

I v. I Exclusion Inapplicable to Action by Debtor-in-Possession

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A federal bankruptcy court in Illinois, applying Illinois law, has held that the I v. I exclusion in a D&O policy does not bar coverage for an action by a debtor-in-possession against the former CEO of the insured company. *In re HA 2003, Inc.*, 2004 WL 1354244 (Bankr. N.D. Ill. June 9, 2004). The court also held that an excess carrier could not maintain that its consent was required for a settlement if it was denying coverage under the policy.

Various insurers issued primary and excess D&O policies to a company that later filed for bankruptcy under chapter 11. The primary policy, to which the excess policies followed form, contained an I v. I exclusion, which stated that "the Company shall not be liable for Loss on account of any Claim made against any Insured Person...brought or maintained by or on behalf of any Insured." The primary policy also contained an endorsement that created an exception to the I v. I exclusion for "a claim (whether or not brought in the name of, on behalf of, or in the right of the Insured Organization) brought by or on behalf of a bankruptcy trustee, magistrate or any other person appointed by a bankruptcy court or judge, or authorized under applicable law to act on behalf of a debtor or brought by or on behalf of any creditor of the Insured Organization."

The company, as a debtor-in-possession, sued its former CEO for breach of fiduciary duty and corporate waste. All but one of the insurers settled with the company. The remaining excess insurer maintained that there was no coverage under the policy by virtue of the I v. I exclusion.

The bankruptcy court disagreed with the excess insurer, holding that the company, "as debtor-in-possession, [fell] squarely under the language of [the] Endorsement" to the I v. I exclusion. The court rejected the insurer's argument that the definition of a "person" in the endorsement did not apply to the company, reasoning that "person" was not defined in any of the policies. The court also noted that elsewhere in the policy, the term "person" was clearly limited to a human being. The court therefore concluded that the language in the endorsement "makes it clear that this term includes organizations because organizations are authorized under applicable law to act on behalf of a debtor." The insurer next argued that the endorsement could not be read to apply to actions by a debtor-in-possession because it did not specifically mention a debtor-in-possession. Disagreeing with the insurer, the court stated that if the insurer "did not intend for [the endorsement] to apply to debtors-in-possession, who are clearly authorized to act on behalf of the debtor under the Bankruptcy Code, the insurer[] should have specifically excluded them."

The court did reject the contention by the debtor-in-possession that coverage was also available because the claim was brought "by or on behalf of any creditor" since any recovery would be distributed to creditors under the reorganization plan. The court explained that the claim was one that only the company could bring, and the exception to the

I v. I exclusion would not apply even if the creditors would ultimately benefit if the company prevailed.

The court next addressed whether the insurer could withhold its consent to the company's settlement even though it had denied coverage under the policy. The court held that the insurer "may not deny coverage and still maintain control over the settlement...." In so ruling, the court followed the rule outlined in *Commonwealth Edison Co. v. Nat. Union Fire Ins. Co.*, 752 N.E.2d 555 (Ill. App. Ct. 2001), in which the court held that "an insurer that defended while reserving its right to contest coverage lost the right to consent to a settlement." The insurer contended that this case and others were inapposite because there was no duty to defend under the policy at issue. The court reasoned, however, that the insurer "has done more than reserve its right to contest coverage; it has flat-out denied coverage and i[s] litigating that issue to judgment in this case."

Finally, the company sought a determination that the underlying settlement was reasonable. The court dismissed the claim as non-justiciable because the settlement agreement had not yet been signed.

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