

# Inadequate Consideration Exclusion Bars Coverage

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A federal district court in Delaware, applying New York law, has affirmed a bankruptcy court's dismissal of an adversary proceeding brought by a bankrupt home mortgage company against its directors and officers liability insurers, holding that coverage for a pre-petition lawsuit against the mortgage company was barred by application of an "inadequate consideration" exclusion. *Delta Fin. Corp. v. Westchester Surplus Lines Ins. Co.*, 2009 WL 2392882 (D. Del. Aug. 4, 2009). Wiley Rein LLP represented one of the insurers in the bankruptcy case, which was summarized in the January 2009 edition of the *Executive Summary*.

The underlying lawsuit arose from the mortgage company's 2001 restructuring transaction. In connection with that transaction, the mortgage company allegedly first convinced its unsecured and senior secured note holders to surrender their notes to a newly formed holding company, for which the note holders were granted certain interests in the holding company. Next, the holding company returned the senior notes to the mortgage company, and, in exchange, the mortgage company transferred excess "cash flow certificates" to the holding company. The mortgage company and the holding company intended that the values of the exchanged senior notes and cash flow certificates would each be approximately \$153 million.

In 2003, the former note holders filed suit against the mortgage company and its directors and officers alleging that, at the time of the restructuring transaction, the cash flow certificates had an actual fair market value of only \$43 million. The plaintiffs ultimately asserted eight causes of action against the defendants concerning various aspects of the restructuring transaction. The mortgage company tendered the suit to its directors and officers liability insurers, and the primary insurer denied coverage based in part on the inadequate consideration exclusion. In 2007, the mortgage company filed for bankruptcy and brought an adversary proceeding against the insurers seeking damages and a declaratory judgment that the insurers were obligated to advance defense costs and provide indemnification for the underlying lawsuit.

In considering the insurers' motions to dismiss, the bankruptcy court focused on the primary policy's inadequate consideration exclusion, which provided that "[t]he insurer shall not be liable for Loss on account of any Claim made against any Insured: . . . based upon, arising out of, or attributable to the actual or proposed payment by the Company of allegedly inadequate or excessive consideration in connection with the Company's purchase of securities issued by any company." The district court affirmed the bankruptcy court's

construction and application of this exclusion to bar coverage for the underlying complaint in its entirety. The district court also agreed with the bankruptcy court's application of a three-part "but for" causation test in applying policy exclusions with "arising from" lead-in language.