

# I v. I Exclusion Does Not Bar Coverage for Claims Brought by Liquidator against Trustees of Company

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A federal district court in Illinois has held that the I v. I exclusion in a D&O policy does not bar coverage for claims brought against trustees of a workers compensation trust by the state-appointed liquidator of the trust. *QBE Int'l Ins. Ltd. v. Clark*, 2003 WL 22433117 (N.D. Ill. Oct. 24, 2003). The court also held that material issues of disputed fact precluded a ruling on the insurer's motion for summary judgment to rescind the policy.

The insurer issued a D&O liability insurance policy to a workers compensation trust formed under Illinois law. After a state court entered an order liquidating the trust, the director of the Illinois Department of Insurance became liquidator of the trust. Under the Illinois Insurance Code, the director was authorized to "both sue and defend on behalf of the Trust in his name as Liquidator of the Trust, or in the name of the Trust" and "on behalf of the creditors, members, policyholders or shareholders of the company." The liquidator subsequently brought suit in state court on behalf of the trust, as well as its creditors, members and policyholders, alleging that the trustees, who were insured under the policy, had breached their fiduciary duties to the trust and its participants.

The insurer denied coverage for the suit based on the I v. I exclusion contained in the policy. That exclusion provided that there is no coverage for claims made "by or on behalf of the Company or any Affiliates" or "by any security holder of the Company, whether directly or derivatively except where such security holder bringing such Claim is acting totally independently [of], and totally without the solicitation of, or assistance of, or participation of, or intervention of, any of the Directors and Officers, or the Company or any Affiliate." The insurer argued that the plain language of the exclusion precluded coverage for any claim brought against the trustees by the liquidator on behalf of the trust.

The district court explained that the Illinois Insurance Code empowered the liquidator to bring claims both on behalf of the trust itself and on behalf of the trust's participants. Although the court appeared to agree that if the liquidator had brought claims solely on behalf of the trust, those claims would be barred by the I v. I exclusion, it held that the exclusion did not apply in this case because the liquidator also brought claims on behalf of the trust participants. The court explained that but for the liquidation order, trust participants would have been able to bring such claims on their own behalf without running afoul of the I v. I exclusion. The court

also reasoned that nothing in the policy prescribed a method for allocating between covered and non-covered claims and that exclusions should be narrowly construed. Finally, the court rejected the insurer's argument that the decision exposed it to a risk of collusion, explaining that the insurer had not shown any evidence of collusion between the liquidator and the trust in bringing the suit.

The insurer also moved for summary judgment on its right to rescind the policy because of material misrepresentations in the insured's application for insurance. The insurer first argued that the trust had failed to disclose changes in management in response to a direct question in the application for insurance. The application stated that the "underwriter will have relied upon this renewal application and attachments in issuing any policy.... If the information in this renewal application materially changes prior to the effective date of the policy, the applicant will notify the underwriter, who may modify or withdraw any quotation." While the trust's answer regarding changes in management was correct on the day the application was signed, the trust failed to inform the insurer when two of its trustees departed shortly thereafter, before the policy was issued.

The court agreed that the trust had failed properly to disclose the departure of one of the trustees, but it held that there was a factual dispute concerning whether the trust had properly disclosed the departure of the other trustee. Although the trust never updated the answers on its application, it did provide the insurer with board resolutions signed by its trustees that would, upon comparison, have shown that the trustee had departed the trust. The court held that whether these documents were sufficient to give the insurer notice of the change in management was an issue for the jury. The court also held that fact issues existed as to whether the alleged misrepresentations were material to the insurer's decision to issue the policy. Although the application specifically requested information regarding changes in management, the court noted that the insurer's employees were unable to recall ever declining an application for insurance based on a change in a company's board of directors.

The insurer also argued it was entitled to rescind the policy because the trust made material misrepresentations about its financial condition. At the time the trust was applying for insurance, it faced a deficit, and represented that it intended to charge its members an increased premium in order to eliminate the deficit. The insurer asked to be kept informed of the members' response to this proposal. The trust represented that the response from its members was "healthy," and that it had obtained full payments from various members. During the litigation, however, employees of the trust testified that the members' response could hardly be characterized as "healthy," and that at the time the trust represented that it had received a "healthy" response, it had collected only \$11,000 of its \$1.5 million deficit.

The district court noted that the document containing the trust's representation of a "healthy" response was not anywhere in the insurer's underwriting files, creating a fact issue as whether the insurer relied on the representation. The court further observed that the insurer never asked the insured to define the term "healthy" and never asked how much money the trust had collected from its members. Accordingly, the court denied summary judgment to the insurer based on material issues of disputed fact.

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