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RETHINKING TIG SPECIALTY AND ITS IMPLICATIONS FOR APPLICATION OF THE INSURED VS. INSURED EXCLUSION

When TIG Specialty v. Koken, 855 A.2d 900 (Pa. Commw. Ct. 2004) was first decided in 2004, insurers took comfort in its holding that the insured vs. insured ("IVI") exclusion applied to vitiate coverage in that declaratory judgment action between the insurer and the Pennsylvania Insurance Commissioner as statutory liquidator. But the carrier community did not greet the decision as promising great utility for future application because of the unique policy wording in the contract involved. To be sure, an insurer would be hard pressed to find stronger language to invoke the IVI exclusion since the clause excluded claims "brought by, on behalf of, or at the behest of the Company, *its successor*, . . . its trustee in bankruptcy, . . . or its litigation trustee . . ." 855 A.2d at 907 (emphasis added). TIG argued successfully that the liquidator was the successor to Health Resources Management Health Resources (PA) ("HMRPA") and was thus excluded by the plain language of the policy. The Commissioner then settled pending appeal.

Reconsideration of the decision today suggests that in addition to the clarion holding, other aspects of the court's analysis contain promise for future application. These nuggets of forensic potential include the conceptual foundation for both "character of the insured" and public policy arguments.

A. Character of the Insured. In TIG Specialty the Insurance Commissioner as Liquidator asserted that coverage survived the IVI exclusion because the Liquidator did not merely stand in the shoes of the corporation; the Liquidator had other constituencies (like creditors, depositors, and even taxpayers) whose interests it represented. 855 A.2d at 911-12. The Liquidator argued that the IVI exclusion did not obtain because as representative of these various constituencies, the Liquidator was different in character than the insured, so the IVI clause simply did not apply. As the court put it: "the Liquidator argues that the term "successor" requires the successor to be of like character . . . and since the insurance Act imposes on the Liquidator duties and authority different from that of the corporate board, she is not of like character to the HRMPA board and is not, therefore, a 'successor.'" 855 A.2d at 909-10. Judge Cohn held that even if the Insurance Commissioner did represent interests beyond that of the insured, she was still the "successor" to the insured for purposes of the IVI exclusion.

The Liquidator relied on both Fidelity & Deposit Co., v. Zandstra, 756 F. Supp 429 (N.D. Cal. 1990) and Branning v. CNA Insurance Co., 721 F. Supp.

1180 (W.D. Wash. 1989) for the proposition that a regulatory successor is not precluded from coverage pursuant to the IVI exclusion if the regulator is of a different character than the underlying insured. The Zandstra court emphasized that the FDIC had become the plaintiff in that action "by operation of statute," noting that FSLIC (predecessor plaintiff to the FDIC) had expended over $5 million in implementing a purchase and assumption transaction by which the failed S&L's assets and liabilities were transferred to Old Stone Bank of California:

> **While Fidelity may be correct … that when the underlying actions were originally filed by the new Homestate directors ... the exclusion applied to that action, it does not follow that when FSLIC took over the action, the exclusion still applied. *** Here, however, FSLIC (and later FDIC) took over the action under operation of law, pursuant to the statutory mandate to pay insured depositors of the failed S&L "as soon as possible." … It is clear beyond doubt … that FSLIC's (and now FDIC's) involvement in the underlying actions is not collusive. The "insured v. insured" exception therefore does not excuse Fidelity from coverage.**

756 F. Supp at 432. When the insurer argued that the FDIC had actually asserted claims only on behalf of Homestate, even if it claimed to represent broader constituencies, the court rebuffed the argument: "Fidelity also overlooks the fact that in order to transfer Homestate to Old Stone, FSLIC had to pay out over $ 5 million. That amount represents the potential loss to creditors and depositors that FSLIC took upon itself …" The Zandstra court concluded that FDIC could be seen as possessing claims independent of the insured.

The Branning court was even more emphatic that the differing character of the insured and the regulatory receiver was the key to finding coverage:

> **… FSIC does not merely stand in the shoes of Home Savings. By statute, FSLIC represents depositors, shareholders, creditors and the federal insurance fund as well as the failed institution. The court rules, therefore, that since [the IVI exclusion] does not exclude claims brought on behalf of shareholders, creditors, and the insurance fund, FSLIC's claims are covered. To rule otherwise would frustrate the purpose of the agency as well as its ability to revive failed savings and loans.**

721 F. Supp. at 1184. Again, the Branning court placed substantial emphasis on the fact that FSLIC had expended $22 million from the insurance fund in the sale of Home Savings assets and liabilities to Interwest Savings Bank.

At oral argument on the TIG Specialty DJ action, Judge Cohn focused on this very distinction: "When you're dealing with FDIC or the FSLIC in a banking situation, there is a difference, isn't there, in that they also have an

obligation to actually pay out money from their own funds to help keep the bank afloat . . ." (April 1, 2004 Tr. at 33). Moreover, Judge Cohn was acutely aware that the "character of the insured" concept took one only so far analytically since one of the exceptions to the IVI exclusion was for unsolicited shareholder derivative suits. Judge Cohn understood that no legal sleight-of-hand could render the Liquidator's action equivalent to a shareholder derivative suit. The Liquidator was not a shareholder of HRMPA. It could not cite any authority for the proposition that creditors or the general public -- constituencies in whose interest the Liquidator claimed to act -- had standing to assert a shareholder derivative suit. Thus, the differing "character of the insured" on which the Liquidator purported to act took it beyond the shareholder derivative suit exception to the IVI exclusion, despite the fact that one of the Liquidators' claimed constituencies was shareholders.

B. Public Policy. The TIG Specialty court's response to the argument that denying coverage violated public policy was also both rigorous and straightforward. The court noted first that D&O insurance was a type of insurance not required by Pennsylvania law. It was a voluntary program for HRMPA, and thus a matter of contract: "in an instance such as this one, involving a form of insurance coverage not required by Pennsylvania law, public policy cannot be a means to find coverage that is not there. The potential difficulty in recovering assets directly from the purported perpetrators, cannot, in the name of public policy, be used to eviscerate an otherwise valid exclusion." 855 A.2d at 915.

Whether intentional or not, Judge Cohn's curt summary echoed the more fully-developed analysis by the Maryland Supreme Court in Finci v. American Casualty Co., 323 Md. 358, 593 A.2d 1069 (1991) in addressing both regulatory and IVI exclusions. In Finci, the insurer had issued a D&O policy to First Maryland Savings & Loan ("FMSL"). FMSL became insolvent, and the Maryland Deposit Insurance Fund ("MDIF") was appointed receiver. The Circuit Court effectively awarded MDIF all of the D&O policy proceeds. The Maryland Court of Special Appeals held that the two coverage exclusions (regulatory and IVI) on which the insurer relied were void as against public policy. The Court of Special Appeals found that the relevant statute was enacted "to recover, from the assets of failed savings and loan associations, every dollar available in order to protect not only the depositors and creditors of those associations, but, ultimately, to protect the taxpayers of this State." 323 Md. at 364.

The Maryland Supreme Court reversed the public policy argument as it applied to both the regulatory exclusion and IVI exclusion in the policy. (The court did find the IVI exclusion to be ambiguous). First, the Finci court placed great emphasis on the fact that D&O coverage was not mandatory in Maryland. If there was no public policy requiring that type of coverage for Maryland corporate officers and directors, how could there be a mandatory policy requiring that the proceeds of such policy be directed to the statutory receiver? Judge Rodowsky's opinion carefully distinguished cases invalidating the household exclusion in

automobile liability policies because the statute at issue there made automobile liability coverage mandatory. 323 Md. at 372-73.

Second, the Finci court drew upon United States Supreme Court precedents in Muschany v. United States, 324 U.S. 49, 66 (1945) and Patton v. United States, 281 U.S. 276, 306 (1930). In the former opinion, the Court admonished: "Public policy is to be ascertained by reference to the laws and legal precedents and not from general considerations of supposed public interests. As the term 'public policy' is vague, there must be found definite indications in the law of the sovereignty to justify invalidation of a contract as contrary to that policy." In the latter, the Court urged strong caution in invoking the public policy argument:

> The truth is that the theory of public policy embodies a doctrine of vague and variable quality, and, unless deducible in the given circumstances from constitutional or statutory provisions, should be accepted as the basis of a judicial determination, if at all, only with the utmost circumspection. The public policy of one generation, under changed conditions, may not be the public policy of another.

In reaching the same result, the Finci court expressed its rule as the obverse of the Patton rule: "There is no principled basis on which MDIF's result legally can be achieved without imperiling all contractual defenses of private persons that are good against creditors from whom the State seeks money." 323 Md. at 380. Simply put, public policy's elasticity should not stretch so far. Or as Judge Cohn properly held in TIG: "public policy cannot be a means to find coverage that is not there ... public policy [cannot be invoked] to eviscerate an otherwise valid exclusion." 855 A.2d at 915.

CONCLUSION

The TIG Specialty holding may not strike the reader as surprising given the strength of the policy wording involved. But the inclination of industry specialists to dismiss its application to wider settings and broader arguments constitutes a reflexive response that fails to consider the opinion's theoretical underpinnings and analytical rigor. While there is no doubt that the "successor" language in the IVI exclusion involved pointed to the ultimate outcome, creative and aggressive D&O litigators would be well advised to revisit the conceptual framework of Judge Cohn's 2004 decision to refresh their arsenal of arguments to deny coverage in analogous cases.

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