

Delaware Court Rules I v. I Exclusion Inapplicable to Claims Brought by Creditors Committee

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A Delaware Chancery Court, applying Delaware law, has determined that an insured v. insured exclusion in a D&O liability policy does not bar coverage for a claim brought by a creditors committee against the bankrupt insured company's directors pursuant to a bankruptcy court's grant of authority. *Cirka v. Nat'l Union Fire Ins. Co. of Pittsburgh, PA*, 2004 WL 1813283 (Del. Ch. Aug. 6, 2004). In doing so, the court considered the authority granted by the U.S. Bankruptcy Court to the creditors committee to initiate the litigation and concluded that the committee was not acting "on behalf of" the insured debtor in possession, and thus the exclusion did not apply.

This case involved a claim based on an alleged breach of fiduciary duty by the former directors of the insured company in connection with their approval of certain compensation arrangements. At the time the suit was initiated, the company was operating as a debtor-in-possession under chapter 11 of the Bankruptcy Code. Its creditors committee had previously requested that the company, as debtor-in-possession, initiate the suit, which it refused to do. The committee then sought leave from the Bankruptcy Court to bring the action. The Bankruptcy Court granted that motion, authorizing the committee to "commence an action...on behalf of the Estates asserting any and all claims or causes of action of the Estates, whether derivative or otherwise...[with] recoveries from [those] claims [to] be held [and] used solely for distribution to creditors."

The insured's directors and officers liability carrier denied coverage for the committee's suit based on the insured v. insured exclusion contained in its policy, which provided:

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 or on behalf of any Insured or the Company; or which is brought by any security holder or member of the Company, whether directly or derivatively, unless such security holder's or member's Claim is instigated and continued totally independent of, and totally without the solicitation of, or assistance of, or active participation of, or intervention of, any Director or Officer or the Company....

[T]his exclusion shall not apply...in any bankruptcy proceeding by or against the Named Corporation or any Subsidiary thereof, any Claim brought by the Examiner or Trustee of the Company, if any, or any assignee of

such Examiner or Trustee.

The insureds subsequently initiated a coverage action in the Bankruptcy Court, which declined jurisdiction. They then filed the action in Delaware state court, seeking, *inter alia*, a declaration that the insured v. insured exclusion did not apply to the committee's action.

The Delaware court determined that the exclusion did not apply to bar coverage for the committee's suit. In doing so, the court characterized the essential issue as whether the committee was necessarily proceeding "on behalf of" the debtor-in-possession. To resolve that question, the court focused on the specific grant of authority provided to the committee by the Bankruptcy Court.

Citing *Official Committee of Unsecured Creditors of Cybergenics Corp. ex rel Cybergenics v. Chinery*, 330 F.3d 548, 566 (3d Cir. 2003), the court first concluded that the standing conferred on the committee to bring the lawsuit was derivative in nature. It then analogized the role of the committee to that of a stockholder pursuing a derivative action on behalf a corporation and indicated that, although the right to bring suit was held by the company's directors, the rights to be enforced were held by the corporation itself. The court then concluded as follows:

This is what occurred in the Underlying Action. The Debtor-in-possession was in control of the Estate's claims. The Bankruptcy Court allowed the committee to sue on behalf of the Estate. 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.

Thus, the court concluded that the rights the committee pursued belonged to the bankruptcy estate itself and, while the debtor-in-possession could have asserted them, it did not. Instead, the rights were asserted solely by the committee on the estate's behalf pursuant to the Bankruptcy Court's order. The court also observed that the Bankruptcy Court had transferred only the estate's ability to bring the claim, but that it had not transferred to the committee "all the limitations that would have surrounded the claims if brought by the Debtor-in-possession." Accordingly, the court determined the insured v. insured exclusion in the National Union policy did not apply.

The court acknowledged the insurer's argument that this reasoning meant that the insured v. insured exclusion would never apply to a debtor, but opined that the exclusion would apply where the debtor-in-possession brings the suit, not where a creditors committee does so. While the court did not explain the underlying rationale for such a distinction, it did assert that the insurer could have revised the policy definitions so that its policy's definition of "Company" specifically included the bankruptcy estate to avoid such a result.

The court also addressed the insurer's extensive reliance on *Niemuller v. National Union Fire Insurance Co.* 1993 WL 546678 (S.D.N.Y. 1993). The court found *Niemuller* to be inapplicable because the claimant in *Niemuller* was a third-party assignee of the insured company rather than an entity with derivative standing. According to the court, the *Cirka* committee's rights did not arise from such "a conventional assignment" because it arose out of the Bankruptcy Court's broad equitable powers. The court further

distinguished *Niemuller* because the claim in that action was originally brought by the company, and only subsequently assigned, whereas the committee's action was instituted after it was granted derivative standing.

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