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Escaping the D&O Liability Insurance Policy "Insured vs. Insured" Exclusion Muddle

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ESCAPING THE D&O LIABILITY INSURANCE POLICY "INSURED VS. INSURED" EXCLUSION MUDDLE

STEVEN FRUCHTER*

ABSTRACT

Director and officer liability insurance policies commonly contain an "insured vs. insured" exclusion that bars coverage for claims brought by a party that is "insured" under the policy against another party who is also "insured" under the policy. For over thirty years, the answer to the seemingly straightforward question of whether actions brought by bank receivers and bankruptcy estate representatives are brought by an "insured" claimant for the purposes of the exclusion and barred from coverage under the policy has been frustratingly unsettled.

The reason for the repeat litigation and conflicting judicial opinions on this issue is because the exclusion, as usually drafted, is ambiguous. This Article argues that courts should find that the exclusion does not bar coverage for claims brought by bank receivers and bankruptcy estate representatives, unless the language of the D&O insurance policy at issue contains clear language expressly stating that bank receivers and bankruptcy estate representatives are "insured" claimants for the purposes of the exclusion.

TABLE OF CONTENTS

INTRODUCTION 224

I. STATE LAW RULES FOR INTERPRETING INSURANCE POLICIES 227

II. BANK RECEIVERS AND THE "INSURED VS. INSURED" EXCLUSION 231
   A. *The Shareholders' Derivative Actions Analogy* 232
   B. *The "Standing in the Shoes of" Framework of Niemuller and O'Melveny & Myers* 236

California Western Law Review, Vol. 58, Iss. 2 [], Art. 2

C. Developments in the Drafting and Interpretation of the "Insured vs. Insured" Exclusion 241
D. Conclusion: Actions Brought by Bank Receivers Should Not be Barred from Coverage Unless the Exclusion is Unambiguous 243

III. THE "INSURED VS. INSURED" EXCLUSION IN THE BANKRUPTCY CONTEXT 247
A. The Easy Case: Chapter 7 and Chapter 11 Trustees 248
B. The Hard Case: The Debtor-in-Possession 251
1. The Bildisco "Single Entity" Holding is Limited to the Facts of that Case 253
2. The Debtor-in-Possession is a Legally Distinct Entity from the Debtor 255
3. Public Policy, Bildisco, and Ambiguity in Insurance Contracts 259
C. Conclusion: Actions Brought by a Debtor-in-Possession Should Not be Barred from Coverage Unless the Exclusion is Unambiguous 261

IV. THE MEDIUM-DIFFICULTY CASE: THE ESTATE REPRESENTATIVE 261
A. Court of Appeals Decisions: Reliance, Biltmore, and Indian Harbor 264
1. Reliance Insurance of Illinois v. Weis 265
2. Biltmore and Indian Harbor 268

CONCLUSION 271

INTRODUCTION

Director and officer liability insurance ("D&O insurance") shifts the expense of breach of fiduciary duty lawsuits brought against the directors and officers of a company to an insurance carrier. D&O insurance policies commonly contain an "insured vs. insured" exclusion that

https://scholarlycommons.law.cwsl.edu/cwlr/vol58/iss2/2

Fruchter: Escaping the D&O Liability Insurance Policy "Insured vs. Insured"

bars coverage for claims brought by a party that is insured under the policy[1] against another party that is also insured under the policy.[2]

For over thirty years, the seemingly straightforward question of who is an insured claimant for the purposes of the exclusion has been frustratingly unsettled in the context of claims brought by receivers of failed banks,[3] bankruptcy trustees,[4] Chapter 11 debtors-in-possession, and Chapter 11 bankruptcy estate representatives.[5] One reason for this

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1. Typically, directors, officers, and the company itself are "insured" for purposes of the exclusion. Policies usually call the insured entity the "company," "corporation," "institution" or some other variant thereof.

2. *See* Biltmore Assocs., LLC v. Twin City Fire Ins., 572 F.3d 663, 668 (9th Cir. 2009) ("Insured versus insured exclusions are boilerplate in these and other kinds of liability policies."). For a comprehensive overview of the history and origins of the "insured vs. insured" exclusion see generally Michael D. Sousa, *Making Sense of the Bramble-Filled Thicket: The "Insured vs. Insured" Exclusion in the Bankruptcy Contex*t, 23 EMORY BANKR. DEV. J. 365 (2007).

3. *See, e.g.*, FDIC v. Nat'l Union Fire Ins. of Pittsburgh, Pa., 630 F. Supp. 1149 (W.D. La. 1986) (referring to the FDIC, as bank receiver); Mt. Hawley Ins. v. Fed. Sav. & Loan Ins., 695 F. Supp. 469 (C.D. Cal. 1987) (referring to the FSLIC, as bank receiver); Am. Cas. of Reading, Pa. v. Sentry Fed. Sav. Bank, 867 F. Supp. 50 (D. Mass. 1994) (referring to the FDIC, as bank receiver); Hyde v. Fid. & Deposit Co. of Md., 23 F. Supp. 2d 630 (D. Md. 1998) (referring to the RTC, as bank receiver); W Holding Co. v. Chartis Ins. P.R., 904 F. Supp. 2d 169 (D.P.R. 2012) (referring to the FDIC, as bank receiver); BancInsure, Inc. v. McCaffree, 3 F. Supp. 3d 904 (D. Kan. 2014), *aff'd sub nom.* BancInsure, Inc. v. FDIC, 796 F.3d 1226 (10th Cir. 2015) (referring to the FDIC, as bank receiver); Progressive Cas. Ins. v. FDIC, 80 F. Supp. 3d 923 (N.D. Iowa 2015) (referring to the FDIC, as bank receiver); FDIC v. BancInsure, Inc., 675 F. App'x 666 (9th Cir. 2017) (referring to the FDIC, as bank receiver).

4. *See, e.g.*, Rieser v. Baudendistel (*In re* Buckeye Countrymark, Inc.), 251 B.R. 835, 839 (Bankr. S.D. Ohio 2000) (involving a Chapter 7 trustee); Cohen v. Nat'l Union Fire Ins. of Pittsburgh, Pa. (*In re* Cnty. Seat Stores, Inc.), 280 B.R. 319, 324–26 (Bankr. S.D.N.Y. 2002) (involving a Chapter 11 trustee); Grafenauer v. Mukamal (*In re* Laminate Kingdom, LLC d/b/a Floors Today), Nos. 07-10279-BKC-AJC, 07-01792-AJC, 2008 WL 704396 (Bankr. S.D. Fla. Mar. 13, 2008) (involving a Chapter 7 trustee); Willson v. Vanderlick (*In re Cent.* La. Grain Co-op.), 467 B.R. 390 (Bankr. W.D. La. 2012) (involving a Chapter 7 trustee).

5. *See, e.g.*, Indian Harbor Ins. v. Zucker, 553 B.R. 633, 641–42 (Bankr. W.D. Mich. 2016), *aff'd sub nom.* Indian Harbor Ins. v. Zucker for Liquidation Tr. of Capitol Bancorp Ltd., 860 F.3d 373 (6th Cir. 2017) (discussing a litigation trust assigned claim by Chapter 11 debtor-in-possession under Chapter 11 plan); Biltmore Assocs., LLC v. Twin City Fire Ins., 572 F.3d 663 (9th Cir. 2009) (discussing a litigation trust

is that insurance contracts are governed by state law, and therefore, there is no (and can be no) uniform federal common law answer to the question. Furthermore, while D&O insurance policies tend to contain similar language, the exclusions used by various insurance carriers are not identical.[6] Lastly, the precise identity of the party bringing the lawsuit and the facts and circumstances in which actions are brought vary across cases.[7]

This Article provides an interpretative framework that builds on the work of prior articles written on this subject and seeks to clarify how the exclusion should apply to bank receivers and bankruptcy estate representatives in most circumstances. Part I provides an overview of the interpretive rules used by courts to decide if an insurance contract provision is ambiguous. Part II addresses whether causes of action brought by the Federal Deposit Insurance Corporation ("FDIC") and other bank receivers against directors and officers should be deemed brought by or on behalf of the insured bank for purposes of the exclusion and barred from coverage. Part III addresses that same question in the bankruptcy

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assigned claim by Chapter 11 debtor-in-possession pursuant to Chapter 11 plan); Reliance Ins. of Ill. v. Weis, 148 B.R. 575 (Bankr. E.D. Mo. 1992), *aff'd in part*, 5 F.3d 532 (8th Cir. 1993) (discussing a plan committee assigned claim by Chapter 11 debtor-in-possession pursuant to Chapter 11 liquidation plan); Pintlar Corp. v. Fid. & Cas. Co. of N.Y. (*In re* Pintlar Corp.), 205 B.R. 945, 947–48 (Bankr. D. Idaho 1997) (discussing a litigation trust assigned claim by Chapter 11 debtor-in-possession); Alstrin v. St. Paul Mercury Ins., 179 F. Supp. 2d 376 (D. Del. 2002) (discussing a Chapter 11 estate representative appointed under Bankruptcy Rule 2012(a)); Terry v. Fed. Ins. (*In re* R.J. Reynolds), 315 B.R. 674 (Bankr. W.D. Va. 2003) (discussing a litigation trust assigned claim by Chapter 11 debtor-in-possession); Cirka v. Nat'l Union Fire Ins. of Pittsburgh, Pa., No. CIV.A. 20250-NC, 2004 WL 1813283 (Del. Ch. Aug. 6, 2004) (discussing a creditors' committee); Fed. Ins. v. Surujon, No. 07-22819-CIV, 2008 WL 2949438 (S.D. Fla. July 29, 2008) (discussing a reorganized debtor); Cox Commc'ns, Inc. v. Nat'l Union Fire Ins. of Pittsburgh, Pa., 708 F. Supp. 2d 1322 (N.D. Ga. 2010) (discussing an official committee of unsecured bondholders); Segner v. Admiral Ins. (*In re* Palmaz Sci., Inc.), No. 16-50552-CAG, 2018 WL 3343597 (Bankr. W.D. Tex. June 4, 2018) (discussing a litigation trust assigned claim by Chapter 11 debtor-in-possession).

6. *See Cirka*, 2004 WL 1813283, at *4 (observing that "[o]ver time, the exact language of insured v. insured exclusions has been modified").

7. *Zucker*, 553 B.R. at 641–42 ("[T]he applicability of the insured v. insured exclusion depends on an examination of the facts of each case and the specific language of the directors and officers liability policy under consideration." (citing Sousa, *supra* note 2, at 371)).

context—whether causes of action brought by bankruptcy estate representatives against directors and officers should be deemed to have been brought by or on behalf of the insured bankrupt company for purposes of the exclusion and barred from coverage.

The overarching conclusion of this Article is that there has been three decades of voluminous litigation over whether actions brought by bank receivers and bankruptcy estate representatives are subject to the "insured vs. insured" exclusion because the exclusion, as drafted, is usually ambiguous. In this Author's opinion, courts should strictly construe the exclusion in favor of coverage and against the insurance carrier where express and unambiguous language is absent. This is because insurance companies know how to draft unambiguous exclusions, which expressly state whether an action brought by a bank receiver or bankruptcy estate representative is an action brought by or on behalf of the insured company for purposes of the exclusion.

I. STATE LAW RULES FOR INTERPRETING INSURANCE POLICIES

There is no uniform method of insurance contract interpretation in the United States. Instead, a court seeking to interpret an insurance contract must do so under the state law that governs the contract.[8] Nevertheless, there are some nearly universal rules of insurance contract interpretation that are consistently applied across jurisdictions.

For instance, courts are "required to interpret the language of a contract in such a way as to give effect to the intention of the parties at the

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8. *See* Sphinx Int'l, Inc. v. Nat'l Union Fire Ins. of Pittsburgh, Pa., 412 F.3d 1224, 1227 (11th Cir. 2005) ("Under the *Erie* doctrine, a federal court adjudicating state law claims applies the substantive law of the state." (quoting Ungaro-Benages v. Dresdner Bank AG, 379 F.3d 1227, 1232 (11th Cir. 2004))); *see also id.* ("In particular, '[t]he construction of insurance contracts is governed by substantive state law.'" (quoting Provau v. State Farm Mut. Auto. Ins., 772 F.2d 817, 819 (11th Cir. 1985))); Nat'l Union Fire Ins. of Pittsburgh v. Terra Indus., Inc., 346 F.3d 1160, 1164 (8th Cir. 2003) ("State law governs the interpretation of insurance policies."); *Reliance*, 148 B.R. at 578 ("On one level, this is a case about interpreting a clause in an insurance contract; consequently state law will control . . . ."); Miller v. ACE USA, 261 F. Supp. 2d 1130, 1135 (D. Minn. 2003) ("Insurance policy interpretation is a question of law and is governed by general principles of contract construction."); Boardman Petroleum, Inc. v. Federated Mut. Ins., 498 S.E.2d 492, 494 (Ga. 1998) ("Under Georgia law, contracts of insurance are interpreted by ordinary rules of contract construction.").

time the agreement was entered into."[9] If "the language of an insurance policy is clear and unequivocal, the parties will be bound by its clear meaning."[10] Conversely, if ambiguity does exist, it will generally be construed against the drafter of the policy, which is usually the insurance provider.[11]

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9. *Alstrin*, 179 F. Supp. 2d at 404; Houghton v. Am. Guar. Life Ins., 692 F.2d 289, 291 (3d Cir. 1982) ("In interpreting an insurance policy, which is a contract, courts are required to determine the intent of the parties as disclosed by the language of the policy."); *Cohen*, 280 B.R. at 324 ("When a dispute exists between the parties as to the proper interpretation of language of an insurance policy, a court should seek to determine the parties' intent from the language of the policy by construing the policy as a whole."); *Rieser*, 251 B.R. at 839 ("[C]ourts are required to interpret the contract in such a way as to give effect to the intention of the parties at the time the agreement was entered into, as evidenced by the provisions of the contract." (quoting Watkins v. Brown, 646 N.E.2d 485, 487 (Ohio Ct. App. 1994))); Tech-Built 153, Inc. v. Va. Sur. Co., 898 A.2d 1007, 1009 (N.H. 2006) ("The fundamental goal of interpreting an insurance policy, as in all contracts, is to carry out the intent of the contracting parties.").

10. *Reliance*, 148 B.R. at 579; Gray v. Exec. Risk Indem., Inc. (*In re* Molten Metal Tech., Inc.), 271 B.R. 711, 723 (Bankr. D. Mass. 2002) ("Unless the language is ambiguous, it must be given its plain and ordinary meaning."); Niemuller v. Nat'l Union Fire Ins. of Pittsburgh, Pa., No. 92 CIV. 0070 (SS), 1993 WL 546678, at *2 (S.D.N.Y. Dec. 30, 1993) ("[W]here the relevant terms in insurance policies are clear and unambiguous, a court must give them their plain and ordinary meaning."); *Sphinx*, 412 F.3d at 1227 ("Florida courts have said again and again that 'insurance contracts must be construed in accordance with the plain language of the policy.'" (quoting Swire Pac. Holdings, Inc. v. Zurich Ins., 845 So. 2d 161, 165 (Fla. 2003))); BancInsure, Inc. v. FDIC, 796 F.3d 1226, 1233 (10th Cir. 2015) ("Where the language of an insurance policy is clear and unambiguous, we must apply it in its plain and ordinary sense."); RESTATEMENT OF THE L. OF LIAB. INS. § 3(1) (AM. L. INST. 2021) ("If an insurance policy term has a plain meaning when applied to the facts of the claim at issue, the term is interpreted according to that meaning.").

11. *Reliance*, 148 B.R. at 579 ("[I]f ambiguity does exist, it must be construed against the drafter of the policy, i.e. the insurer."); *Rieser*, 251 B.R. at 839 ("[B]ecause it is typically the insurance carrier that drafts the policy, ambiguous language is construed in the way most favorable to the insured."); *Alstrin*, 179 F. Supp. 2d at 389 ("Where an ambiguity does exist, the ambiguity is generally resolved in favor of the insured and against the insurer."); Cox Commc'ns, Inc. v. Nat'l Union Fire Ins. of Pittsburgh, Pa., 708 F. Supp. 2d 1322, 1328 (N.D. Ga. 2010) ("When the language of an insurance [policy] is ambiguous and subject to more than one reasonable construction, the policy must be construed in the light most favorable to the insured, which provides him with coverage." (quoting W. Pac. Mut. Ins. v. Davies, 601 S.E.2d 363, 369 (Ga. Ct. App. 2004))); *Cohen*, 280 B.R. at 324 ("Insurance contracts are construed strictly against the insurer."); St. Paul Guardian Ins. v. Leopold, No. 5:14-CV-00040,

Fruchter: Escaping the D&O Liability Insurance Policy "Insured vs. Insured"

Additionally, once an insured party has shown that a loss has occurred and that coverage exists for the loss under the general terms of the insurance policy, "the burden is upon the insurer to prove that an exclusion applies."[12] The Restatement of the Law of Liability Insurance (the "Restatement") explains why the insurance company bears the burden of proof:

> This burden of proof reflects the basic structure of liability insurance policies, which generally contain a relatively broad grant of coverage and a set of narrower exclusions from coverage. Each exclusion represents an insurer's efforts to identify a class of claims that differs in some material way from the broad class of claims that are covered by the policy. It is the insurer that has identified the excluded classes of claims and will benefit from being able to place a specific claim into an excluded class. Thus, assigning the insurer the burden of proving that the claim fits into the exclusion is appropriate.[13]

2014 WL 12640233, at *4 (D. Vt. Nov. 4, 2014), *aff'd*, 622 F. App'x 27 (2d Cir. 2015) ("Ambiguous language is construed in favor of the insured—which typically means in favor of coverage."); Conklin Co. v. Nat'l Union Fire Ins., No. CIV. 4-86-860, 1987 WL 108957, at *3 (D. Minn. Jan. 28, 1987) ("Since the 'insured v. insured' exclusion . . . is ambiguous, it must be construed against the insurer, which is bound by the accepted usage of such provision since it failed to specify clearly that it intended a broader exclusion." (citation omitted)); RESTATEMENT OF THE L. OF LIAB. INS. § 4(2) (AM. L. INST. 2021) ("When an insurance policy term is ambiguous . . . the term is interpreted against the party that supplied the term, unless that party persuades the court that a reasonable person in the policyholder's position would not give the term that interpretation.").

12. *Cohen*, 280 B.R. at 324; *St. Paul Guardian Ins.*, 2014 WL 12640233, at *4 ("[T]he burden is on the insurer to show that a third party's claim against the insured is entirely excluded from coverage."); St. Paul Mercury Ins. v. Hahn, No. SACV 13-0424 AG (RNBX), 2014 WL 5369400, at *7 (C.D. Cal. Oct. 8, 2014), *aff'd sub nom.* St. Paul Mercury Ins. v. FDIC, 669 F. App'x 851 (9th Cir. 2016) ("The burden is on the insured to show that the claim is within the basic scope of coverage and on the insurer to establish that the claim is specifically excluded."); RESTATEMENT OF THE L. OF LIAB. INS. § 32 cmt. e (AM. L. INST. 2021) ("The insurer bears the burden of proving that a claim falls within the scope of an exclusion in the policy.").

13. RESTATEMENT OF THE L. OF LIAB. INS. § 32 cmt. e (AM. L. INST. 2021); *see also Hahn*, 2014 WL 5369400, at *7 ("[E]xclusionary clauses are interpreted narrowly against the insurer." (quoting Mackinnon v. Truck Ins. Exch., 73 P.3d 1205 (Cal. 2003))).

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Ambiguity exists as follows:

> [W]hen a word or phrase is "capable of more than a single meaning when viewed objectively by a reasonably intelligent person who has examined the context of the entire integrated agreement and who is cognizant of the customs, practices, usages and terminology as generally understood in the particular trade or business."[14]

The Restatement provides that "competing interpretations need not be equally reasonable for a term to be ambiguous."[15] Rather, what is required is that the "language of the policy be reasonably susceptible to [another] proposed alternative for it to be deemed ambiguous."[16]

Courts have found that "[t]he fact that judicial opinions have interpreted identical policy provisions differently may demonstrate ambiguity."[17] The U.S. Supreme Court has observed that a "sharp divergence of opinion among the circuit judges" with respect to the meaning of the

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14. *Cohen*, 280 B.R. at 324 (quoting Garza v. Marine Transp. Lines, Inc., 861 F.2d 23, 27 (2d Cir. 1988)); *Hahn*, 2014 WL 5369400, at *2 ("Policy provisions that are capable of two or more reasonable constructions are ambiguous and must be interpreted to protect 'the objectively reasonable expectations of the insured.'" (quoting Bank of the W. v. Superior Ct., 833 P.2d 545, 552 (Cal. 1992))).

15. RESTATEMENT OF THE L. OF LIAB. INS. § 3 cmt. f (AM. L. INST. 2021).

16. *Id.*

17. Bankwest v. Fid. & Deposit Co. of Md., 63 F.3d 974, 978 (10th Cir. 1995); *see* St. Paul Mercury Ins. v. FDIC, 774 F.3d 702, 709 (11th Cir. 2014) ("[A]n important indication of ambiguity in a policy is whether nearly identical or similar language has been construed differently by other courts."); Little v. MGIC Indem. Corp., 836 F.2d 789, 796 (3d Cir. 1987) ("[T]hat different courts have arrived at conflicting interpretations of" language in an insurance policy "is strongly indicative of the policy's essential ambiguity."); Lefrak Org., Inc. v. Chubb Custom Ins., 942 F. Supp. 949, 957 (S.D.N.Y. 1996) (finding exclusionary language ambiguous based, in part, on the "range and variety of judicial opinions" on interpretation of that language and granting partial summary judgment in favor of insured); Sullins v. Allstate Ins., 667 A.2d 617, 624 (Md. 1995) ("[C]onflicting interpretations of policy language in judicial opinions is not determinative of, but is a factor to be considered in determining the existence of ambiguity."); United Nuclear Corp. v. Allstate Ins., 285 P.3d 644, 653 (N.M. 2012) ("Many courts have reasonably concluded, both inside and outside of the insurance context, that such a lack of interpretive consensus is itself an indicator of ambiguity."); Greenville Cnty. v. Ins. Rsrv. Fund, 443 S.E.2d 552, 553 (S.C. 1994) ("That different courts have construed the language of an insurance policy differently is some indication of ambiguity.").

same set of words used in different contracts suggests that their meaning "is not obvious."[18]

As discussed below, decades of repeat litigation over whether bank receivers and bankruptcy estate representatives are subject to the "insured vs. insured" exclusion is strong evidence that the exclusion, as usually drafted, is ambiguous. Therefore, courts should strictly construe the exclusion in favor of coverage, unless the exclusion drafted by the insurance provider expressly states that an action brought by a bank receiver or bankruptcy estate representative is an action brought by the insured company for purposes of the exclusion.

II. BANK RECEIVERS AND THE "INSURED VS. INSURED" EXCLUSION

The "insured vs. insured" exclusion arose in reaction to "several lawsuits in the mid-1980s in which insured corporations sued their own directors to recoup operational losses caused by improvident or unauthorized actions."[19] Since the purpose of D&O insurance is to protect "against claims by outsiders, not intracompany claims,"[20] insurance carriers added the "insured vs. insured" exclusion to their policies in order to protect against "collusive suits between the insured corporation and its insured officers and directors."[21]

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18. INS v. Errico, 385 U.S. 214, 218 (1966).

19. Biltmore Assocs., LLC v. Twin City Fire Ins., 572 F.3d 663, 668 (9th Cir. 2009).

20. *Id.*

21. Rieser v. Baudendistel (*In re* Buckeye Countrymark, Inc.), 251 B.R. 835, 840–41 (Bankr. S.D. Ohio 2000); *see, e.g.*, Indian Harbor Ins. v. Zucker, 860 F.3d 373, 375 (6th Cir. 2017) ("Not unlike a homeowners insurance policy that excludes coverage for a fire that the policyholder intentionally sets, these exclusions limit the management-liability insurance to claims by outsiders, prohibiting coverage for claims by people within the insured company. A company thus cannot hope to push the costs of mismanagement onto an insurance company just by suing (and perhaps collusively settling with) past officers who made bad business decisions."); Miller v. St. Paul Mercury Ins., 683 F.3d 871, 872 (7th Cir. 2012) ("The exclusion serves to limit moral hazard. Without such an exclusion, a D & O policy could require the insurer to pay for the business mistakes of insured directors and officers if the corporation (also an insured) or if former officers or directors brought suit, collusive or otherwise, against them."); Twp. of Ctr., Butler Cnty., Pa. v. First Mercury Syndicate, Inc., 117 F.3d 115, 119 (3d Cir. 1997) ("The primary focus of the exclusion is to prevent collusive suits in which an insured company might seek to force its insurer to pay for the poor business decisions of its officers or managers. The exclusion arose

California Western Law Review, Vol. 58, Iss. 2 [], Art. 2

A. The Shareholders' Derivative Actions Analogy

A lawsuit brought by an insured bank against its former directors and officers would be barred from coverage by the plain wording of the "insured vs. insured" exclusion. The bank is an "insured" party under the policy. The bank is suing its directors and officers, who are also "insured" parties under the policy. Therefore, the "insured vs. insured" exclusion is triggered, and coverage is barred.

A more difficult question, however, is whether a lawsuit brought by a bank receiver against the bank's directors and officers triggers the exclusion and bars the directors and officers from coverage. On the one hand, the bank receiver which brought the action is acting on behalf of the bank and steps into its shoes. On the other hand, an action brought by a bank receiver can be analogized to an action brought by a third-party outsider to recover losses on behalf of the bank's creditors. Since the third-party outsider is not "insured" under the policy, such an action would not trigger the exclusion and would not be barred from coverage.

FDIC v. National Union Fire Insurance Co. and *Mount Hawley v. Federal Savings & Loan* are two of the earliest reported decisions which addressed the "insured vs. insured" exclusion.[22] In both cases, the issue being litigated was whether an action brought by the receiver of a failed bank was brought by an "insured" party—for purposes of the "insured vs. insured" exclusion of the D&O policy at issue in each case.[23] The courts reached opposite conclusions.[24] The *National Union Fire* court found that the bank receiver was not an "insured" party, so the exclusion did not bar coverage for the action,[25] while the *Mount Hawley* court found that the bank receiver was an "insured" party, so the exclusion did bar coverage for the action.[26]

Although these two holdings are seemingly contradictory, they can be reconciled based on the different language used in the "insured vs.

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from a wave of litigation in the mid-1980's when corporations attempted to use their Director and Officer policies to recoup operational losses.")

22. FDIC v. Nat'l Union Fire Ins. of Pittsburgh, Pa., 630 F. Supp. 1149 (W.D. La. 1986); Mt. Hawley Ins. v. Fed. Sav. & Loan Ins., 695 F. Supp. 469 (C.D. Cal. 1987).

23. *Nat'l Union Fire*, 630 F. Supp. at 1149; *Mt. Hawley*, 695 F. Supp. at 469.

24. *Nat'l Union Fire*, 630 F. Supp. at 1149; *Mt. Hawley*, 695 F. Supp. at 469.

25. *Nat'l Union Fire*, 630 F. Supp. at 1149.

26. *Mt. Hawley*, 695 F. Supp. at 483–84.

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insured" exclusions at issue in the two cases.[27] In *Mount Hawley*, the policy contained language expressly stating that the insurance company would not provide coverage for shareholders' derivative lawsuits,[28] while in *National Union Fire*, the policy expressly stated that such suits would be covered by the policy and not subject to the exclusion.[29]

The *National Union Fire* court observed that "the FDIC has been viewed traditionally in a different light than ordinary assignees" and noted that the FDIC "represents not only the failed bank's shareholders, but also itself as a creditor, as well as its predecessor's other creditors."[30] Accordingly, the court found that the "insured vs. insured" exclusion did not bar coverage for lawsuits brought by the FDIC—just as it would not bar coverage for shareholders' derivative actions brought by third-party outsiders.[31]

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27. In *National Union Fire*, the exclusion provided that the:

> Insurer shall not be liable to make any payment for loss . . . in connection with any claim or claims made against the Insureds by an Insured as defined in this policy, including [Planters Bank], *except for stockholders' derivative actions* brought by a shareholder of the Company other than an Insured.

Nat'l Union Fire, 630 F. Supp. at 1152 (emphasis added). In *Mount Hawley*, the exclusion provided that "the insurer shall not be liable to make any payment in connection with any claim or suit, *including but not limited to shareholders' derivative suits* . . . brought by one or more past, present or future Directors and/or Officers including . . . the company." *Mt. Hawley*, 695 F. Supp. at 481 (emphasis added).

28. Policies commonly contain a provision that expressly excepts shareholders' derivative actions brought on behalf of the company from falling within the "insured vs. insured" exclusion. *Mt. Hawley*, 695 F. Supp. at 484; *see, e.g.*, Fid. & Deposit Co. of Md. v. Zandstra, 756 F. Supp. 429, 430 (N.D. Cal. 1990) ("It is understood and agreed that the Company [Fidelity] shall not be liable to make any payment for Loss in connection with any claim made against the Directors and Officers by any other Director or Officer of the Association [Homestate] or by the Association, except for a shareholders' derivative action by a shareholder of the Association, when such shareholder is not a Director or Officer of the Association." (brackets in original)).

29. *Nat'l Union Fire*, 630 F. Supp. at 1152; *Mt. Hawley*, 695 F. Supp. at 481. The *Mount Hawley* court noted that it "is a strange exclusion to find in a D&O policy; ordinarily, shareholders' suits are the primary source of covered claims against directors and officers." *Id.* at 484. However, the court noted because the bank had only one shareholder, it was reasonable for the bank not to pay for coverage of derivative suits. *Id.*

30. *Nat'l Union Fire*, 630 F. Supp. at 1157.

31. *Id.* at 1152. The *Mount Hawley* court, in contrast, found that the "insured vs. insured" exclusion barred coverage for an action brought by a bank receiver. *Mt. Hawley*, 695 F. Supp. at 483 (holding that "it would be completely unreasonable to

In the years immediately following the *Mount Hawley* and *National Union Fire* decisions, courts considering whether the "insured vs insured" exclusion barred coverage for an action brought by a bank receiver focused on whether the exclusion contained a shareholders' derivative action exception.[32] If the exclusion contained an exception,

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read [the exclusion] as excluding coverage for suits brought against the officers and directors by the company but not for suits brought against them by the receiver in the name of the company").

32. *See, e.g.*, Am. Cas. Co. of Reading, Pa. v. Baker, 758 F. Supp. 1340, 1349–50 (C.D. Cal. 1991), *aff'd*, 22 F.3d 880 (9th Cir. 1994), *as amended*, (May 2, 1994) (finding existence of exception to "insured vs. insured" exclusion for shareholders' derivative actions dispositive in determining that claims were not barred from D&O insurance coverage); Branning v. CNA Ins., 721 F. Supp. 1180, 1184 (W.D. Wash. 1989) (finding that since "insured vs. insured" exclusion "does not exclude claims brought on behalf of shareholders, creditors, and the insurance fund, FSLIC's claims are covered"); *Zandstra*, 756 F. Supp. at 431 (finding that "[t]his issue is decided by the existence of the exception for shareholder derivative actions in the 'insured v. insured' exclusion. The existence of this exception demonstrates that Fidelity intended to place itself on the risk for actions against the directors and officers based upon allegations of mismanagement, waste, fraud, or abuse of Homestate."); Am. Cas. Co. of Reading, Pa. v. Sentry Fed. Sav. Bank, 867 F. Supp. 50, 59 (D. Mass. 1994) (finding that "[s]ince shareholders' derivative suits are not prohibited, the RTC should not be barred from coverage . . . ."); FDIC v. Zaborac, 773 F. Supp. 137, 144 (C.D. Ill. 1991) (finding that "[i]n this case, the FDIC does not merely stand in the shoes of Grove, it can also stand in the shoes of the shareholders; therefore, as a shareholder, it has the independent authority to bring a suit against American Casualty. Therefore, this Court concludes that the insured versus insured exclusion does not prevent the FDIC from bringing this lawsuit."); Finci v. Am. Cas. Co. of Reading, Pa., 593 A.2d 1069, 1082 (Md. 1991) (finding that "[r]einforcing this interpretation is the language excising from the exclusion 'a shareholders derivative action brought by a shareholder of the Institution other than an Insured.' . . . Thus, if the purpose of the exclusion is satisfied even if a shareholder's derivative suit is involved, the intent of the parties is not to exclude claims for the benefit of FMSL."); Fed. Ins. v. Hawaiian Elec. Indus., Inc., No. 94-00125HG, 1995 WL 1916123, at *9 (D. Haw. Dec. 15, 1995) (finding that shareholders' derivative action exemption inclusion in the policy indicated that insurance company "intended to put itself at risk for the malfeasance of the insured officers and directors" in certain circumstances). *But see, e.g.*, Gary v. Am. Cas. Co. of Reading, Pa., 753 F. Supp. 1547, 1550 (W.D. Okla. 1990) (finding the exclusion unambiguously barred coverage for claims brought by the FDIC notwithstanding shareholders' derivative lawsuit carveout); Am. Cas. Co. of Reading, Pa. v. FDIC, No. CIV.A. S90-0496 (BR), 1993 WL 610760, at *13 (S.D. Miss. Apr. 8, 1993) (finding the FDIC barred from coverage notwithstanding shareholders' derivative lawsuit exception).

which expressly provided that a shareholders' derivative suit[33] would not be barred from coverage, then the court would usually find that the bank receiver's action, which represented not only the failed bank but also its creditors, would also not be barred from coverage by the "insured vs. insured" exclusion.[34]

Since the "insured vs. insured" exclusions of most D&O policies contained a shareholders' derivative action exception, the majority of court decisions from the late 1980s and early 1990s found that the exclusion does not bar a bank receiver's action from coverage.[35] Indeed, a 1992 law review article observed that "[t]he weight of opinions concerning 'insured vs. insured' exclusions in the receivership context" allows "coverage when receivers sue the former directors and officers of a failed institution."[36] Similarly, a 1995 law review article argued that "[a] majority of better-reasoned opinions holds that the 'insured vs. insured' exclusion does not unambiguously exclude suits by the FDIC from coverage."[37]

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33. A cause of action against the directors and officers of a corporation for malfeasance belongs "to the corporation—not to the shareholders—and the board of directors is primarily responsible for enforcing the corporation's rights." FDIC v. BancInsure, Inc., 675 F. App'x 666, 668 (9th Cir. 2017). "A shareholder derivative suit is a secondary means of enforcing a corporation's rights . . . a shareholder may bring a derivative suit only 'when the board of directors fails or refuses to do so.'" *Id.* at 669 (quoting Grosset v. Wenaas, 175 P.3d 1184, 1189 (Cal. 2008); *see also* Biltmore Assocs., LLC v. Twin City Fire Ins., 572 F.3d 663, 669 (9th Cir. 2009) ("Shareholders and creditors can bring a suit for mismanagement only derivatively, on behalf of the corporation."); Gray v. Exec. Risk Indem., Inc. (*In re* Molten Metal Tech., Inc.), 271 B.R. 711, 725 (Bankr. D. Mass. 2002) ("Derivative claims belong to a corporation and are brought by its shareholders on the corporation's behalf.").

34. *See* sources cited *supra* note 33 and accompanying text.

35. *See* sources cited *supra* note 33 and accompanying text.

36. Melanie K. Palmore, Comment, *"Insured v. Insured" Exclusions in Director and Officer Liability Insurance Policies: Is Coverage Available When Chapter 11 Trustees and Debtors–in–Possession Sue Former Directors and Officers?*, 9 BANKR. DEV. J. 101, 118 (1992).

37. *See* Peter D. Rosenthal, Note, *Have Bank Regulators Been Missing the Forest for the Public Policy Tree? The Case for Contract-Based Arguments in the Litigation of Regulatory Exclusions in Director and Officer Liability Policies*, 75 B.U. L. REV. 155, 173 (1995). Rosenthal noted that:

> These opinions are grounded in three theories. First, courts identify the purpose of the exclusion as protection for the insurer against collusive suits between the failed institution and its D&Os. Because the FDIC is a genuinely adverse party not involved in the procurement of the insurance policy,

B. The "Standing in the Shoes of" Framework of Niemuller and O'Melveny & Myers

In *Niemuller v. National Union Fire Insurance Co.*, a 1993 case decided by then Judge Sotomayor, a company (Qantel) was sold pursuant to an asset purchase agreement to two purchasing companies.[38] After the purchasing companies sued Qantel's former director for breach of fiduciary duty, the former director requested that Qantel's D&O insurance carrier cover the claims brought against him.[39] The former director argued that the "insured vs. insured" exclusion[40] contained in the policy did "not apply to his request for defense costs."[41] Namely, while the exclusion barred coverage for claims brought by the insured com-

> such considerations are not implicated. Second, the FDIC does not simply "stand in the shoes" of the failed bank, but rather "is authorized to bring suit as a creditor itself, on behalf of the creditors and shareholders of the institution, and as subrogee to the rights of the depositors." Finally, courts have found no language in the "insured v. insured" exclusion indicating an intent to include the assignees or successors of the insured. In fact, the very existence of a regulatory exclusion in the same policy obviates the need to interpret the "insured v. insured" clause as excluding regulatory actions, because such a construction would render the regulatory exclusion redundant.

Id. at 173–74 (quoting Slaughter v. Am. Cas. Co., 842 F. Supp. 371, 374 (E.D. Ark. 1993)).

38. Niemuller v. Nat'l Union Fire Ins. of Pittsburgh, Pa., No. 92 CIV. 0070 (SS), 1993 WL 546678, at *1 (S.D.N.Y. Dec. 30, 1993). The asset purchase agreement provided that each purchasing company would "receive fifty percent interest in all rights and claims against" Qantel's former director. *Id.*

39. *Id.*

40. The "insured vs. insured" exclusion at issue in *Niemuller* provided that the Insurer was not liable for claims made against a director or officer:

> [W]hich are brought by any Insured or the Company; or which are brought by any security holder of the Company, whether directly or derivatively, unless such claim(s) is instigated and continued totally independently of, and totally without the solicitation of, or assistance of, active participation of, or intervention of, any Insured or the Company . . . .

Id.

41. *Id.*

pany Qantel against its former directors, the exclusion did not bar coverage for claims brought by other parties such as the purchasing companies.[42]

The *Niemuller* court rejected the former director's argument, noting that the purchasing companies were assignees and under "well-established principles of assignment law . . . an assignee *steps into the shoes* of the assignor and gains only so much as that to which the assignor is entitled."[43] The court held that because the insurance policy excluded coverage for claims brought by Qantel against other insured parties such as directors, it also excluded coverage for claims brought against directors by the purchasing companies, as successors-in-interest of Qantel.[44]

In rendering its decision, the court distinguished the case at hand from FDIC cases, finding that "regulatory banking agencies have greater standing than ordinary successors-in-interest because they, empowered by statute, represent the bank as well as the creditors, depositors[,] and shareholders of the bank," and therefore, do "not merely *stand in the shoes of the original party*."[45] In contrast to the FDIC, which is not barred from coverage by the "insured vs. insured" exclusion because of its unique legal status, the purchasing companies, as "ordinary assignees . . . continuing an action brought by their assignors," were subject to the exclusion in the exact same manner as the predecessor insured company.[46]

Shortly after *Niemuller* was decided, the U.S. Supreme Court rendered the *O'Melveny & Myers v. FDIC* decision. There, the Court held that when the FDIC takes over as a bank's receiver, it "steps into the

42. *Id.* at *3. The former director also argued that "because Qantel assigned its claim" against him to the purchasing companies, and those companies brought the breach of fiduciary duty claim as its successors-in-interest, the exclusion did not apply to bar coverage. *Id.*

43. *Id.* (emphasis added).

44. *Niemuller*, 1993 WL 546678, at *3.

45. *Id.* at *4 (emphasis added).

46. *Id.* In sum, the *Niemuller* court held that (1) the "insured vs. insured" exclusion applies to bar coverage with respect to claims brought by voluntary assignees who are "ordinary successors-in-interest" of an insured company; and (2) the exclusion does not apply to actions brought by the FDIC acting in its capacity as a statutory receiver, because the FDIC does not merely "step in the shoes of" a bank as a voluntary assignee but rather succeeds the bank by operation of statute and represents not only the bank but also its "creditors, depositors[,] and shareholders." *Id.*

California Western Law Review, Vol. 58, Iss. 2 [], Art. 2

shoes" of the failed bank, and any valid defense to a claim brought by the failed bank is also valid against the same claim if brought by the bank's receiver.[47] Read together, *Niemuller* and *O'Melveny* may suggest that because the FDIC "steps into the shoes" of a failed bank, an action brought by the FDIC is an action brought by an "insured" under the exclusion—even if the exclusion contains a shareholders' derivative action exception.[48]

For example, in *St. Paul Mercury Insurance Co. v. Miller*, the district court found that the exclusion applied to claims brought by the FDIC, because the banking regulator "stepped into the shoes of [the bank], and, under *O'Melveny*, whatever claims would have been good against [the bank] are also good against the FDIC."[49] Interpreting *O'Melveny* as conclusively establishing that an action brought by the FDIC is brought by an "insured" claimant for purposes of the exclusion, if an action brought by the bank itself would have been brought by an "insured" claimant, however, turns the *O'Melveny* holding on its head. In *O'Melveny*, the U.S. Supreme Court expressly stated that there is no federal general common law[50] and held that state law is not displaced in the bank receivership context.[51]

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47. O'Melveny & Myers v. FDIC, 512 U.S. 79, 86 (1994).

48. *Compare Niemuller*, 1993 WL 546678, at *4 ("The FDIC in *Zandstra*, as a separate entity, had incurred losses due to the directors' alleged misfeasance. Consequently, FDIC possessed independent claims against the directors and officers. . . [and] did not merely stand in the shoes of the original party." (internal quotes and citations omitted)), *with O'Melveny*, 512 U.S. at 86 ("This language appears to indicate that the FDIC as receiver 'steps into the shoes' of the failed S & L.").

49. St. Paul Mercury Ins. v. Miller, 968 F. Supp. 2d 1236, 1242 (N.D. Ga. 2013), *rev'd sub nom.* St. Paul Mercury Ins. v. FDIC, 774 F.3d 702 (11th Cir. 2014) (finding that "[t]he Insured v. Insured exclusion expressly excludes from coverage suits brought by an insured against another insured. If [the bank] had sued, . . . the exclusion would have applied to absolve Plaintiff from a duty to provide coverage . . . . As such, the exclusion applies equally to the FDIC.").

50. The Supreme Court merely held that the FDIC "steps into the shoes" of failed banks for the purposes of "the imputation of knowledge to corporate victims of alleged negligence." *O'Melveny*, 512 U.S. at 84–85.

51. Indeed, on appeal, the Eleventh Circuit observed that another court in the same district as the *Miller* court, interpreting a nearly identically worded "insured v. insured exclusion," which was also governed by Georgia law, had "reached opposite conclusions about" whether the exclusion barred coverage for claims brought by the FDIC. *St. Paul Mercury Ins.*, 774 F.3d at 710. The Eleventh Circuit concluded that this disagreement between courts "plainly support[ed] a finding of ambiguity under

In *O'Melveny*, the controlling officers of a California-based savings and loan institution ("S&L") fraudulently overvalued the S&L's assets.[52] After the S&L failed and the FDIC took over as receiver, the FDIC brought breach of fiduciary duty and professional negligence claims against the S&L's law firm, which had allegedly aided and abetted in the fraud.[53] In its defense, the law firm argued that the bank's officers had knowledge of the fraud that would "be imputed to the S&L, and hence to [the FDIC], which as receiver, stood in the shoes of the S&L."[54] The law firm further argued that under California law, as a result of that knowledge imputation, the S&L, and hence the FDIC, would be estopped from bringing claims against the law firm.[55] In response, the FDIC argued that federal general common law governed its rights to recover against the law firm, because the FDIC had been appointed as a receiver under a federal statute.[56]

The U.S. Supreme Court disagreed with the FDIC, explaining that there is no "federal general common law."[57] Instead, state law, "not federal law, governs the imputation of knowledge to corporate victims of alleged negligence . . . ."[58] The Court further held that because Congress promulgated a "comprehensive and detailed" statute regarding the FDIC's legal rights and obligations as a bank receiver, matters unaddressed in the federal statute are "left subject to the disposition provided by state law."[59] The Court held that when the FDIC becomes a receiver, it "*steps into the shoes*" of the failed financial institution and

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Georgia law" and therefore remanded the case back to the district court to consider extrinsic evidence to resolve the contract's ambiguity under Georgia state law. *Id.* at 710–11.

52. *O'Melveny*, 512 U.S. at 81.

53. *Id.* at 82.

54. *Id.*

55. *Id.* The law firm based its argument that the FDIC steps into the bank's shoes on the language of FIRREA, which was passed in 1989 in response to the savings and loan crisis of the late 1980s, which provides that when the FDIC becomes the receiver of a failed bank "by operation of law," it "succeed[s] to [] all rights, titles, powers, and privileges of the insured depository institution . . . ." 12 U.S.C. § 1821(d)(2)(A)(i).

56. *O'Melveny*, 512 U.S. at 83.

57. *Id.* (quoting Erie R. Co. v. Tompkins, 304 U.S. 64, 78 (1938)).

58. *Id.* at 84–85.

59. *Id.* at 85.

California Western Law Review, Vol. 58, Iss. 2 [], Art. 2

obtains the same state law-created rights the bank had prior to receivership.[60] As a result, to the extent that under California law the law firm had a valid defense against the bank's claim prior to the FDIC taking over as receiver, the law firm still had a valid defense after the FDIC stepped into the bank's shoes.[61]

The *Miller* court's reliance on *O'Melveny* to decide the "insured vs. insured" issue was misplaced. *O'Melveny* did not decide whether a breach of fiduciary duty action brought by a bank receiver should be treated as if it was brought by the "insured" bank for the purposes of the "insured vs. insured" exclusion.[62] Rather, under the *O'Melveny* precedent, to decide this issue, the court should have applied Georgia contract law to interpret the language of the policy exclusion.[63] As a number of district court decisions have correctly observed, to interpret:

> "[O]n behalf of" as "stepping into the shoes of," based on *O'Melveny & Myers*, would seem to be tantamount to creation of federal common law on the meaning of "on behalf of," where the Supreme Court itself eschewed creation of federal common law concerning claims by the FDIC as receiver for a bank in that very decision.[64]

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60. *Id.* at 86.

61. *Id.*

62. *See* St. Paul Mercury Ins. v. FDIC, 669 F. App'x 851, 853 (9th Cir. 2016) ("[I]t is ambiguous whether the FDIC as receiver is pursuing its claims against the directors and officers 'on behalf of' the defunct bank within the meaning of the 'insured v. insured' exclusion, because the FDIC as receiver represents a number of interests and does not operate as a normal successor in interest."); BancInsure, Inc. v. McCaffree, 3 F. Supp. 3d 904, 913 (D. Kan. 2014), *aff'd sub nom.* BancInsure, Inc. v. FDIC, 796 F.3d 1226 (10th Cir. 2015) ("The court notes that the majority view holds that coverage exists for FDIC claims even though it steps into the shoes of a failed bank.").

63. *See* St. Paul Mercury Ins. v. Miller, 968 F. Supp. 2d 1236, 1238–39 (N.D. Ga. 2013), *rev'd sub nom.* St. Paul Mercury Ins. v. FDIC, 774 F.3d 702 (11th Cir. 2014) (noting that the insurance contract was governed by Georgia law).

64. Progressive Cas. Ins. v. FDIC, 80 F. Supp. 3d 923, 948–49 (N.D. Iowa 2015) (citing *O'Melveny*, 512 U.S. at 87 (1994)); *see, e.g.*, St. Paul Mercury Ins. v. Hahn, No. SACV 13-0424 AG (RNBX), 2014 WL 5369400, at *4 (C.D. Cal. Oct. 8, 2014) ("Although the Supreme Court held in *O'Melveny & Myers* that the FDIC as a receiver 'steps into the shoes' of a failed bank when pursuing tort claims that belonged exclu-

https://scholarlycommons.law.cwsl.edu/cwlr/vol58/iss2/2

C. Developments in the Drafting and Interpretation of the "Insured vs. Insured" Exclusion

The boilerplate language of the "insured vs. insured" exclusion found in most D&O policies has changed over time. The earliest exclusions precluded coverage for lawsuits brought "*by*" an insured against another insured.[65] As the caselaw developed, most insurance providers redrafted the exclusion to also bar coverage for actions brought "*on behalf of*" an insured.[66]

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sively to the bank, its holding did not concern insurance or an insured v. insured exclusion. The latter issues require interpretation of the Policy and specifically the phrase 'on behalf of.' *O'Melveny & Myers* doesn't tell us whether 'on behalf of' means the same thing as 'steps into the shoes,' or whether FDIC–R, who represents a number of interests, even steps into the shoes of the Bank for these particular claims." (internal citations omitted)); Grafenauer v. Mukamal (*In re* Laminate Kingdom, LLC d/b/a Floors Today), Nos. 07-10279-BKC-AJC, 07-01792-AJC, 2008 WL 704396, at *5 (Bankr. S.D. Fla. Mar. 13, 2008) ("The interpretation and construction by federal courts of insurance contracts is governed by substantive state law."); FDIC v. PricewaterhouseCoopers, LLP, No. 2:12-CV-957-WKW, 2013 WL 4851613, at *3 (M.D. Ala. Sept. 10, 2013) ("The procedural history of *O'Melveny* highlights the Court's holding that state law applies.").

65. *See, e.g.*, FDIC v. Nat'l Union Fire Ins. of Pittsburgh, Pa., 630 F. Supp. 1149 (W.D. La. 1986); Mt. Hawley Ins. v. Fed. Sav. & Loan Ins., 695 F. Supp. 469 (C.D. Cal. 1987).

66. *See, e.g.*, Reliance Ins. of Ill. v. Weis, 148 B.R. 575, 578 (Bankr. E.D. Mo. 1992), *aff'd in part*, 5 F.3d 532 (8th Cir. 1993) (noting the exclusion barred coverage for claims brought "by or on behalf of a Director and/or Officer or by or on behalf of the Company, except for stockholder(s) derivative actions brought by a shareholder(s) of the Company other than a Director and/or Officer"); Fed. Ins. v. Hawaiian Elec. Indus., Inc., No. 94-00125HG, 1995 WL 1916123, at *12 (D. Haw. Dec. 15, 1995) (noting the exclusion provided that insurance carrier "shall not be liable for Loss on account of any Claims made against any Insured Person . . . brought or maintained by or on behalf of any Insured."); Terry v. Fed. Ins. (*In re* R.J. Reynolds), 315 B.R. 674 (Bankr. W.D. Va. 2003) ("The Policy excludes claims which are 'brought or maintained by or on behalf of any Insured.'"); Miller v. St. Paul Mercury Ins., 709 F. Supp. 2d 397, 402 (D. Md. 2009) ("The Insurer shall not be liable for Loss on account of any Claim made against any Insured . . . brought or maintained by or on behalf of any Insured, or Company, in any capacity . . . ."); W Holding Co. v. Chartis Ins. P.R., 904 F. Supp. 2d 169, 183–84 (D.P.R. 2012) (noting the exclusion barred coverage for claims "brought by, on behalf of or in the right of, an Organization or any Insured Person . . . whether or not collusive"); *BancInsure, Inc.*, 3 F. Supp. 3d at 908 (noting the exclusion barred coverage for "a Claim by, or on behalf, or at the behest of, any other Insured Person, the Company, or any successor, trustee, assignee or receiver of

Some policies also bar coverage for actions brought "*in the name of*" or "*in the right of*" an insured.[67]

As a matter of common sense, an exclusion that bars coverage for actions that are brought "on behalf of" a company is broader than an exclusion that only bars coverage for actions brought "by" the company. However, the broadening effect of this additional language has done little to clarify matters. Unfortunately, just as with the older "by" an insured language, courts have rendered contradictory decisions with respect to policies containing the "on behalf of" an insured language.

Some courts have found that even if an action brought by a receiver was not brought "by" the insured bank, it was brought "on behalf of" the insured bank. For example, in *Hyde v. Fidelity*, the court found that coverage was barred for a lawsuit brought by the Resolution Trust Corporation ("RTC"), which acted as the bank's receiver. This is because the D&O policy's "insured vs. insured" exclusion provided that the insurer "shall not be liable to make any payment for Loss in connection with any claim made against the Directors and Officers . . . *by*, *or on behalf of or in the name of*" the insured bank.[68] The court found that even if the receiver was technically not the bank, at a minimum, it was standing in the bank's shoes and bringing a claim on its behalf. Therefore, the plain meaning of the exclusion barred coverage for the action.[69]

Not all courts have so held. For example, in *Progressive v. FDIC*, a court (applying Iowa contract law) held that an exclusion barring coverage for "any Claim *by*, *on behalf of*, *or at the behest of the Company*" against another insured did not apply to an action brought by the FDIC.[70] In its holding, the court noted that there were provisions of the

the Company"); *Progressive*, 80 F. Supp. 3d at 946 (noting the exclusion barred coverage for "any Claim by, on behalf of, or at the behest of the Company . . . ."); FDIC v. BancInsure, Inc., 675 F. App'x 666, 668 (9th Cir. 2017) ("The D&O Policy excludes from coverage losses arising from legal actions brought 'by, or on behalf of, or at the behest of' Security Pacific . . . .").

67. *See, e.g.*, Indian Harbor Ins. v. Zucker, 860 F.3d 373, 375 (6th Cir. 2017); Fed. Ins. v. Surujon, No. 07-22819-CIV, 2008 WL 2949438, at *5 (S.D. Fla. July 29, 2008).

68. Hyde v. Fid. & Deposit Co. of Md., 23 F. Supp. 2d 630, 633 (D. Md. 1998) (emphasis added).

69. *Id.* at 634.

70. *Progressive*, 80 F. Supp. 3d at 963 (emphasis added).

D&O insurance policy that "expressly include[d] references to 'receivers.'"[71] Thus, the court concluded that if the insurance company had "intended to address coverage issues relating to 'receivers,'" such as the FDIC, the policy would have expressly mentioned receivers in the language of the exclusion.[72] In an identically captioned case brought in the Northern District of Georgia, the court (applying Georgia contract law) similarly found with respect to an identically worded exclusion that it was unclear whether the FDIC's claims were barred from coverage.[73]

As is made clear by this split in authority, the addition of the "on behalf of" language to the exclusion has done little to clarify if the exclusion bars coverage for an action brought by a bank receiver. For this reason, in 2016, the Ninth Circuit upheld a district court's ruling that an "insured vs. insured" exclusion was ambiguous as it applied to an action brought by the FDIC against the directors and officers of a failed bank.[74] The Ninth Circuit explained that the insurer "bears the burden to 'phrase exceptions and exclusions in clear and unmistakable language' and of establishing that a 'claim is specifically excluded,'" and determined that the insurance carrier had "failed to carry that burden, despite having notice that similar exclusions had been deemed ambiguous by other courts."[75]

D. Conclusion: Actions Brought by Bank Receivers Should Not be Barred from Coverage Unless the Exclusion is Unambiguous

Insurance companies have "the ability[] as a repeat party" to D&O insurance contracts "to ensure that ambiguities are eliminated over time."[76] With respect to the "insured vs. insured" exclusion, insurance companies are aware that the boilerplate exclusion usually contained in

71. *Id.* at 947.

72. *Id.* at 948.

73. Progressive Cas. Ins. v. FDIC, 926 F. Supp. 2d 1337, 1340 (N.D. Ga. 2013); *see* St. Paul Mercury Ins. v. FDIC, 774 F.3d 702, 710 (11th Cir. 2014) (finding exclusion ambiguous where two district courts that both applied Georgia law "reached opposite conclusions about the effect of a nearly identically worded insured v. insured exclusion" which contained the "on behalf of" language).

74. St. Paul Mercury Ins. v. FDIC, 669 F. App'x 851, 853 (9th Cir. 2016).

75. *Id.*

76. St. Paul Mercury Ins. v. Hahn, No. SACV 13-0424 AG (RNBX), 2014 WL 5369400, at *4 (C.D. Cal. Oct. 8, 2014).

D&O policies has been deemed ambiguous in numerous lawsuits brought by bank receivers.[77] These companies are also aware that some courts have found that unless a policy contains clear and unambiguous language expressly addressing whether the exclusion bars a bank receiver's action from coverage, the provision is deemed ambiguous and must be interpreted in favor of the insured.[78]

Directors and officers of banks purchase D&O insurance to shift the expenses of breach of fiduciary duty lawsuits to insurance carriers.

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77. *See, e.g.*, Cirka v. Nat'l Union Fire Ins. of Pittsburgh, Pa., No. CIV.A. 20250-NC, 2004 WL 1813283, at *4 (Del. Ch. Aug. 6, 2004) (noting that both sides of the litigation noted that "insured v. insured exclusions have a long history of litigation").

78. *See, e.g.*, Am. Cas. Co. v. FDIC, 791 F. Supp. 276, 278 (W.D. Okla. 1992), *aff'd sub nom.* Am. Cas. Co. of Reading, Pa. v. FDIC, 33 F.3d 62 (10th Cir. 1994) ("Here, the exclusion provision contains no expressed reference to the FDIC or to any successors, assigns or receivers. Such language could easily have been made a part of the policy exclusion if it was so intended and, in fact, has been on numerous other occasions."); St. Paul Fire & Marine Ins. v. FDIC, 765 F. Supp. 538, 548 (D. Minn. 1991), *aff'd*, 968 F.2d 695 (8th Cir. 1992) ("[I]t is by no means clear that Insured includes the FDIC which took the bank over as a receiver. This interpretation of the policy is further supported by the fact that St. Paul specifically included an endorsement that precluded suits by the FDIC. This demonstrates that St. Paul knew what language to use to explicitly preclude such suits. In addition, neither the Insured v. Insured Exclusion nor the definition of 'Insured' specifically includes language indicating that such terms and the prescription of coverage contained therein is to apply to assignees of the insured."); Am. Cas. Co. of Reading, Pa. v. Fed. Sav. & Loan Ins., 704 F. Supp. 898, 901 (E.D. Ark. 1989) (concluding that the policy was ambiguous in part because there was no reference in the exclusion to "successors, assigns, trustees or receivers"); Reliance Ins. of Ill. v. Weis, 148 B.R. 575, 580 (Bankr. E.D. Mo. 1992), *aff'd in part*, 5 F.3d 532 (8th Cir. 1993) ("[T]he Court believes that since Reliance is the drafter of the policy and did address the issue of bankruptcy elsewhere in the policy, then it appears reasonable to conclude that if Reliance had wanted to expressly address the issue of bankruptcy in [the exclusion], it would have done so."); *Hahn*, 2014 WL 5369400, at *3 ("[T]he Insured v. Insured Exclusion is ambiguous when applied to the FDIC is evidenced by the fact that courts considering this exclusion have reached varying conclusions." (citations omitted)); FDIC v. Bowen, 865 P.2d 868, 870 (Colo. App. 1993); Grafenauer v. Mukamal (*In re* Laminate Kingdom, LLC d/b/a Floors Today), Nos. 07-10279-BKC-AJC, 07-01792-AJC, 2008 WL 704396, at *5 (Bankr. S.D. Fla. Mar. 13, 2008) (interpreting the exclusion as not applying to an action brought by a bankruptcy trustee where "the plain language of the definitions and the exclusion do not include the bankruptcy trustee"); TIG Specialty Ins. v. Koken, 855 A.2d 900, 909 (Pa. Commw. Ct. 2004) (reaching the same conclusion about the interpretation of the exclusion).

If the directors and officers are aware of the conflicting judicial opinions on this issue, then it would be fair for them to assume that if their bank were to fail, and the FDIC were to step into the bank's shoes and bring a breach of fiduciary duty action against the directors and officers, a court would likely find that the exclusion does not apply to bar coverage (absent clear contractual language to the contrary).

This assumption is reasonable given that the original purpose of the exclusion—to protect against "collusive suits between the insured corporation and its insured officers and directors"—is not implicated when a receiver takes over a bank and the bank's causes of action by operation of statute.[79]

In this Author's opinion, where a D&O policy does not expressly address the applicability of the "insured vs. insured" exclusion to a bank receiver, courts should find in favor of coverage. If an insurance company does not like this outcome, it can readily avoid the outcome by simply redrafting the exclusion to remove any ambiguities.

It is worth noting that this suggestion is simple and already employed in practice. In cases where insurance carriers have drafted a clear and unambiguous "insured vs. insured" exclusion that expressly states a claim brought by a bank receiver is brought by an "insured" for the purposes of the exclusion, courts have enforced the express contractual language. For example, in *Hawker v. BancInsure*, the policy excluded from coverage claims brought "by, or on behalf of, or at the be-

79. Rieser v. Baudendistel (*In re* Buckeye Countrymark, Inc.), 251 B.R. 835, 840–41 (Bankr. S.D. Ohio 2000); Fid. & Deposit Co. of Md. v. Zandstra, 756 F. Supp. 429, 431 (N.D. Cal. 1990) (reaching the same conclusion about the interpretation of the exclusion); *see Am. Cas. Co.*, 791 F. Supp. at 278 ("The obvious intent behind the 'insured vs. insured' exclusion is to protect the insurer from collusive suits among a bank and its directors and officers."); *see, e.g.*, *What is Directors & Officers (D&O) Liability Insurance?*, TRAVELERS, https://www.travelers.com/professional-liability-insurance/directors-officers (last visited Feb. 27, 2022) ("Directors & Officers (D&O) Liability insurance is designed to protect the people who serve as directors or officers of a company from personal losses if they are sued by the organization's employees, vendors, customers or other parties."); *D&O Insurance Explained*, ALLIANZ GLOB. CORP. & SPECIALTY, https://www.agcs.allianz.com/news-and-insights/expert-risk-articles/d-o-insurance-explained.html (last visited Feb. 27, 2022) ("D&O insurance policies offer liability cover for company managers to protect them from claims which may arise from the decisions and actions taken within the scope of their regular duties.").

hest of, any other insured person, the company, or any successor, trustee, assignee *or receiver* of the company . . . ."[80] After finding that the FDIC "meets the 'ordinary and popular' definition of receiver," the court found that the "insured vs. insured" exclusion unambiguously barred coverage under the D&O policy for a claim brought by the FDIC.[81] Similarly, in *BancInsure v. FDIC*, the Tenth Circuit affirmed the district court's finding that a claim brought by the FDIC was excluded from coverage by an "insured vs. insured" provision that expressly provided that the insurer would not be liable to make any payment for a loss in connection with any claim made "by, or on behalf of, or at the behest of, any other Insured Person, the Company, or any successor, trustee, assignee *or receiver* of the Company."[82]

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80. Hawker v. BancInsure, Inc., No. 1:12-CV-01261-SAB, 2014 WL 1366201, at *2 (E.D. Cal. Apr. 7, 2014), *aff'd sub nom.* Hawker v. Doak, 685 F. App'x 565 (9th Cir. 2017) (emphasis added).

81. *Id.* at *14.

82. BancInsure, Inc. v. FDIC, 796 F.3d 1226, 1231 (10th Cir. 2015) (emphasis added). The court further noted that it was unsurprising that "in the absence of clear language stating that claims by a receiver of the company were excluded . . . courts found the exclusions at least ambiguous as to claims by a receiver, given the similarity of such claims to shareholder derivative actions." *Id.* at 1236; *see* FDIC v. BancInsure, Inc., 675 F. App'x 666, 670 (9th Cir. 2017) (finding "the term 'receiver' is clear and unambiguous and includes the FDIC in its role as receiver . . . [a]s such, the FDIC's claims fall within the scope of the D&O Policy's insured-versus-insured exclusion"); *TIG Specialty Ins.*, 855 A.2d at 900 (finding that "insured vs. insured" exclusion which barred coverage for "[a]ny Claim brought by, on behalf of or at the behest of the Company, its successor, its assignee, its trustee in bankruptcy, its debtor-in-possession, or its litigation trustee" unambiguously barred coverage with respect to a claim brought by the Pennsylvania Insurance Commissioner in her role as Statutory Liquidator).

III. THE "INSURED VS. INSURED" EXCLUSION IN THE BANKRUPTCY CONTEXT

Filing a bankruptcy petition creates an estate that consists of "all legal or equitable interests of the debtor in property as of the commencement of the case,"[83] including claims against directors and officers for "breach of fiduciary duties."[84] In a bankruptcy proceeding, there are various parties that can potentially bring breach of fiduciary duty and related actions on behalf of the bankruptcy estate, including Chapter 7 trustees, Chapter 11 trustees, estate representatives appointed pursuant to a Chapter 11 plan,[85] and debtors-in-possession.[86]

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83. 11 U.S.C. § 541(a)(1); La. World Exposition v. Fed. Ins., 858 F.2d 233, 245 (5th Cir. 1988).

84. Torch Liquidating Tr. *ex rel.* Bridge Assocs. LLC v. Stockstill, 561 F.3d 377, 388 (5th Cir. 2009) ("When Torch filed its chapter 11 petition, all claims owned by it, including claims against the Directors for breach of fiduciary duties, became part of the estate."); *see* United States *ex rel.* Gebert v. Transp. Admin. Servs., 260 F.3d 909, 913 (8th Cir. 2001) ("[T]he property of the bankruptcy estate includes all causes of action that the debtor could have brought at the time of the bankruptcy petition."); Delgado Oil Co. v. Torres, 785 F.2d 857, 860 (10th Cir. 1986) ("The § 541 estate . . . includes any right of action the debtor corporation may have to recover damages for misconduct, mismanagement, or neglect of duty by a corporate officer or director.").

85. Section 1123(b)(3)(B) of the Bankruptcy Code provides that a Chapter 11 plan of reorganization can provide for "the retention and enforcement by the debtor, by the trustee, or by a representative of the estate appointed for such purpose, of any such claim or interest . . ." This grants debtors the authority to, with court approval, establish a post-confirmation litigation or liquidation trust to pursue causes of action. 11 U.S.C. § 1123(b)(3)(B). *See, e.g.*, *Torch*, 561 F.3d at 388 ("[T]he Plan, as confirmed by the bankruptcy court, transferred all of the debtor estate's remaining assets to the Trust. As part of that transfer, the Plan and the court's order expressly preserved and transferred all D&O claims. To administer the estate and the Trust, the Plan provided for the appointment of a Plan Administrator and Trustee, which was granted the 'rights and powers of a debtor-in-possession under Section 1107 of the Bankruptcy Code,' including the duty "to prosecute any D&O Claims and distribute the proceeds of such claims, and other rights and powers set forth in the Liquidating Trust Agreement." (citations omitted)).

86. *La. World Exposition*, 858 F.2d at 245 (noting that trustees and debtors-in-possession have "the authority to bring an action for damages on behalf of a debtor corporation against corporate principals for gross negligence, mismanagement or breach of fiduciary duty where such an action could have been asserted by the debtor corporation, or by its stockholders in a derivative action, prior to bankruptcy").

In an influential law review article, it was suggested that the various parties who can act on behalf of the bankruptcy estate "should be viewed as points on a linear continuum whereby the farther removed from the debtor-in-possession, the more likely the 'insured vs. insured' exclusion will not apply."[87] This Article's following section analyzes the exclusion as it applies to bankruptcy trustees, debtors-in-possession and estate representatives. Further, the below section builds on (and disagrees with) some of the arguments made in judicial decisions and law review articles that have addressed whether the various representatives of the bankruptcy estate are an "insured" for the purposes of the exclusion.

A. The Easy Case: Chapter 7 and Chapter 11 Trustees

When a debtor files for Chapter 7 bankruptcy protection, a trustee is appointed to marshal the assets of the debtor's estate, liquidate the non-exempt assets and distribute the proceeds to creditors.[88] When a debtor files for Chapter 11 bankruptcy protection, a trustee is not always appointed;[89] rather, under Bankruptcy Code section 1104, the bankruptcy court will appoint a trustee in a Chapter 11 case "for cause, including fraud, dishonesty, incompetence or gross mismanagement of the affairs of the debtor . . . or if such appointment is in the interests of creditors, any equity securityholders and other interests of the estate

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87. Sousa, *supra* note 2, at 371; Indian Harbor Ins. v. Zucker, 553 B.R. 633, 641–42 (Bankr. W.D. Mich. 2016), *aff'd sub nom.* Indian Harbor Ins. v. Zucker for Liquidation Tr. of Capitol Bancorp Ltd., 860 F.3d 373 (6th Cir. 2017) (citing Sousa, *supra* note 2, at 371).

88. *See* 11 U.S.C. §§ 704(a)(1), 726; Mender v. Franqui (*In re* Sanchez), 604 B.R. 643, 649 (Bankr. D.P.R. 2019) ("In cases under chapter 7, a trustee is appointed, tasked with taking possession of all non–exempt assets of the estate and administering them for the benefit of creditors.").

89. *In re* G-I Holdings, Inc., 385 F.3d 313, 319 (3d Cir. 2004) ("In the usual chapter 11 proceeding, the debtor remains in possession throughout reorganization . . . ." (quoting *In re* Marvel Ent. Grp., Inc., 140 F.3d 463, 471 (3d Cir. 1998)); *In re* V. Savino Oil & Heating Co., 99 B.R. 518, 524 (Bankr. E.D.N.Y. 1989) ("Typically, in a business reorganization case under Chapter 11 of the Bankruptcy Code a debtor will remain in possession, meaning that pre-Chapter 11 management will continue to manage the debtor's affairs. The underlying assumption of Chapter 11 is that debtor-in-possession governance is to be the norm.").

. . . ."[90] If a trustee is appointed in a bankruptcy case, the debtor's directors are ousted and stripped of their management powers.[91] In the director's place, the trustee assumes control of the debtor's business.[92]

A trustee acting on behalf of a bankruptcy estate is conceptually analogous to the FDIC acting as a bank receiver for purposes of the "insured vs. insured" exclusion.[93] "[T]he FDIC represents the interests of the creditors and depositors of a failed bank," while a bankruptcy trustee acts on behalf of the bankruptcy estate and brings claims for the ultimate benefit of the bankrupt company's creditors.[94] The FDIC and the bankruptcy trustee are both creatures of statute[95] and are both obligated to recover funds on behalf of the failed institution they represent, as well as on behalf of the institution's creditors.[96]

Most courts that considered this issue found that an action brought by a bankruptcy trustee on behalf of a bankruptcy estate is not brought "by" or "on behalf of" the company for the purposes of the "insured vs. insured" exclusion.[97] This is because "the bankruptcy trustee 'is a legal

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90. 11 U.S.C. § 1104(a)(1–2).

91. Hillis Motors, Inc. v. Haw. Auto. Dealers' Ass'n, 997 F.2d 581, 585 (9th Cir. 1993) (citing 11 U.S.C. § 1108).

92. La. World Exposition v. Fed. Ins., 858 F.2d 233, 245 (5th Cir. 1988) ("Until a corporation which is in Chapter 11 can be reorganized or liquidated pursuant to a plan under 11 U.S.C. §§ 1121–29, a trustee or the debtor-in-possession is authorized to manage the property of the estate." (citing 11 U.S.C. § 1108)).

93. Cohen v. Nat'l Union Fire Ins. of Pittsburgh, Pa. (*In re* Cnty. Seat Stores, Inc.), 280 B.R. 319, 325–26 (Bankr. S.D.N.Y. 2002) (finding that "a bankruptcy trustee is a statutory creature whose role is analogous to that of the FDIC"); Rieser v. Baudendistel (*In re* Buckeye Countrymark, Inc.), 251 B.R. 835, 840–41 (Bankr. S.D. Ohio 2000) (analogizing Chapter 7 trustee to FDIC for purposes of "insured vs. insured" exclusion).

94. *Cohen*, 280 B.R. at 325–26; *Rieser*, 251 B.R. at 841 ("[T]he Trustee does not represent the Debtor nor is the Trustee acting on the Debtor's behalf in this litigation. Instead, the Trustee brings his claims as a separate legal entity acting on behalf of the bankruptcy estate and the estate's creditors.").

95. *Cohen*, 280 B.R. at 325–26.

96. *Id.*; *see* 11 U.S.C. § 323(a) (providing that "[t]he trustee in a case under this title is the representative of the estate"); *see also id.* § 1104(d) (providing that the trustee must be a disinterested person).

97. *See Rieser*, 251 B.R. at 841 (noting that "[i]n summary, the Trustee does not represent the Debtor nor is the Trustee acting on the Debtor's behalf in this litigation. Instead, the Trustee brings his claims as a separate legal entity acting on behalf of the

California Western Law Review, Vol. 58, Iss. 2 [], Art. 2

entity separate and distinct from the debtor' and upon appointment must act in the best interests of the general creditors in collecting and preserving the bankruptcy estate."[98] Just as a bank receiver's action is not brought "by" or "on behalf of" the failed bank and is not barred from coverage by the "insured vs. insured" exclusion, a bankruptcy trustee's action brought on behalf of the bankruptcy estate is not brought "by" or

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bankruptcy estate and the estate's creditors. Mindful of the rule of construction requiring the court to construe ambiguous language in an exclusionary provision liberally in favor of coverage, the court concludes that the insurance contract provision excluding coverage for claims brought "by" or "on the behalf of" the Debtor does not apply to exclude coverage for claims brought by the Chapter 7 Trustee"); *Cohen*, 280 B.R. at 328–29 (finding Chapter 11 trustee "is an entity separate and distinct from the pre-petition corporation and the Debtor []" and, therefore, an action brought by the trustee unambiguously does not trigger the exclusion); Grafenauer v. Mukamal (*In re* Laminate Kingdom, LLC d/b/a Floors Today), Nos. 07-10279-BKC-AJC, 07-01792-AJC, 2008 WL 704396, at *6 (Bankr. S.D. Fla. Mar. 13, 2008) (concluding that the "insured vs. insured" exclusion did not bar Chapter 7 Trustee's claim for coverage under the D&O policy); Willson v. Vanderlick (*In re* Cent. La. Grain Co-op.), 467 B.R. 390, 398 (Bankr. W.D. La. 2012) (finding that if the insurance company had intended to include "bankruptcy trustees in the exclusion, it could have included language clearly expressing its intent[]" and therefore denying the insurance company's motion for summary judgment requesting a ruling that the "insured vs. insured" exclusion barred coverage for claims brought by a Chapter 7 Trustee); Sousa, *supra* note 2, at 401 (noting that "[t]he majority of cases confronting the issue of whether an 'insured vs. insured' exclusion in a directors and officers liability insurance policy applies to a chapter 11 bankruptcy trustee when the trustee is asserting claims against the directors and officers of the debtor corporation have answered the inquiry in the negative").

98. Sousa, *supra* note 2, at 401; *see Cohen*, 280 B.R. at 325–26 (finding that "a bankruptcy trustee charged with a statutory duty and endowed with special statutory powers, is an independent and disinterested entity, separate and distinct from the debtor, as well as the pre-petition company, and as such does not strictly 'stand in the shoes' of the debtor"); Gray v. Exec. Risk Indem., Inc. (*In re* Molten Metal Tech., Inc.), 271 B.R. 711, 729–30 (Bankr. D. Mass. 2002) (finding that the Trustee is not the legal equivalent of the Debtor because (1) both entities co-exist "side-by-side, having different powers and rights;" (2) the duty of the Trustee is to the estate, whereas the duty of the Debtor is to the company's stockholders; (3) the Trustee is not governed by the pre-petition company's officers and directors; and (4) the claims brought by the Trustee belong to the bankruptcy estate which is separate from the Debtor); *Rieser*, 251 B.R. at 840 (finding a bankruptcy trustee is a separate legal entity from the debtor because it does not represent the Debtor nor owe it a fiduciary obligation).

Fruchter: Escaping the D&O Liability Insurance Policy "Insured vs. Insured"

"on behalf of" the bankrupt company and is not barred from coverage by the exclusion either.[99]

B. The Hard Case: The Debtor-in-Possession

Under the modern Bankruptcy Code, the debtor and its estate are separate and distinct legal entities.[100] For this reason, courts usually find that a bankruptcy trustee acting on behalf of the bankruptcy estate is not acting "by" or "on behalf of" the bankrupt company for the purposes of the "insured vs. insured" exclusion. A more complicated question, however, is how to characterize a debtor-in-possession that is acting on behalf of the bankruptcy estate.

A debtor-in-possession has most of the powers of a Chapter 11 trustee to pursue claims on behalf of the estate[101] and is "authorized to manage the property of the estate" until the debtor is reorganized or liquidated under a Chapter 11 plan.[102] However, the debtor "operates in a dual universe," since it acts as a fiduciary for the bankruptcy estate but is also controlled by the prepetition management of the company.[103] This dual identity "as debtor—qua—debtor" and "as debtor—qua—trustee" renders the question of whether the debtor-in-possession should be considered "the company" for the purposes of the "insured vs. insured" exclusion a difficult one.[104]

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99. Sousa, *supra* note 2, at 401 ("[W]hile the bankruptcy trustee is asserting claims that originally belonged to the prepetition debtor prior to the bankruptcy filing, the trustee does not merely 'stand in the shoes' of the debtor and has not 'somehow assumed the identity of the debtor.'").

100. United States v. Annamalai, 939 F.3d 1216, 1231 (11th Cir. 2019) ("A Chapter 11 estate, which is created by the filing of a bankruptcy petition, is separate and distinct from the corporate debtor, which 'continues to exist as a legal entity after the filing of [the] petition, whether under [C]hapter 7 or 11.'" (quoting 5 COLLIER ON BANKRUPTCY ¶ 541.02 (16th ed. 2018))).

101. 11 U.S.C. § 1107(a); *see id.* § 1107; *Chapter 11 - Bankruptcy Basics*, U.S. CTS., https://www.uscourts.gov/services-forms/bankruptcy/bankruptcy-basics/chapter-11-bankruptcy-basics (last visited Feb. 27, 2022) ("Section 1107 of the Bankruptcy Code places the debtor-in-possession in the position of a fiduciary, with the rights and powers of a chapter 11 trustee, and it requires the debtor to perform all but the investigative functions and duties of a trustee.").

102. La. World Exposition v. Fed. Ins., 858 F.2d 233, 245 (5th Cir. 1988).

103. Sousa, *supra* note 2, at 416–17.

104. *Id.*

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California Western Law Review, Vol. 58, Iss. 2 [], Art. 2

In *NLRB v. Bildisco & Bildisco*, the U.S. Supreme Court stated that for purposes of the case before the Court, it was "sensible to view the debtor-in-possession as the same 'entity' which existed before the filing of the bankruptcy petition . . . ."[105] There is a split in authority with respect to how broadly *Bildisco's* "same entity" holding should be applied. Some courts have interpreted the *Bildisco* "same entity" holding as "expressly limited to the facts of that case."[106] Other courts have interpreted *Bildisco* as conclusively establishing that a debtor-in-possession is the same entity as the prepetition debtor in all circumstances, including for the purposes of the "insured vs. insured" exclusion.[107]
The cases that found *Bildisco's* "same entity" holding applies in all circumstances, including for the purposes of the "insured vs. insured" exclusion, were wrongly decided for at least three reasons. First, it is apparent from a close reading of the disputed issues in *Bildisco* and from the context in which the U.S. Supreme Court made its "same entity" statement, that the Court meant to limit its holding to the legal dispute before it. Second, under Bankruptcy Act precedent, the debtor and debtor-in-possession are considered separate legal entities. Interpreting

105. NLRB v. Bildisco & Bildisco, 465 U.S. 513, 528 (1984).

106. CIGNA Ins. v. Gulf USA Corp., No. CV-97-250-N-EJL, 1997 WL 1878757, at *4 (D. Idaho Sept. 11, 1997), *overruled by* Biltmore Assocs., LLC v. Twin City Fire Ins., 572 F.3d 663 (9th Cir. 2009); Fed. Ins. v. Cont'l Cas. Co., No. 2:05-CV-305, 2006 WL 3386625, at *11 (W.D. Pa. Nov. 22, 2006) (finding that there was "no need to make a clear distinction between the prebankruptcy debtor and the debtor-in-possession for the purpose of the precise question presented for resolution in *Bildisco*. The principle that the Supreme Court's language in *Bildisco* is limited to the facts of that case has been recognized in subsequent decisions issued by federal courts."); *In re* Durrett, 187 B.R. 413, 418 (Bankr. D.N.H. 1995) (finding "the language of *Bildisco* does not mandate a definitive determination that there is no distinction between the debtor and debtor in possession in all situations in all chapter 11 cases"); *In re* Winom Tool & Die, Inc., 173 B.R. 613, 622 (Bankr. E.D. Mich. 1994) (finding that *Bildisco* "does imply that the debtor and debtor in possession are one and the same," and, instead, *Bildisco*'s holding was limited "to the facts before it" and left "open the possibility that distinctions between the debtor and the debtor in possession may be appropriate in other contexts").

107. Indian Harbor Ins. v. Zucker, 860 F.3d 373, 377 (6th Cir. 2017) (finding that "features of Chapter 11 confirm that we should treat the debtor-in-possession as the pre-bankruptcy company in the context of a contract that straddles the before and after of a bankruptcy filing") (citing *Bildisco*, 465 U.S. at 528); *Biltmore*, 572 F.3d at 673 (finding substantially same that the debtor-in-possession should be treated as the pre-bankruptcy company when a contract that comes before or after a bankruptcy filing).

Bildisco as overturning that Bankruptcy Act precedent would require a court to ignore the legislative history surrounding the Bankruptcy Code's enactment, which indicates that Congress sought to maintain the legal distinction between a debtor-in-possession and a debtor by having the debtor-in-possession "step in the shoes of a trustee in every way."[108] Third, if for purposes of the exclusion, a Chapter 11 trustee's causes of action were treated differently than a debtors-in-possession's causes of action, then Congress's intent for those two entities to be functional equivalents would be thwarted.

1. The Bildisco "Single Entity" Holding is Limited to the Facts of that Case

In *Bildisco*, a debtor-in-possession unilaterally rejected a collective-bargaining agreement ("CBA").[109] In response, the National Labor Relations Board ("NLRB") issued an order finding that in rejecting the CBA, the debtor-in-possession, as the alter-ego of the prepetition company, was guilty of an unfair labor practice.[110] The Third Circuit refused to enforce the NLRB's order for two reasons. First, it found that under the Bankruptcy Code, a debtor-in-possession is "a 'new entity' not bound by the debtor's prior collective-bargaining agreement."[111] Second, it noted that the Bankruptcy Code allows debtors to reject contracts (including CBAs) with bankruptcy court approval and therefore, found that the NLRB was "precluded from premising an unfair labor practice" on the "rejection of the labor contract," if the rejection was ultimately approved by the bankruptcy court.[112]

On appeal, the U.S. Supreme Court agreed with the Third Circuit on the merits. The Court found that the NLRB could not find a debtor-in-possession guilty of an unfair labor practice for unilaterally rejecting a CBA if the decision to reject the contract was ultimately approved by the bankruptcy court.[113] However, in rendering its opinion, the U.S.

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108. S. REP. NO. 95-989, at 116 (1978), *as reprinted in* 1978 U.S.C.C.A.N. 5787, 5902.

109. *Bildisco*, 465 U.S. at 518–19.

110. *Id.* at 521.

111. *Id.*

112. *Id.*

113. *Id.* at 534.

California Western Law Review, Vol. 58, Iss. 2 [], Art. 2

Supreme Court disagreed with the "new entity" rationale of the Third Circuit, finding the following:

> Much effort has been expended by the parties on the question of whether the debtor is more properly characterized as an "alter ego" or a "successor employer" of the pre-bankruptcy debtor, as those terms have been used in our labor decisions . . . . We see no profit in an exhaustive effort to identify which, if either, of these terms represents the closest analogy to the debtor-in-possession.
>
> Obviously if the [debtor-in-possession] were a wholly "new entity," it would be unnecessary for the Bankruptcy Code to allow it to reject executory contracts, since it would not be bound by such contracts in the first place. For our purposes, it is sensible to view the debtor-in-possession as the same "entity" which existed before the filing of the bankruptcy petition, but empowered by virtue of the Bankruptcy Code to deal with its contracts and property in a manner it could not have done absent the bankruptcy filing.[114]

A noteworthy fact about the *Bildisco* holding is that the issue of whether a debtor and debtor-in-possession are legally distinct entities was irrelevant to the outcome of the case.[115] The U.S. Supreme Court found that even if they are the same entity, a debtor-in-possession is still not guilty of an unfair labor practice, if its rejection of a CBA is approved by the bankruptcy court.[116] The Court also found that a Chapter 11 trustee, acting on behalf of the estate, could be guilty of an unfair labor practice if it were to reject the prepetition debtor's CBA without obtaining bankruptcy court approval.[117] This is not because a Chapter 11 trustee is the same legal entity as the debtor (it is not), but because the identity of the party doing the rejecting on behalf of the debtor is irrelevant to the question of whether the unilateral rejection of a prepetition debtor's CBA is an unfair labor practice.[118] For this reason, the

114. *Id.* at 527–28.
115. *Bildisco*, 465 U.S. at 528.
116. *Id.* at 516–17.
117. *Id.* at 528.
118. *Id.*

Bildisco Court noted that "[a]lthough the term debtor-in-possession is not fully interchangeable with the term trustee . . . with respect to the issues before us the analysis is the same whether it is the debtor-in-possession or trustee in bankruptcy who is attempting to reject a collective-bargaining agreement."[119]

For the purposes of determining the issue before the U.S. Supreme Court in *Bildisco*—whether the unilateral rejection of a prepetition debtor's CBA constitutes an unfair labor practice—the rejector's identity was irrelevant. Therefore, for the Court's purposes in deciding *Bildisco*, it made sense to simply view the prepetition debtor and the debtor-in-possession as the same entity.

2. The Debtor-in-Possession is a Legally Distinct Entity from the Debtor

In a Chapter X case brought under the now-repealed Bankruptcy Act,[120] the U.S. Supreme Court explained that:

> The concept of leaving the Debtor in possession, as a "receivership without a receiver," was designed to obviate the need to appoint a trustee for the supervision of every small corporation undergoing reorganization . . . so long as the Debtor remains in possession, it is clear that the corporation bears essentially the same fiduciary obligation to the creditors as does the trustee for the Debtor out of possession.[121]

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119. *Id.* at 528 n.2.

120. Under Chapter X of the former Bankruptcy Act of 1898, "in any case where the debtor's liabilities exceeded $250,000 . . ." the appointment of a disinterested trustee was required; in smaller cases brought under Chapter X, a debtor was allowed to remain in possession. *In re* GHR Cos., 43 B.R. 165, 171 (Bankr. D. Mass. 1984) (citing Bankruptcy Act, Chapter X, § 156); *In re* Premier Intern. Holdings, Inc., 423 B.R. 58, 68 (Bankr. D. Del. 2010) (finding that "[t]he defining element of Chapter X was the mandatory appointment of a trustee in any case where the liabilities exceeded $250,000"); Jerome N. Frank, SEC Comm'r, Address at the American Bar Association Sixty-First Annual Meeting 2 (July 25, 1938) (explaining that Chapter X of the Chandler Act requires "the designation of independent, disinterested trustees in all cases of substantial size . . . .").

121. Wolf v. Weinstein, 372 U.S. 633, 649 (1963).

California Western Law Review, Vol. 58, Iss. 2 [], Art. 2

The Court further noted that "in practice these fiduciary responsibilities fall not upon the inanimate corporation, but upon the officers and managing employees who must conduct the Debtor's affairs under the surveillance of the court."[122]

Not only was a bankruptcy trustee a fiduciary of the bankrupt company under the court's supervision, but "those who perform[ed] similar tasks and incur[ed] like obligations to the creditors and shareholders," i.e., the managers of a debtor that remained in possession, were also fiduciaries of the estate and under the court's supervision under the Bankruptcy Act.[123] For this reason, "a debtor in possession was not considered the same entity as the pre-bankruptcy company, but a new entity created with its own rights and duties, subject to judicial supervision,"[124] and obligated to act on behalf of the estate.[125]

In 1978, Congress enacted the modern Bankruptcy Code, which included a new reorganization chapter (Chapter 11) that replaced Chapter X.[126] In enacting section 1107, which sets forth the "[r]ights, powers, and duties of [the] debtor in possession,"[127] the Senate Judiciary Committee stated that it:

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122. *Id.* at 649–50.

123. *Id.* at 650.

124. Matter of Searles Castle Enters., Inc., 12 B.R. 127, 128 (Bankr. D. Mass. 1981), *aff'd sub nom. In re* Searles Castle Enters., Inc., 17 B.R. 440 (B.A.P. 1st Cir. 1982).

125. In other words, under the Bankruptcy Act, the fiduciary obligations of a debtor-in-possession were the same as those of a bankruptcy trustee: both were fiduciaries acting on behalf of the bankruptcy estate for the benefit of creditors. The debtor-in-possession, therefore, succeeded to any right of action that the debtor corporation had to recover damages for the violation of fiduciary duty by officers or directors in the exact same manner that a trustee would. Mitchell Excavators, Inc. v. Mitchell, 734 F.2d 129, 131 (2d Cir. 1984) ("The Bankruptcy Reform Act of 1978 did not change this structure in significant ways. Under 11 U.S.C. § 541, the rights of action of the debtor pass to the estate created by the commencement of the bankruptcy proceeding, not directly to the trustee.").

126. Bankruptcy Reform Act of 1978, Pub. L. No. 95-598, 92 Stat. 2549; *see* Maharaj v. Stubbs & Perdue, P.A. (*In re* Maharaj), 681 F.3d 558, 561 (4th Cir. 2012) ("In 1978, Congress passed the Bankruptcy Reform Act of 1978, replacing the Act with the Code and creating the structure of modern bankruptcy practice. In enacting the Code, Congress merged many aspects of Chapters X and XI (as well as the infrequently-used Chapter XII) of the Act into the newly created Chapter 11.").

127. 11 U.S.C. § 1107. Unlike under Chapter X, the managers of a large company that have filed for bankruptcy protection under Chapter 11 are not automatically

> Places a debtor in possession in the shoes of a trustee in every way. The debtor is given the rights and powers of a Chapter 11 trustee. He is required to perform the functions and duties of a Chapter 11 trustee (except the investigative duties).[128]

Accordingly, under the Bankruptcy Code, as was the case under the Bankruptcy Act, "if a debtor remains in possession—that is, if a trustee is not appointed—the debtor's directors bear essentially the same fiduciary obligation to creditors and shareholders as would the trustee for a debtor out of possession."[129]

The U.S. Supreme Court has noted that "the willingness of courts to leave debtors in possession 'is premised upon an assurance that the officers and managing employees can be depended upon to carry out

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replaced with a court appointed trustee. Instead, they are generally allowed to continue running the company during the pendency of the Chapter 11 bankruptcy proceedings as debtors-in-possession. *See* Adams v. Marwil (*In re* Bayou Grp., LLC), 564 F.3d 541, 546 (2d Cir. 2009) (noting that the standard for the appointment of a Chapter 11 trustee "is very high" and "appointment of a trustee in a Chapter 11 case is an extraordinary remedy" (internal quotes and citations omitted)).

128. S. REP. NO. 95-989, at 116 (1978), *as reprinted in* 1978 U.S.C.C.A.N. 5787, 5902.

129. Commodity Futures Trading Comm'n v. Weintraub, 471 U.S. 343, 355 (1985) (citing Wolf v. Weinstein, 372 U.S. 633, 649–52 (1963)); *see* Advanced Contracting Sols., LLC v. Metallic Lathers & Reinforcing Ironworkers Local 46 (*In re* Advanced Contracting Sols., LLC), 582 B.R. 285, 304 (Bankr. S.D.N.Y. 2018) (finding that a debtor remaining in possession owes the same fiduciary obligation to creditors and shareholders as the trustee to the debtor's directors); Fulton State Bank v. Schipper (*In re* Schipper), 109 B.R. 832, 835 (Bankr. N.D. Ill. 1989) (finding that "[a] debtor-in-possession holds its powers in trust for the benefit of the creditors and has the duty to protect and conserve property in his possession for their benefit"), *aff'd*, 933 F.2d 513 (7th Cir. 1991); Anand v. China Int'l Trust & Inv. Corp. (*In re* Intermagnetics Am., Inc.), 926 F.2d 912, 917 (9th Cir. 1991) (finding that "[o]fficers of a debtor-in-possession are officers of the court because of their responsibility to act in the best interests of the estate as a whole and the accompanying fiduciary duties"); Ramette v. Bame (*In re* Bame), 251 B.R. 367, 373 (Bankr. D. Minn. 2000) (finding that "it is clear that a DIP has a duty to creditors of the estate not to waste the estate's assets"); *In re* China Fishery Grp. Ltd. (Cayman), No. 16-11895 (JLG), 2016 WL 6875903, at *14 (Bankr. S.D.N.Y. Oct. 28, 2016) (finding that "[i]t is fundamental that a debtor in possession owes the same fiduciary duties to creditors and the estate as a trustee"); Nilhan Devs., LLC v. Ronald Glass (*In re* Nilhan Devs., LLC), 631 B.R. 507, 535 (Bankr. N.D. Ga. 2021) (finding that "[a]s debtor in possession and *de jure* trustee, the debtor holds its powers in trust for the benefit of creditors" (citations omitted)).

the fiduciary responsibilities of a trustee.'"[130] For this reason, when a debtor files a Chapter 11 petition, the debtor becomes both functionally and "legally different from what it was the moment before filing, as it now assumes the mantle of a new juridical entity, a debtor-in-possession . . . an officer of the court subject to the supervision and control of the Bankruptcy Court and the provisions of the Bankruptcy Code."[131]

To read *Bildisco* as holding that a debtor and debtor-in-possession are the same legal entity in all cases is to interpret the *Bildisco* case as subtly overturning sound Bankruptcy Act precedent without expressly stating so.[132] The far more parsimonious interpretation of *Bildisco* is that the U.S. Supreme Court's "same entity" holding was simply limited to the facts of that case. Indeed, even after *Bildisco*, some courts have

130. *Commodity Futures Trading Comm'n*, 471 U.S. at 355 (citing *Wolf*, 372 U.S. at 651); *Advanced Contracting Sols.*, 582 B.R. at 304; *In re* V. Savino Oil & Heating Co., 99 B.R. 518, 524 (Bankr. E.D.N.Y. 1989) (explaining that the default Chapter 11 rule that a debtor will remain in possession "arises from a belief that current management is generally best suited to orchestrate the process of rehabilitation for the benefit of creditors and other interests of the estate").

131. *In re V. Savino Oil & Heating Co.*, 99 B.R. at 524 (finding that a "debtor-in-possession in a Chapter 11 case has the same fiduciary duties as a trustee appointed by a court . . . [and] occupies the shoes of a trustee in every major way" (citations omitted)); *see Nilhan Devs., LLC*, 631 B.R. at 536 ("The debtor, acting in the capacity of a debtor in possession, is the representative of the estate through which the estate acts, has substantially all of the rights and powers of a trustee, is required to perform many of the functions and duties of a trustee, and has a fiduciary duty to creditors and the estate. By contrast, the debtor when not acting in its capacity as debtor in possession, is not the representative of the estate, does not have any of the rights, powers or duties of a trustee, and does not have the same fiduciary duties of a debtor in possession. Thus, a debtor can exist in separate capacities in much the same way that an individual serving as trustee does not lose his or her separate identity but has rights, powers, duties and obligations as trustee that are separate from those in his or her personal capacity." (citing 7 COLLIER ON BANKRUPTCY ¶ 1101.01 (16th ed. 2021))).

132. Interpreting *Bildisco* in this manner would also require a court to ignore the clear intention of Congress in enacting the Bankruptcy Code which was for the debtor-in-possession to stand in the shoes of the trustee. Just as *O'Melveny's* holding that the FDIC "stands in the shoes" of a failed bank does not constitute a conclusive determination that the FDIC is an "insured" for purposes of the exclusion, the *Bildsco* holding, likewise, does not constitute a conclusive determination that a debtor-in-possession is an "insured" for purposes of the exclusion. Instead, this question must be answered by turning to state contract law and the language of the policy at issue.

found that the debtor-in-possession "is an entity distinct from the Debtor and is a fiduciary of the estate."[133]

3. Public Policy, Bildisco, and Ambiguity in Insurance Contracts

When Congress enacted Chapter 11, it stated that the "rigid and formalized procedures . . . under which management [was] always ousted and replaced by an independent trustee" led to a needlessly "time-consuming and inherently uncertain process."[134] Congress feared that if the management of a debtor would not be allowed "to remain in control" during Chapter 11 bankruptcy proceedings, management would simply avoid filing a case "until it would be too late" for the debtor to effectively reorganize.[135] Therefore, Congress allowed the management of the debtor to remain in control in most cases and placed the "debtor in possession in the shoes of a trustee in every way."[136]

Courts should not treat actions brought by debtors-in-possession as brought "by" or "on behalf of" the debtor for the purposes of the "insured vs. insured" exclusion and therefore barred from coverage. Instead, courts should treat Chapter 11 trustees' actions as brought by a separate and distinct legal entity and therefore as not barred from coverage. In enacting Chapter 11, Congress expressed its intention for debtors-in-possession and Chapter 11 trustees to be treated as functional equivalents in almost all circumstances.[137] This was done to avoid a scenario in which the management of a company would delay filing for bankruptcy protection to avoid being ousted and losing control over the company.[138] If actions brought by a debtor-in-possession will be barred from coverage by the exclusion, but actions brought by Chapter 11 trustees will not be barred, then in cases where there are valuable D&O breach of fiduciary duty claims that the estate can bring, creditors

133. *Ramette*, 251 B.R. at 375; *see* Gordon Sel-Way, Inc. v. United States (*In re* Gordon Sel-Way, Inc.), 270 F.3d 280, 290 (6th Cir. 2001) ("In Chapter 11 bankruptcy, the debtor files a petition for bankruptcy, becomes a debtor in possession, and thus succeeds to a set of statutorily defined powers and duties. The debtor in possession is considered to be a separate legal entity from the debtor himself.").

134. H.R. REP. NO. 95-595, at 6181 (1977).

135. *Id.* at 6191.

136. *Id.* at 6360.

137. *Id.*

138. *Id.* at 6180.

will seek to have the debtor-in-possession ousted and replaced by a Chapter 11 trustee.[139]

In *Pepper v. Litton*, Justice Douglas explained that in the event of bankruptcy, a corporation's breach of fiduciary duty claims are enforceable "for the protection of the entire community of interests in the corporation—creditors as well as stockholders."[140] Whether those claims are brought on behalf of the estate by a debtor-in-possession or on behalf of the estate by a Chapter 11 trustee should be of no moment to the question of whether such claims are being brought "by" or "on behalf

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139. Alternatively, the creditors may seek to defeat a debtor-in-possession's Chapter 11 plan in order to propose a plan of their own, which would call for the appointment of an independent estate representative to pursue the D&O claims. This outcome would be costly in terms of professional fee expenditures and judicial resources. Either outcome would be inequitable because it would mean that creditors would achieve a lesser recovery in a Chapter 11 case if the debtor were to remain in possession. This is in direct contravention of the intent of Congress in allowing the debtor to remain in possession in most cases.

140. Pepper v. Litton, 308 U.S. 295, 307 (1939); Koch Ref. v. Farmers Union Cent. Exch., Inc., 831 F.2d 1339, 1343 (7th Cir. 1987) (finding that during a bankruptcy a corporation's breach of fiduciary claims are enforceable to protect its creditors and stockholders); Torch Liquidating Tr. *ex rel.* Bridge Assocs. LLC v. Stockstill, 561 F.3d 377, 386 n.9 (5th Cir. 2009) (finding that "[a]fter the commencement of a chapter 11 case and before the confirmation of a chapter 11 plan, it is clear beyond peradventure that a debtor in possession or trustee 'has the authority to bring an action for damages on behalf of a debtor corporation against corporate principals for . . . breach of fiduciary duty where such an action could have been asserted by the debtor corporation, or by its stockholders in a derivative action, prior to bankruptcy'" (quoting La. World Exposition v. Fed. Ins., 858 F.2d 233, 246 (5th Cir. 1988))); Seinfeld v. Allen, 169 F. App'x 49 (2d Cir. 2006) (finding that "the trustee's authority over the bankruptcy estate is applicable in the instant case because the debtor in possession is authorized to exercise the same powers as the trustee" (citing 11 U.S.C. § 1107(a))); Mixon v. Anderson (*In re* Ozark Rest. Equip. Co.), 816 F.2d 1222, 1225 (8th Cir. 1987) (finding that "causes of action belonging to the debtor at the commencement of the case are included within the definition of property of the estate." This includes actions "for damages on behalf of a debtor corporation against corporate principals for alleged misconduct, mismanagement, or breach of fiduciary duty, because these claims could have been asserted by the debtor corporation, or by its stockholders in a derivative action."); Regan v. Vinick & Young (*In re* Rare Coin Galleries of Am., Inc.), 862 F.2d 896, 901 (1st Cir. 1988) (finding that "[t]he trustee steps into the shoes of the debtor for the purposes of asserting or maintaining the debtor's causes of action, which become property of the estate"); N. Am. Cath. Educ. Programming Found., Inc. v. Gheewalla, 930 A.2d 92, 101 (Del. 2007) (finding that "the creditors of an insolvent corporation have standing to maintain derivative claims against directors on behalf of the corporation for breaches of fiduciary duties").

of" the bankrupt company for the purposes of the "insured vs. insured" exclusion. In either case, such claims should be deemed as having been brought on behalf of the bankruptcy estate by a fiduciary acting on its behalf and not by or on behalf of the debtor.

C. Conclusion: Actions Brought by a Debtor-in-Possession Should Not be Barred from Coverage Unless the Exclusion is Unambiguous

The U.S. Supreme Court's *Bildisco* holding did not address Bankruptcy Act precedent or the legislative history of Chapter 11—both of which establish that the debtor and debtor-in-possession are separate and distinct legal entities in most circumstances. Had the U.S. Supreme Court intended to overrule prior precedent and Congressional intent in enacting Chapter 11, by creating a rule that a debtor and debtor-in-possession are to be treated as the same legal entity in all circumstances, the Court would have done so explicitly.

As is the case with respect to bank receivers, D&O insurance providers are well aware that courts disagree about whether a debtor-in-possession is the same entity as the debtor for the purposes of the exclusion. If courts were to consistently rule against the insurance companies and in favor of the insured in cases where a policy fails to expressly state whether a debtor-in-possession falls under the "insured vs. insured" exclusion, then insurance companies seeking to avoid having to provide coverage for actions brought by debtors-in-possession would be encouraged to fix the ambiguity of the exclusion language.[141]

IV. THE MEDIUM-DIFFICULTY CASE: THE ESTATE REPRESENTATIVE

Upon confirmation of a Chapter 11 plan, all property of the estate vests in the reorganized debtor, unless the plan provides otherwise.[142]

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141. Insurance carriers could clearly and unambiguously state in their D&O insurance contracts that debtors-in-possession are "insured" parties for purposes of the exclusion, thereby putting an end to the repeat litigation that has occurred on this issue.

142. 11 U.S.C. § 1141(b); *see* Segner v. Admiral Ins. (*In re* Palmaz Sci., Inc.), No. 16-50552-CAG, 2018 WL 3343597, at *6 (Bankr. W.D. Tex. June 4, 2018) ("It is not unreasonable to interpret the 'assignment' of the Litigation Trust Assets, not as a contractual assignment . . . but rather as a vesting of assets from one entity to another entity to otherwise accomplish the effect of § 1141(b), which automatically vests all

Bankruptcy Code section 1123 states that the plan can provide for certain claims or interests of the estate to not be vested in the reorganized debtor, but to instead be retained and enforced "by the debtor, by the trustee or by a *representative of the estate* appointed for such purpose . . . ."[143] Thus, the bankruptcy court may confirm a plan that provides for a "representative of the estate" to bring specifically enumerated causes of action, including actions for breach of fiduciary duty, on behalf of the estate.[144]

A representative of the estate that has been appointed pursuant to a plan can be called many names, including "trustee,"[145] "litigation trustee,"[146] and "liquidating trustee."[147] The term "trustee" in the bankruptcy context, therefore, does not always refer to a Chapter 7 trustee or a Chapter 11 trustee that has been directly appointed by a bankruptcy court.[148]

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property of the estate in the debtor unless the plan or order confirming the plan provides otherwise.").

143. 11 U.S.C. § 1123(b)(3)(B) (emphasis added).

144. Citicorp Acceptance Co. v. Robison (*In re Sweetwater*), 884 F.2d 1323, 1326 (10th Cir. 1989) (noting that "the appointment of a representative of the estate under § 1123(b)(3)(B) must be approved by the court and may not be accomplished by a unilateral declaration of the debtor in possession").

145. Biltmore Assocs., LLC v. Twin City Fire Ins., 572 F.3d 663, 675 (9th Cir. 2009) ("A bankruptcy proceeding may be crowded with trustees, perhaps the trustees under deeds of trust on real property seeking relief from the stay so that they can foreclose, trustees for minors and for inter vivos trusts trying to keep assets out of the bankruptcy estate, and trustees for decedents, but they are not all the same."); *see, e.g.*, Terry v. Fed. Ins. (*In re* R.J. Reynolds), 315 B.R. 674, 676 (Bankr. W.D. Va. 2003) ("The Plan provided for the creation a trust . . . . The Plan also provided that the Debtor would, on or before the effective date of the Plan, transfer to the Trust all claims against directors and officers.").

146. *See, e.g.*, *Biltmore*, 572 F.3d at 667 ("[The debtor in possession] filed a chapter 11 reorganization plan which assigned its claims against the directors and officers to a [creditor's] trust established for its creditors . . . ."); *Segner*, 2018 WL 3343597, at *9 ("[T]he issue before this Court is whether the Litigation Trustee is an Insured.").

147. *See, e.g.*, Indian Harbor Ins. v. Zucker, 860 F.3d 373, 374 (6th Cir. 2017) ("After negotiations between Capitol's officers and the company's creditors during the bankruptcy process, Capitol created a Liquidation Trust to pursue the estate's legal claims.").

148. The powers and obligations of plan created trustees are generally spelled out in the plan rather than in the Bankruptcy Code itself.

Some courts treat plan-created trustees as voluntary assignees of the plan proponent and, as a result, treat actions brought by such trustees as barred from coverage by the "insured vs. insured" exclusion if an action brought by the plan proponent would have been barred.[149] By way of example, if a debtor-in-possession files a plan that provides for the creation of a litigation trust, then any action brought by the litigation trustee against an "insured" would be barred from coverage for purposes of the "insured vs. insured" exclusion if an action brought by the debtor-in-possession would have been barred from coverage.[150]

At least one district court has found that plan-created trustees are not "mere assignees" but rather separate and distinct entities from the plan proponent.[151] The dissenting opinion in the Sixth Circuit's *Indian Harbor* decision, likewise, observed that many cases have "held that court-appointed [Chapter 7 and Chapter 11] trustees are exempt from the insured-versus-insured exclusion because there is no risk of collusion since a court-appointed trustee is a completely independent entity," and found there is no functional distinction between a section 1123 trustee, which a bankruptcy court must determine "is independent and does

149. *See Zucker*, 860 F.3d at 375 ("As a voluntary assignee, the Trust stands in Capitol's shoes and possesses the same rights subject to the same defenses."); *Terry*, 315 B.R. at 680 ("The Trustee in this case is a mere assignee. His rights arise by virtue of provisions in the plan, not directly by operation of statute.").

150. Conversely, if the plan is filed by a Chapter 11 trustee (rather than by the debtor-in-possession), then the litigation trustee, as a voluntary assignee under the plan, will be subject to the exclusion to the same extent that the Chapter 11 trustee would have been.

151. The district court found that:

> The Litigation Trust Agreement was drafted and executed in the context of a chapter 11 bankruptcy for purposes of confirming the Plan. It is not unreasonable to interpret the "assignment" of the Litigation Trust Assets, not as a contractual assignment . . . but rather as a vesting of assets from one entity to another entity to otherwise accomplish the effect of §1141(b)(6) which automatically vests all property of the estate in the debtor unless the plan or order confirming the plan provides otherwise. To hold that vesting of Litigation Trust Assets in the Litigation Trust was a contractual assignment . . . ignores the context in which the Litigation Trust was executed, the functioning of §1141(b), and the purpose of the Litigation Trust. As such, the Court does not agree that the assignment language contained in the Litigation Trust Agreement is sufficient for deeming this Litigation Trustee as an assignee for purposes of the Exclusion.

Segner, 2018 WL 3343597, at *6–7.

not pose a risk of collusion and one that is appointed by a bankruptcy court [e.g., a Chapter 7 or Chapter 11 trustee] and is by nature of that appointment independent."[152] Accordingly, the dissenting opinion argued that a litigating trustee, which had been assigned breach of fiduciary duty claims pursuant to a debtor-in-possession's Chapter 11 plan under Bankruptcy Code section 1123, should not be deemed an "insured" for purposes of the exclusion.[153]

In this Author's view, the approach suggested by the dissenting opinion in *Indian Harbor* is correct. An "insured vs. insured" exclusion that does not expressly state that plan-created estate representatives are "insured" for the purposes of the exclusion is ambiguous with respect to actions brought by such entities. This is because the collusion concerns that originally led to the creation of the exclusion are not present when a court approves the transfer of a bankrupt company's right to bring claims to a bankruptcy estate representative under the statutory provisions of the Bankruptcy Code and pursuant to the terms of a Chapter 11 plan that has been approved by a bankruptcy court. Using the interpretive framework advocated for in this Article, courts should find that the "insured vs. insured" exclusion does not bar coverage for actions brought by plan-created section 1123 estate representatives, unless the language of the insurance policy at issue clearly and expressly states otherwise.

A. Court of Appeals Decisions: Reliance,[154] Biltmore,[155] and Indian Harbor[156]

There are a number of Circuit Court of Appeals decisions that have held the "insured vs. insured" exclusion bars an estate representative's action from coverage. Under the framework advocated for in this Article, these cases were wrongly decided.

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152. *See Zucker*, 860 F.3d at 378–79 (Donald J., dissenting).

153. *Id.* at 380.

154. Reliance Ins. of Ill. v. Weis, 148 B.R. 575 (Bankr. E.D. Mo. 1992), *aff'd in part*, 5 F.3d 532 (8th Cir. 1993).

155. Biltmore Assocs., LLC v. Twin City Fire Ins., 572 F.3d 663, 673 (9th Cir. 2009).

156. *Zucker*, 860 F.3d at 377.

Fruchter: Escaping the D&O Liability Insurance Policy "Insured vs. Insured"

1. *Reliance Insurance of Illinois v. Weis*

In *Reliance*, a debtor-in-possession filed a Chapter 11 liquidating plan that transferred all of the estate's causes of action to an estate representative called the "plan committee."[157] The plan committee sued the company's former officers for breach of fiduciary duty and negligence.[158] The officers sought coverage under the company's D&O policy, but the insurance company denied coverage and argued that the committee's claims were made "on behalf of" the company and fell within the exclusion.[159] The district court agreed.[160] The Eighth Circuit affirmed the district court's holding without comment.[161] In its decision, the district court stated that:

> On one level, this is a case about interpreting a clause in an insurance contract; consequently state law will control . . . . Secondly, interpretation of the clause in question involves application of bankruptcy law since the insured has been liquidated under Chapter 11 . . . and its affairs are being managed under Chapter 7.[162]

The district court then explained that under Delaware law, which governed the contract, "[w]hen the language of an insurance policy is clear and unequivocal, the parties will be bound by its clear meaning."[163]

The court found that "[t]he phrase 'on behalf of the Company' takes on special meaning due to the bankruptcy" and "in order to assess

157. *Reliance*, 148 B.R. at 577–78.

158. *Id.* at 578.

159. *Id.*

160. *Id.* at 583 ("Any lawsuit brought on behalf of [the company] against its former officers falls within this exclusion clause.").

161. Reliance Ins. of Ill. v. Weis, 5 F.3d 532 (8th Cir. 1993).

162. *Reliance*, 148 B.R. at 578–79 (holding that Delaware law applied because the insurance policy stated that Delaware law controlled in cases regarding interpretation and application of the policy).

163. *Id.* at 579.

California Western Law Review, Vol. 58, Iss. 2 [], Art. 2

whether or not ambiguity exists . . . the phrase in question must be construed within the realm of bankruptcy law."[164] The district court then analyzed the nature of the bankruptcy estate under Bankruptcy Code section 541 and the obligations of the plan committee under the debtor's liquidating plan to bring actions on behalf of the estate.[165] The court concluded that:

> [W]hatever right of action [the company] had against its former officers for mismanagement and breach of fiduciary duty was transferred to the bankruptcy estate upon the filing of its bankruptcy petition. Once [the company] was liquidated . . . the Plan Committee w[as] obligated to pursue [the company's] right of action in order to recover assets for [its] estate . . . . It is clear that the pending [breach of fiduciary duty] action was filed on behalf of [the company] and its estate, although the benefits sought may eventually inure to the creditors. For purposes of this litigation, there is no significant legal distinction between [the company] and its bankruptcy estate.[166]

Based on this analysis, the district court found that the "insured vs. insured" exclusion barred from coverage the breach of fiduciary duty action brought by the plan committee on behalf of the bankruptcy estate.[167]

The district court's methodology for interpreting the insurance contract was simply incorrect.[168] The court was tasked with interpreting the

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164. *Id.* at 580. The Court noted that "[a]n ambiguity exists only when the contract language is subject to two or more reasonable interpretations." *Id.* at 579.

165. *Id.* at 581–82.

166. *Id.* at 583.

167. *Id.*

168. Other courts have similarly paid lip service to the idea that the contract must be interpreted under state law but then incorrectly decided the issue based on a technical analysis of the difference between a debtor and an estate representative under the Bankruptcy Code. *See, e.g.*, Nat'l Union Fire Ins. of Pittsburgh v. Olympia Holding Corp., No. 1:94-CV-2081, 1996 WL 33415761, at *7 (N.D. Ga. June 4, 1996) (The court found that a Chapter 7 trustee "acting solely in his capacity as Trustee in bankruptcy . . . can only assert claims against insureds that belong to [the bankrupt company]. Therefore, for purposes of this litigation, there is no legal distinction between [the company] and . . . [the] Trustee for the bankruptcy estate.").

exclusion in accordance with the exclusion's plain meaning, as was required by the state contract law governing the contract.[169] Instead of applying a "plain meaning" interpretation to the words used in the exclusion, the court commenced a complex and thorough analysis of bankruptcy law.[170] The reality is that most people reading the "insured vs. insured" exclusion at issue in *Reliance* would not have a technical understanding of bankruptcy law that would allow them to readily determine whether a bankruptcy estate representative suing to recover proceeds on behalf of a bankruptcy estate is suing "on behalf of" the insured company or "on behalf of" a legally distinct entity.

Moreover, even if a person did have the subject matter expertise required to develop an informed opinion on this issue, there have been numerous conflicting judicial answers to this question rendered in the twenty plus years since *Reliance* was decided. To this day, there is a split in authority as to whether an estate representative sues "on behalf of" the company, and, therefore, an action brought by such entity is barred from coverage for the purposes of the exclusion, or whether an estate representative sues "on behalf of" the legally separate and distinct bankruptcy estate, and, therefore, an action brought by such entity is not barred from coverage for the purposes of the exclusion.[171]

The answer to the technical question of whether an estate representative acts "on behalf of" a bankrupt company or only acts "on behalf of the estate" does not conclusively determine the coverage issue under a D&O insurance policy.[172] Instead, courts should decide this question under state contract law. In *Reliance*, the court should have

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169. *See id.* at 579.

170. *See id.*

171. The *Reliance* court heavily relied on the Delaware Supreme Court's *Hallowell v. State Farm* decision in discussing the rules of insurance contract interpretation under Delaware law. One statement from the *Hallowell* case that the *Reliance* decision did not quote is that a "policy will be read in accordance with the reasonable expectations of the insured 'so far as its language will permit.'" Hallowell v. State Farm Mut. Auto. Ins., 443 A.2d 925, 927 (Del. 1982) (quoting State Farm Mut. Auto. Ins. v. Johnson, 320 A.2d 345, 347 (Del. 1974)). Had the directors and officers read the policy before the company entered into the contract, they would have found it all but impossible to conclusively determine whether the exclusion would apply to actions brought by an estate representative on behalf of the estate based on the plain meaning of the language in the policy alone.

172. *Reliance*, 148 B.R. at 580 ("[T]he issue central to this case is what is meant, under bankruptcy law, by the phrase 'on behalf of the Company.'").

determined that under the principles of Delaware contract law interpretation, the exclusion was ambiguous as applied to estate representatives.[173]

2. Biltmore and Indian Harbor

In *Biltmore*, a debtor-in-possession brought breach of fiduciary duty claims against the bankrupt company's former directors and officers and then filed a Chapter 11 plan that assigned the bankruptcy estate's claims to a creditors' trust.[174] The trustee and the debtor's former directors and officers then agreed to settle the breach of fiduciary duty claims.[175] As part of the settlement, the directors and officers assigned their rights to recover against the company's insurance carriers to the creditors' trust.[176] The creditors' trustee then sued the insurance carriers to recover on the claims of the former directors and officers.[177] The district court dismissed the case based on a finding that the lawsuit fell under the "insured vs. insured" exclusion.[178] The Ninth Circuit affirmed the district court's decision, holding that "a post-bankruptcy debtor in possession acts in the same capacity as a pre-bankruptcy debtor for purposes of directors and officers liability insurance."[179]

In *Indian Harbor*, Capitol Bancorp ("Capitol") filed for Chapter 11 bankruptcy protection and remained a debtor-in-possession for the entirety of the case.[180] Pursuant to its liquidation plan, Capitol assigned its causes of action to a liquidating trust that would pursue claims on behalf of Capitol's creditors.[181] The D&O policy excluded coverage for claims made against insured persons "by, on behalf of, or in the name

173. The *Reliance* court should have found that an action brought by the estate representative was not barred from coverage even if as a technical matter of bankruptcy law, an estate representative acts "on behalf of" the bankrupt company when it brings a lawsuit on behalf of the estate since the technical legal conclusion the *Reliance* court ultimately reached did not render the insurance contract unambiguous.

174. Biltmore Assocs., LLC v. Twin City Fire Ins., 572 F.3d 663, 666–67 (9th Cir. 2009).

175. *Id.* at 667.

176. *Id.*

177. *Id.*

178. *Id.*

179. *Id.* at 668.

180. Indian Harbor Ins. v. Zucker, 860 F.3d 373, 374 (6th Cir. 2017).

181. *Id.* at 374–75.

or right of, the Company or any Insured Person . . . ."[182] The litigation trustee sued Capitol's officers for breach of fiduciary duty.[183] Indian Harbor sought a declaratory judgment that it had no obligation to cover any damages from the lawsuit, because the claims brought by the litigation trustee fell within the "insured vs. insured" exclusion.[184] The Sixth Circuit, citing *Biltmore* and *Bildisco*, found that a debtor and debtor-in-possession are the same entity for purposes of the exclusion.[185] Therefore, the Court of Appeals held that claims brought by the litigation trustee, as the assignee of the debtor-in-possession, were brought on behalf of Capitol (the insured Company) for purposes of the exclusion and were barred from coverage by the exclusion.[186]

Both *Biltmore* and *Indian Harbor* were decided based on a finding that a debtor-in-possession and a prepetition company are the same entity for purposes of the "insured vs. insured" exclusion.[187] The courts in both cases relied on *Bildisco* in making that finding. As previously set forth in this Article, those courts were wrong to rely on *Bildisco* for the following reasons: (1) *Bildisco's* "same entity" holding was limited to the facts of that case; (2) even if as a technical matter of bankruptcy law a debtor and debtor-in-possession are the same legal entity, that fact alone does not conclusively establish that under state contract law a debtor-in-possession is unambiguously suing "on behalf of" an insured company for purposes of the exclusion; and (3) even if the exclusion bars coverage for actions brought by debtors-in-possession, it is still

182. *Id.* at 375.

183. *Id.*

184. *Id.*

185. *Id.* at 376 ("'[T]he debtor in possession is the debtor, and the debtor is the person'—pre-bankruptcy Capitol—'that filed for bankruptcy . . . .' The Supreme Court rejected the argument that a debtor in possession is a 'wholly new entity' unbound by the pre-bankruptcy company's contracts.") (quoting NLRB v. Bildisco & Bildisco, 465 U.S. 513, 528, (1984)).

186. *Zucker*, 860 F.3d at 378.

187. *Id.* ("We hold only that a voluntary assignee like the Trust, which stands in Capitol's shoes, brings a breach-of-fiduciary-duty suit 'by, on behalf of, or in the name or right of' the debtor in possession."); Biltmore Assocs., LLC v. Twin City Fire Ins., 572 F.3d 663, 677 (9th Cir. 2009) (affirming "dismissal of the complaint because the insured versus insured exclusion bars coverage for claims brought as the assignee of the debtor in possession").

unclear if the exclusion should apply to plan-created estate representatives, who are granted by a bankruptcy court the authority to bring actions on behalf of the estate.[188]

It should be noted that, just as is the case in the bank receiver context, courts enforce clear and unambiguous exclusion language in the bankruptcy context. Most recently, a New York state court determined that an "insured vs. insured" exclusion that had an express carveout for claims asserted by a "bankruptcy trustee" or "comparable authority" did not bar coverage for claims brought by a creditor trustee established by a debtor's Chapter 11 plan, since the creditor trustee constituted a "comparable authority" under the policy.[189]

In summary, under the Bankruptcy Code, numerous entities can potentially bring claims on behalf of the estate, including Chapter 7 trustees, Chapter 11 trustees, estate representatives and debtors-in-possession. There is significant disagreement among the courts with respect to whether actions brought by these disparate entities are brought "by" or "on behalf of" the insured company for purposes of the exclusion. Much of this confusion is due to a misunderstanding of the U.S. Supreme Court's *NLRB v. Bildisco & Bildisco* decision. There, the Court held, in connection with the rejection of a CBA by a debtor-in-possession, that "it is sensible to view the debtor-in-possession as the same 'entity' which existed before the filing of the bankruptcy petition . . . ."[190] Just as courts have improperly interpreted *O'Melveny & Myers* as conclusively establishing that an action brought by a bank receiver was brought by the bank for purposes of the exclusion, courts have incorrectly interpreted *Bildisco* as conclusively establishing that an action brought by a debtor-in-possession was brought by or on behalf of the debtor (the insured company) for purposes of the exclusion.

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188. This Article argues that a debtor and debtor-in-possession are two legally distinct entities. A court need not need to agree with this conclusion to find that for the purposes of the exclusion, a debtor-in-possession is not barred from coverage. If (i) it is unclear whether the debtor-in-possession is a legally distinct entity from the prepetition, (ii) the answer to this question is subject to conflicting judicial determinations, or (iii) it is difficult to arrive at an answer to this question without a deep knowledge of bankruptcy law, then the status of a debtor-in-possession and applicability of the exclusion to the debtor-in-possession is ambiguous.

189. Westchester Fire Ins. v. Schorsch, 129 N.Y.S.3d 67, 70 (App. Div. 2020).

190. *Bildisco*, 465 U.S. at 528.

Fruchter: Escaping the D&O Liability Insurance Policy "Insured vs. Insured"

CONCLUSION

State law, policy language, and the clear intentions of the contracting parties govern insurance contract interpretation. If a reasonably educated person reading a D&O policy's "insured vs. insured" exclusion would have difficulty answering the question of whether a bank receiver, bankruptcy trustee, or debtor-in-possession is bringing an action on behalf of the insured company for purposes of the "insured vs. insured" exclusion, then the language of the exclusion is ambiguous.

Courts rendering decisions on the applicability of the exclusion often conduct extensive legal analysis to determine whether the entity bringing the claim that has stepped into the shoes of the company is a mere assignee of the company or is a statutory assignee with greater rights and a different legal status than the company. The fact that the outcome of this analysis is usually not straightforward or obvious, even to expert judges, suggests that the boilerplate "insured vs. insured" exclusion provisions currently used by insurance providers are ambiguous.

Under most states' rules of insurance contract interpretation, if the exclusion can be reasonably interpreted as either encompassing or not encompassing a particular type of claimant, then ambiguity exists with respect to that class of claimant. This is true regardless of what a court believes is the better answer to that question. Accordingly, without clear and unambiguous language indicating that a bank receiver, bankruptcy trustee, or debtor-in-possession should be treated in the same manner as the insured company for purposes of the "insured vs. insured" exclusion, courts should find that the exclusion does not apply to bar coverage for actions brought by such entities.

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