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NEWSLETTER

Two Massachusetts Federal Judges Conclude that Insured v. Insured Exclusion Does Not Apply to Claim by Bankruptcy Trustee

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The United States Bankruptcy Court for the District of Massachusetts has recommended a finding that the insured v. insured exclusion does not bar coverage for a claim by a bankruptcy trustee against the former directors and officers of the debtor. Gray v. Executive Risk Indem. Inc., et al. (In re Molten Metal Technology, Inc.), Adv. No. 00-1386 (Bankr. D. Mass. Jan. 3, 2002) (Kenner, J.). In another coverage suit arising out MMT's bankruptcy, the United States District Court for the District of Massachusetts likewise held, inter alia, that the insured v. insured exclusion does not bar coverage for the trustee's action against the debtor's former directors and officers. Lewis v. Executive Risk Indem. Inc., No. 00-11093-RWZ (D. Mass. Dec. 28, 2001) (Zobel, J.).

The Chapter 11 trustee of Molten Metal Technologies, Inc. ("MMT") filed an adversary proceeding against the former directors and officers of MMT alleging breach of fiduciary duties and duties of loyalty, corporate waste, insider trading, and gross negligence. Thereafter, the directors and officers tendered the claim to their D&O insurers in two successive policy periods. The insurers determined that the claim was barred under their policies' insured v. insured exclusion. In response, the Trustee filed an insurance coverage adversary proceeding, seeking, inter alia, a declaration that insurers are required to indemnify the directors and officers.

The bankruptcy court focused on the policies issued in the first of the two relevant policy periods. The operative exclusion during that period barred coverage for "a Claim made against an insured . . . which is brought by any Insured or the Company." Concluding that the adversary proceeding was non-core and that the bankruptcy court therefore could not issue final findings, the court issued recommendations subject to review by the district court. First, the bankruptcy court looked to the language of the exclusion and determined that under the unambiguous language of the exclusion, the Trustee is not an "Insured" or the "Company." Therefore, the court reasoned that the policy language supported the Trustee's position. In the alternative, the court indicated that at least the terms "Insured" and "Company" are ambiguous and thus should be construed against the insurers.

Second, the court looked at the relationship between the debtor, to which the insured v. insured exclusion applied, and Chapter 11 trustees. Attempting to distinguish First Circuit precedent holding that a trustee stands in the shoes of the debtor, the court held that the debtor and a Chapter 11 trustee are legally distinct entities and that the Trustee was prosecuting the claim against the directors and officers on behalf of the creditors and not just MMT. The court also asserted that the purpose of the insured v. insured exclusion—prevention of collusive suits—was not implicated because a Chapter 11 trustee is "genuinely adverse" to the directors and officers. (As discussed in the article beginning on page 1 in this issue of The Executive Summary, this analysis is at odds with other recent precedent.) Lastly, the court refused to consider the insurers' evidence regarding MMT's interpretation of the insured v. insured exclusion and admissions by the Trustee that he stood in the shoes of MMT.

Separately, in the Lewis case, which involved a former officer's claim for coverage for the same underlying adversary proceeding under the insurance policy in place in the second relevant policy period, the United States District Court for the District of Massachusetts held, inter alia, that the insured v. insured exclusion does not bar coverage for the Trustee's action against MMT's former directors and officers. Lewis v. Executive Risk Indem. Inc., No. 00-11093-RWZ (D. Mass. Dec. 28, 2001) (Zobel, J.). In so holding, the court rejected the insurer's claim that the insured v. insured exclusion applied because the Trustee's action was brought "by, or on behalf of" MMT, which was the operative language in the second policy period. The court found that, contrary to the insurer's assertions, the Trustee's action was brought on behalf of the creditors of MMT and not MMT itself, relying on Pintlar Corp. v. Fidelity Casualty Co. of New York, 205 B.R. 945 (Bankr. D. Idaho 1997), and American Casualty Co. of Reading, Pennsylvania v. Sentry Savings Bank, 867 F. Supp. 50 (D. Mass. 1994). Moreover, the court asserted that the perceived purpose of the exclusion, "to protect the insurance carrier from collusive suits," is not implicated because the Trustee was a "genuinely adverse party."

The insurer also denied coverage for the adversary proceeding based on the "pending litigation" and the "prior notice" exclusions. The policy provided no coverage for losses for "Claims" related to "pending litigation or to litigation with respect to which prior notice had been given pursuant to a previous insurance policy." Prior to the insurer's policy period, a consolidated securities class action was filed against several MMT directors and officers, but not the plaintiff, and notice of the suit was provided to MMT's insurers from a previous policy period. The insurer claimed that the adversary proceeding related back to the prior pending securities class action. The plaintiff countered that because he was not a defendant in the securities class action, the allegations contained therein are not "sufficiently related to the claims made against him" in the adversary proceeding. The court held that the "pending litigation" exclusion did not apply. The court reasoned that the policy's severability clause modified the "pending litigation" exclusion. Thus, the court found that when the adversary proceeding was filed, there was no pending litigation filed against Lewis because he was not named as a defendant in the securities class action, and the conduct of the directors and officers at issue in the securities action could not be used against the plaintiff to deny him coverage.