wiley

NEWSLETTER

$56 Million Consent Judgment Secured by Creditors' Trust Against Former Officer Does Not Constitute "Loss"

November 2010

The United States District Court for the Western District of Missouri, applying Missouri law, has held that a creditors' trust established pursuant to the insured entity's plan of reorganization could not recover from the company's directors and officers liability insurers a $56 million consent judgment entered against the insured's former officer for claims assigned by the debtor to the trust because the judgment did not constitute "Loss" as defined by the primary policy. *U.S. Bank Nat'l Ass'n v. Fed. Ins. Co.*, No. 10-CV-0266 (W.D. Mo. Oct. 4, 2010). The court rejected the application of an Insured versus Insured exclusion. However, it determined that a covenant not to execute against the former officer's personal assets contained in the assignment absolved the officer from payment, and a carveout from the definition of "Loss" therefore applied. Wiley Rein LLP represented the primary insurer.

The insured company filed for bankruptcy and operated as a debtor in possession. As part of its plan of reorganization, it assigned its claims against former directors and officers to a creditors' trust on the condition that any judgment could only be enforced against available insurance. The bankruptcy court approved the plan, and the claims were assigned subject to that restriction. The creditors' trustee sued a former officer, who ultimately agreed to a $56 million judgment against him. The former officer then assigned his rights under the applicable policies to the trust. The insurers denied coverage based on the Insured versus Insured exclusion and based on the definition of Loss, which carved out any amount not indemnified by the company for which insured persons were "absolved from payment by reason of any covenant, agreement, or court order."

The court first determined that the Insured v. Insured Exclusion did not bar coverage. The exclusion contained exceptions for claims brought by "any bankruptcy trustee or examiner of" the company or any trustee "appointed by the court in any such proceeding to take control of, supervise, manage or liquidate the" company. The court assumed, based on *Reliance Insurance Co. v. Weis*, 148 B.R. 575 (E.D. Mo. 1992), that the debtor in possession and pre-petition debtor were the same entity. However, the court concluded that the bankruptcy court's approval of the trust's selection of trustee constituted "a form of court-selection" that effectively rendered the trustee a "bankruptcy trustee." The court also held that the second exception to the exclusion potentially applied, rejecting an interpretation requiring that the trustee "be charged with complete liquidation rather than partial liquidation by collecting assets and paying creditors."

However, the court determined that the "absolved from payment" carveout from the definition of Loss applied, finding that the language "seems crystal clear." The court also rejected the trustee's position that the insurers were precluded from relying on the limitations on Loss by denying coverage. The court adopted the insurers' argument that the earlier assignment agreement provided the officer with complete protection, and the court concluded that there was no basis to estop the insurers from relying on the Loss carveout.