholly “new entity,” it would be unnecessary for the Bankruptcy Code to allow it to reject executory contracts, since it would not be bound by such contracts in the first place. *For our purposes, it is sensible to view the debtor in possession as the same “entity” which existed before the filing of the bankruptcy petition, but empowered by virtue of the Bankruptcy Code to deal with its contracts and property in a manner it could not have done absent the bankruptcy filing.*²⁰⁶

¹⁹⁷ *Id.* at *17.

¹⁹⁸ *Id.* at *18.

¹⁹⁹ *Id.* at *20.

²⁰⁰ *Id.* at *20–22.

²⁰¹ *Id.* at *24.

²⁰² *Id.*

²⁰³ *Id.* at *29.

²⁰⁴ *Id.* at *29.

²⁰⁵ *Id.* at *29–30.

²⁰⁶ *Id.* at *32–33 (quoting *NLRB v. Bildisco & Bildisco*, 465 U.S. 513, 528 (1984)).

The court determined that the *Bildisco & Bildisco* holding should be limited to treatment of executory contracts under 11 U.S.C. §365.²⁰⁷

Ultimately, the *Segner* court held that (1) a “[t]rustee represents an independent and disinterested entity, . . . distinct from the debtor . . . and as such did not ‘stand in the shoes’ of the debtor,” and (2) that classifying a debtor and debtor in possession as separate and distinct entities for purposes of the “insured versus insured” exclusion is not adverse to any Supreme Court precedent.²⁰⁸

CONCLUSION & RECOMMENDATIONS

While courts follow different approaches when dealing with the “insured versus insured” exclusion’s applicability in bankruptcy, over twenty-five years of case law as well as bankruptcy, insurance, and contract law concepts serve as the foundations for a uniform approach courts can use when faced with such a case. The following four step approach helps create a uniform approach for courts to follow which will hopefully help future cases run more efficiently with consistent results.

Step 1: Does the Applicable D&O Insurance Policy Contain an “Insured Versus Insured” Exclusion?

The obvious first step should be determining if there is an “insured versus insured” exclusion within the applicable insurance policy. If no such exclusion exists within the policy, no further analysis is necessary. However, the case likely will contain an exclusion. In this case, the court should take note of the specific language of the exclusion, noting (1) who is defined as the insured, and (2) any exceptions to the exclusion. As previously noted, the policy’s language is important because contract law supersedes bankruptcy law when interpreting the intent of the parties.

Step 2: Does any Exception within the “Insured Versus Insured” Exclusion Apply?

Many “insured versus insured” exclusions contain exceptions allowing certain claims brought against the insured by an insured. Some exceptions include derivative claims by shareholders, claims by successors-in-interest,

²⁰⁷ *Id.* at *33 (quoting *Cohen v. Nat’l Union Fire Ins. Co. (In re Cty. Seat Stores, Inc.)*, 280 B.R. 319, 326 (Bankr. S.D.N.Y. 2002).

²⁰⁸ *Id.* at *32.

claims against or brought by former insureds, and employment practice claims.²⁰⁹

If the applicable policy includes any such exclusion, determine if it is applicable to the suit being brought. For example, if the policy contains an exclusion for suits brought by a bankruptcy trustee (a type successor-in-interest), then one must conduct no further analysis, and the suit is allowed. Again, contract law will govern if the true intent of the parties can be discerned from the policy without ambiguity. As such, an applicable exception within the “insured versus insured” exclusion will allow otherwise barred claims.

Step 3: Who is Bringing the Suit?

Determining who brought the suit is vital to establishing whether a court must conduct further analysis. If the suit is brought by a debtor in possession, the court’s analysis should bar the suit. On the contrary, if the suit is brought by a trustee, further analysis is necessary.

Step 4: The Multi-Factor Test

“A simple, flat rule is deliciously clear and easy to apply, but it may be both underinclusive and overinclusive in relation to the purpose that animates it.”²¹⁰ Such is the case when it comes to the “insured versus insured” exclusion in the bankruptcy context. As Michael D. Sousa stated, “a completely overriding, definitive rule such as ‘no coverage for collusive suits’ under an ‘insured versus insured’ provision would prove unworkable when applied to the bankruptcy context, given the dynamics of the bankruptcy process and the differing ways in which an “insured [versus] insured exclusion might arise in litigation.”²¹¹ To combat this, Sousa proposed a four factor test in which courts should consider when deciding whether to exclude coverage under an “insured versus insured” exclusion.²¹² Sousa’s four factor test with some slight modifications is the best and most comprehensive approach to “harmonizing elements” of both insurance law and bankruptcy law.²¹³

The modified four factor test is comprised of the following factors: (1) the reasonable expectations of the parties; (2) the status of the plaintiff at the time the claim is filed; (3) the beneficiaries of the claim; and (4) whether “true

²⁰⁹ See generally *AMWINS GROUP, INC.*, *supra* note 98.

²¹⁰ *Level 3 Commc’ns, Inc. v. Fed. Ins. Co.*, 168 F.3d 956, 958 (7th Cir. 1999).

²¹¹ Sousa, *supra* note 7, at 404 (citing *Level 3 Commc’ns, Inc.*, 168 F.3d at 958).

²¹² Sousa, *supra* note 7, at 404–05.

²¹³ Sousa, *supra* note 7, at 404.

adversity” exists between the litigating parties.²¹⁴

The first factor of the modified four factor test is the reasonable expectations of the parties. While any unambiguous, expressly stated provisions of a D&O insurance policy should have already been considered prior to even implementing the modified four factor test, the court must consider the reasonable expectations of the parties for any ambiguous provisions to determine the parties’ intent when drafting the D&O insurance policy. Although a highly sophisticated corporation should be aware of their ability to include express language excluding the barring of certain actions by the “insured versus insured” exclusion, that these exceptions were not included is not indicative that the parties intended for the excluded exceptions to in fact be excluded. Some factors to consider when determining the intent of the parties at the time of drafting the D&O policy are as follows: (1) the existence of other express exceptions to the “insured versus insured” exclusion itself;²¹⁵ (2) the terms of any previous D&O policies between the company and insurance company²¹⁶; and (3) the insurers standard selling practices.²¹⁷

Of great importance when interpreting the intent of the parties of the insurance policy is the doctrine of *contra proferentum*.²¹⁸ The doctrine of *contra proferentum* refers to the rule that any ambiguous language within a contract must be construed against the drafter.²¹⁹ In all insurance contracts, the insurance company is the drafter. As such, all ambiguous language within insurance policies must be construed against the insurance company and in favor of the insured. In the case of the applicability of an “insured versus insured” exclusion would mean in favor of allowing not barring coverage for the claim.

The second factor of the modified four factor test is the status of the plaintiff

²¹⁴ Sousa’s proposed four factor test listed the factors as “(1) whether “true adversity” exists between the litigating parties; (2) the status of the plaintiff at the time the claim is made; (3) the identity of the beneficiaries of the claim, or stated differently, on whose behalf are the claims being pursued; and (4) the reasonable expectations of the parties.” Sousa, *supra* note 7, at 405 (The modified four factor test proposed in this Comment changes the order of importance of the factors while adding and subtracting certain criteria from each).

²¹⁵ Having a well thought out list of exclusions to the “insured versus insured” exclusion demonstrates that the parties deliberated the true intent of what should and should not be included as exceptions and made a conscious decision to not include some potential exceptions.

²¹⁶ Looking to other policies between the company and insurer can help speak to whether additions or subtractions were made in subsequent policies. For example, if a previous policy contained an exception to the “insured versus insured” exclusion and subsequent policies did not, it may be indicative that the parties intended to exclude such exception.

²¹⁷ Looking into the insurers standard selling practices can indicate whether the company informs potential clients of the possibility of including exceptions or other language in their D&O policy.

²¹⁸ *Tri-S Corp. v. W. World Ins. Co.*, 135 P.3d 82, 98 (2006).

²¹⁹ *Shelby Cty. State Bank v. Van Diest Supply Co.*, 303 F.3d 832, 838 (7th Cir. 2002).

at the time the claim was filed. This factor is identical in name to Sousa's second factor, but its applicability has been slightly modified.²²⁰ Sousa states that:

The applicability of an "insured versus insured" exclusion in the bankruptcy context can perhaps best be understood as a linear continuum, whereby the points on this continuum represent, in sequential order, the debtor in possession, Chief Restructuring Officer, plan trustee, bankruptcy trustee, and creditors' committee. And while the application of the "insured vs. insured" in a given case cannot be predicted with mathematical certainty, the further away from the debtor in possession on the continuum and the closer to the creditors' committee, the more likely it is that a court will find that the "insured vs. insured" exclusion does not apply.²²¹

The modified four factor test removes the need to include the debtor in possession in the analysis as recent case law seems to settle on the notion that a debtor in possession and debtor should be treated as one in the same for purposes of the "insured versus insured" exclusion.

All else remains consistent with Sousa's approach, as the farther one moves away from the debtor in possession and closer to the creditor's committee, the lesser the chance of a suit being brought for collusive purposes. The debtor in possession can be the prepetition debtor itself using a mere pseudonym attempting to conceal its identity as an insured, but none of the other listed entities have that ability since they are not and never were the debtor.

The third factor in the modified four factor test are the identities of the claim's beneficiaries. As Mr. Sousa states when discussing what he too noted as the third factor in his test, "[t]he identity of the beneficiaries of the claim, and the corollary inquiry of on whose behalf the claim is being pursued, is the third factor"²²² Claims asserted against directors and officers can in some cases be brought for harms against the corporation itself.²²³ Claims of this type could have been brought by the prepetition debtor as the affected party.²²⁴ If brought prior to the bankruptcy filing, these claims would obviously be barred under the "insured versus insured" exclusion.²²⁵

²²⁰ Sousa, *supra* note 7, at 405.

²²¹ Sousa, *supra* note 7, at 405. Compare *Biltmore Assocs., LLC v. Twin City Fire Ins. Co.*, 572 F.3d 663 (9th Cir. 2009) with *Stratton v. Nat'l Union Fire Ins. Co.*, No. 03-CV-12018-RGS, 2004 LEXIS 17613 (D. Mass. Sept. 3, 2004).

²²² Sousa, *supra* note 7, at 409.

²²³ *See id.*

²²⁴ *See id.*

²²⁵ *See id.*

In contrast, claims asserted against the company, in its own capacity, for the same conduct described above may have been brought by shareholders (derivative suits) or creditors of the corporation for the harms they experienced.²²⁶ Because claims might be brought against director and officers on behalf of both the effected corporation or the corporation's shareholders or creditors, "a court can work through this problem by identifying the beneficiaries of the causes of action should the claims prove successful, and in so doing determine (at least in part) whether the 'insured vs. insured' exclusion should apply."²²⁷

When applying this factor, a court must remember:

If the recovery of a lawsuit against directors and officers would benefit a constituency that would have implicated the "insured vs. insured" exclusion if the claims had been brought in its own stead outside of the bankruptcy context, then the "insured vs. insured" exclusion should preclude coverage despite the happenstance of bankruptcy.²²⁸

Cirka v. National Union Fire Insurance Co. of Pittsburg exemplifies this thought process.²²⁹ In *Cirka*, the issue before the court was "whether the Committee brought the action 'on behalf of' the debtor-in-possession when the lawsuit could have been brought by the debtor in possession itself."²³⁰ In coming to its conclusion, the court notes: (1) the claims belonged to the prepetition entity and continued to belong to the post-petition estate; and (2) the derivative standing of the Committee to pursue the claims was essentially to enforce a corporate right.²³¹ Ultimately, the Chancery Court concludes that the coverage was not barred under the "insured versus insured" exclusion and stated that:

While one may view this case as one where the Committee is bringing an action that may also be brought by the Debtor in Possession, there is no doubt the Committee is not bringing the action "on behalf of" the Debtor in Possession. It is simply enforcing a right belonging to the Estate that the Debtor in Possession *could have* itself enforced.²³²

²²⁶ See Sousa, *supra* note 7, at 409–10.

²²⁷ Sousa, *supra* note 7, at 410.

²²⁸ *Id.*

²²⁹ *Cirka v. National Union Fire Insurance Co. of Pittsburg*, C.A. No. 20250-NC, 2004 Del. Ch. LEXIS 118 (Del. Ch. Aug. 6, 2004).

²³⁰ Sousa, *supra* note 7, at 411 (citing *Cirka v. National Union Fire Insurance Co. of Pittsburg*, C.A. No. 20250-NC, 2004 Del. Ch. LEXIS118 (Del. Ch. Aug. 6, 2004)).

²³¹ Sousa, *supra* note 7, at 411 (citing *Cirka*, 2004 Del. Ch. LEXIS118, at *15–16).

²³² *Cirka*, 2004 Del. Ch. LEXIS118, at *29.

In other words, because the estate, not the debtor in possession, stood to benefit from any recovery, the Chancery Court determined that the “insured versus insured” exclusion did not apply.²³³

The fourth factor in the modified four factor test is whether “true adversity” exists between the litigating parties. This fourth factor is identical to Mr. Sousa’s first factor in his test.²³⁴ The goal of including an “insured versus insured” exclusion’s within D&O insurance policies is preventing collusion in lawsuits “such as suits in which a corporation sues its officers or directors in an effort to recoup the consequences of their business mistakes, . . . thus turning liability insurance into business-loss insurance”²³⁵ Evidence of such collusion between insured will never be ascertainable and “the mere presence of covered insureds on both sides of the ‘vs.’ is an insufficient barometer for measuring whether the litigating parties conspired to transfer financial loss to the corporation’s insurance carrier.”²³⁶ Therefore, to determine collusion was at play when bringing suit, “a court should instead analyze whether the litigating parties are truly adverse from one another, and thereby not implicating the very hazards that the insurance carrier attempted to protect itself against by including the ‘insured vs. insured’ exclusion in the liability policy.”²³⁷

Exemplifying this approach, the decision in *Conklin Co. v. National Union Fire Insurance Co.* determined that “[a]lthough National Union Fire Insurance Company was correct in maintaining that the former officer was an insured under the directors and officers liability policy, and thus by strict definition the ‘insured vs. insured’ exclusion applied, the court nevertheless concluded that the exclusion did not bar coverage of the lawsuit.”²³⁸ In doing so, the *Conklin* court looked to the intent behind the applicable clause within the D&O policy, not simply the terms of the clause itself.²³⁹ Although the approach taken by the *Conklin* court has been criticized both within²⁴⁰ and outside²⁴¹ of its jurisdiction,

²³³ Sousa, *supra* note 7, at 412.

²³⁴ Sousa, *supra* note 7, at 405.

²³⁵ Level 3 Commc’ns, Inc. v. Fed. Ins. Co., 168 F.3d 956, 958 (7th Cir. 1999).

²³⁶ Sousa, *supra* note 7, at 405.

²³⁷ *Id.*

²³⁸ Sousa, *supra* note 7, at 406 (2007) (citing *Conklin Co. v. Nat’l Union Fire Ins. Co.*, Civil No. 4-86-860, 1987 U.S. Dist. LEXIS 12337, at *3 (D. Minn. Jan. 23, 1987)).

²³⁹ See *Conklin Co.*, 1987 U.S. Dist. LEXIS 12337.

²⁴⁰ See *Miller v. ACE USA*, 261 F. Supp. 2d 1130, 1139 (D. Minn. 2003) (criticizing *Conklin* and solely embracing the plain language of the insured versus insured clause).

²⁴¹ See *Alanco Techs., Inc. v. Carolina Cas. Ins. Co.*, No. CV 04-0789-PHX-DGC, 2004 U.S. Dist. LEXIS 28266, at *6 (D. Ariz. Sept. 16, 2004) (determining the *Conklin* reasoning to not be persuasive).

the criticizing cases take a far too narrow approach, constraining themselves solely to the plain language of the applicable D&O insurance policy.²⁴²

While the criticizing cases do rely on the well-established notion that the interpretation of an insurance contract should be based on the plain meaning of its terms, they fail to take note of the ambiguity in “insured versus insured” exclusions that arises when the insured entity has previously filed for bankruptcy. Referring to “Step 2” as described above, many D&O insurance policies have become sophisticated enough to include express exceptions for the “insured versus insured” exclusion. The terms of such policies are usually not ambiguous, meaning the policy interpretation is based on its terms and nothing more. However, given that “Step 2” precedes this modified factors test, a court analyzing an unambiguous D&O policy would likely not even get to this point in the analysis process. Instead, only courts tasked with analyzing D&O policies containing ambiguous terms would look to apply this and analyze said D&O policies using this modified four factor test. As such, Conklin’s rationale serves as the best framework as it pertains to clauses containing ambiguity.²⁴³

In conclusion, although there is no completely uniform approach for courts to follow concerning the applicability of the “insured versus insured” exclusion in the context of bankruptcy that would eliminate the potential for overinclusion or underinclusion, the four steps and modified four factor test described above should help eliminate any profound inconsistency by courts across jurisdictions. With such a framework in place, insurers should be able to better evaluate a client’s litigation risk, thus reducing the likelihood of a market-wide increase in premiums even with a potential financial downturn on the horizon.

EMIL KRANZ*

²⁴² See, e.g., *Sphinx Int’l, Inc. v. Nat’l Union Fire Ins. Co.*, 412 F.3d 1224, 1229–30 (11th Cir. 2005) (rejecting *Conklin* because Florida jurisprudence dictates that “the rule for interpreting insurance contracts is the plain meaning of its terms”).

²⁴³ *Conklin Co.*, 1987 U.S. Dist. LEXIS 12337, at *8 (finding ambiguity in the insured versus insured exclusion and noting that “[u]sing this endorsement to deny coverage for claims arising from [the former officer’s] clearly adverse wrongful termination suit, simply because [the former officer] is a potential ‘insured’ under the policy’s insuring clause, would thwart the intentions and purposes of the contracting parties”).

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