Benchnotes

By Aaron M. Kaufman, Paul R. Hage and Patrick A. Clisham

Coordinating Editor
Aaron M. Kaufman
Dykema Gossett PLLC
Dallas

Coordinating Editor
Paul R. Hage
Jaffe Raitt Heuer & Weiss, PC
Southfield, Mich.

Coordinating Editor
Patrick A. Clisham
Engelman Berger, PC
Phoenix

Aaron Kaufman is a member of Dykema Gossett PLLC in Dallas. Paul Hage is a partner with Jaffe Raitt Heuer & Weiss, PC in Southfield, Mich. Patrick Clisham is the managing shareholder of Engelman Berger, PC in Phoenix.

Contractual Exclusion in D&O Policy Barred Claims by Liquidating Trustee

All too often, chapter 11 cases result in some form of a plan that establishes a liquidating trust to pursue litigation for creditors. In many of these cases, the bankruptcy estate assigns to the liquidating trust certain causes of action, including chapter 5 avoidance actions and director and officer (D&O) claims.

The liquidating trust established in *Indian Harbor Insurance Co. v. Zucker*[1] followed this fact pattern. As is common, the liquidating trustee in *Indian Harbor* pursued certain reserved causes of action against the debtors' former management, seeking to collect from the debtor's D&O insurance carrier.

However, what makes *Indian Harbor* noteworthy is the "insured-versus-insured" exclusion, as explained by the court, from the debtor's D&O policy. The policy in question excluded from coverage any claims "by, on behalf of, or in the name or right of, the Company or any Insured Person" against an insured person. Citing this insured-versus-insured exclusion, the carrier commenced a declaratory judgment action, arguing that the liquidating trustee's claims were not covered under the policy.

The issue presented to the Sixth Circuit Court of Appeals was whether the exclusion applied to the liquidating trustee's claims against the D&Os of the debtor. In a split decision, the *Indian Harbor* court recognized that while there is a legal distinction between a prebankruptcy debtor and the post-petition debtor in possession (DIP), that distinction made no difference in the context of the insured-versus-insured exclusion in an insurance policy. "A lawsuit by Capitol as [the DIP] on behalf of the bankruptcy estate remains a lawsuit 'by' Capitol and thus would still fit within the insured-versus-insured exclusion." The split panel applied the same logic to the liquidating trustee, explaining that the trustee (like the DIP) was merely pursuing litigation "on behalf of" or "by" the debtor company.

The liquidating trustee argued that the exclusion's purpose was to prevent collusion, and that under the circumstances, the plan-confirmation process provided sufficient safeguards to protect against collusion such that the insured-versus-insured exclusion need not apply — but the split Sixth Circuit panel rejected this argument, stating:

> That a contractual term, like a statutory term, was designed to avoid certain problems [and] does not mean that a fact-intensive search for that problem — here for collusion — must occur each time someone invokes the provision. And it does not mean that collusion must be found before the provision applies. We ask only whether "the Company" includes Capitol as [the DIP]. The contract itself, together with core principles of bankruptcy law, confirms that it does.

The court affirmed judgment in favor of the insurance carrier and held that the trustee's claims were not covered under the policy.

Judicial Estoppel Applied to Unscheduled Claims that Became Public Post-Petition

The issue before the Second Circuit in *BPP III LLC v. Royal Bank of Scotland Group PLC*[2] was whether the plaintiff, BPP, could pursue London Interbank Offered Rate (LIBOR) manipulation claims against its former lender. Here, the LIBOR manipulation claims were unknown at the time of BPP's bankruptcy filing, but became public during the bankruptcy case and prior to the confirmation of BPP's chapter 11 plan.

The plaintiff/debtor was a group of hotel-related businesses and their owners and investors. Prior to BPP's bankruptcy case, it borrowed money from Royal Bank of Scotland (RBS) and other lenders under terms carrying interest at rates tied to LIBOR. BPP commenced its bankruptcy case in 2010 in the Eastern District of Texas. It did not list any potential claims against RBS in its initial bankruptcy schedules, because it was unaware of the existence of such claims. However, by May 2011, news had broken out about RBS's potential LIBOR manipulations, and by August 2011, other unrelated borrowers began to commence lawsuits against RBS for LIBOR manipulation. BPP was not among the early rounds of litigants.

Later that same year, after the news of RBS's actions became public, the debtor obtained confirmation on a reorganization plan in its Texas bankruptcy case. Like the debtor's schedules, the plan also failed to disclose or reserve any LIBOR manipulation claims against RBS. The bankruptcy case was closed in November 2012. Thereafter, in 2013, BPP commenced a lawsuit against RBS in the Southern District of New York for fraud and LIBOR manipulation. RBS moved to dismiss on the basis that BPP lacked standing and was judicially estopped from pursuing such claims due to the absence of reservations in BPP's plan. The district court granted RBS's motion to dismiss, and this appeal followed.

1 860 F.3d 373 (6th Cir. 2017).

2 859 F.3d 188 (2d Cir. 2017).

In affirming the dismissal of BPP's complaint, the Second Circuit relied on Fifth Circuit precedent for the proposition that "[w]hen a bankruptcy debtor 'omit[s] ... claims from its schedules and stipulation[s], [the debtor] represent[s] that none exist.'"[3] Where a plan is filed and confirmed, the court explained that it might "matter whether the debtor obtained sufficient notice of its cause of action before confirmation of the bankruptcy plan, or afterward." While BPP may not have known of the existence of the manipulation claims until *after* it filed its bankruptcy schedules, the circumstances demonstrated that BPP knew or should have known of the existence of such claims before its bankruptcy plan was confirmed. Since BPP's bankruptcy schedules and confirmed plan failed to list such "known" claims, the court concluded that the "inconsistency" and "adoption" elements of the judicial estoppel doctrine were present. Because it would be unfair to allow BPP to assert the claims following its representations through the bankruptcy process that no such claims existed, the court also concluded that the third and final element of estoppel (advantage) was present. Accordingly, the court applied judicial estoppel and affirmed judgment in favor of RBS.

Miscellaneous

• *Emerald Capital Advisors Corp. v. Bayerische Moteren Werke Aktiengellshaft (In re FAH Liquidating Corp.)*, 2017 WL 2559892 (Bankr. D. Del. June 13, 2017) (bankruptcy court held that § 548 of Bankruptcy Code applies to extraterritorial transactions such that payments to BMW for work performed in Germany and subject to German law could be avoided as constructive fraudulent transfers; although court dismissed majority of liquidating trustee's claims on limitations grounds, it permitted trustee to proceed with its unjust-enrichment claims notwithstanding existence of contractual relationship between parties);

• *Gupta v. Quincy Med. Ctr.*, 2017 WL 2389407 (1st Cir. June 2, 2017) (bankruptcy court entered post-confirmation judgment against purchaser of debtor's assets in lawsuit brought by debtor's former employees for severance that they were entitled to under § 363 sale order; on appeal, First Circuit held that state law breach-of-contract claims were not claims over which bankruptcy court could exercise subject-matter jurisdiction, nothwithstanding inclusion of retention-of-jurisdiction provisions in sale-approval order and plan-confirmation order; "Bankruptcy courts — like all federal courts — may retain jurisdiction to interpret and enforce their prior orders.... However a bankruptcy court may not 'retain' jurisdiction it never had");

• *In re Eustler*, 2017 WL 1157114 (Bankr. E.D. Wash. March 24, 2017) (co-shareholders of debtor filed motion for relief from automatic stay in order to exercise contractual right to buy debtor's shares upon filing of bankruptcy case by debtor; bankruptcy court held that co-shareholders' contractual right was unenforceable *ipso facto* clause); and

• *In re Fansteel Inc.*, 2017 WL 1929489 (Bankr. S.D. Iowa May 9, 2017) (bankruptcy court held that post-petition legal bill from counsel for oversecured creditor under § 506(b) was "staggering" and "unreasonable" and therefore cut firm's million-dollar fee request in half; "Based simply upon the number of attorneys and hours billed leads to the inherent conclusion that there was a distinct lack of billing judgment" by firm). abi

3 *Id.* (quoting *In re Coastal Plains Inc.*, 179 F.3d 197, 210 (5th Cir. 1999)).

Copyright 2017
American Bankruptcy Institute.
Please contact ABI at (703) 739-0800 for reprint permission.