

I v. I Exclusion Bars Coverage for Litigation Brought by Successor Corporation Created Pursuant to Bankruptcy Reorganization

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A federal district court, applying Massachusetts law, has held that the insured v. insured exclusion in a D&O policy applied to bar coverage for litigation brought against insured directors and officers by a successor corporation formed pursuant to a plan of reorganization in bankruptcy. *Stratton v. Nat'l Union Fire Ins. Co.*, 2004 WL 1950337 (D. Mass. Sept. 3, 2004).

An insurer issued a D&O policy to a company that provided post-acute trauma healthcare. The company was later acquired by an acute care network, and the insurer issued a D&O policy to the network. Both policies contained exclusions barring coverage for any claim made against the insured "which is brought by any Insured or by the Company; or which are brought by any security holder of the Company, whether directly or derivatively, unless such 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." The policy defined "Company" to include a "successor."

The company and the network subsequently filed for bankruptcy under chapter 11. The bankruptcy court approved a plan of reorganization that required the network to surrender its interest in the company and to reissue the company's stock to both entities' creditors. The network was renamed and assumed the liabilities of both the company and the network. The renamed corporation held itself out as the successor to both entities.

The successor corporation then sued certain current and former directors of the company, alleging fraudulent misrepresentation and breach of fiduciary duty. In addition, two brothers, one a former director of the company and the other a current director of the network, also sued the directors on behalf of themselves and a consortium of stockholding entities, primarily family trusts. The defendant directors instituted this declaratory action against the insurer to determine whether the insured v. insured exclusion applied to bar coverage for the lawsuits brought by the successor corporation and the brothers.

The court ruled in favor of the insurer. It first held that the insured v. insured exclusion barred coverage for the successor corporation's lawsuit as the successor to both the company and the network. The court rejected the directors' argument that the policy was ambiguous because the word "successor" was not specifically defined in the policy to include "the Named Corporation that emerges from Bankruptcy." The court concluded that "successor" was not ambiguous and clearly included the successor corporation, which retained the network's certificate of incorporation, Internal Revenue Service number, corporate headquarters, key employees, remaining obligations, assets and subsidiaries.

The court rejected the directors' argument that the claims against them did not constitute a true insured v. insured situation because "the creditors of [the company and network] are using [the successor corporation] as a vehicle for their own financial interests." The court first explained that this statement was not factually correct because any recovery against the directors, "while it may indirectly benefit the creditors to the extent that it contributes to the viability of [the successor corporation] as a going enterprise," would be paid into the successor corporation. The court also rejected the directors' argument that it should evaluate whether there had been any collusion before applying the insured v. insured exclusion, explaining that this "argument founders on the rule of contract interpretation that precludes a court from looking to extrinsic evidence to contradict and defeat the meaning of plain language in a contract."

Finally, the court found that the exclusion barred coverage for the litigation brought by the brothers on behalf of the stockholding entities. The court noted that the exclusion stated that claims brought against an insured by shareholders would be covered if "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." Because the shareholding entities' claims were brought "without differentiation," as part of the director brothers' claims, the court determined that the exclusion barred coverage.

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