

UNITED STATES DISTRICT COURT  
DISTRICT OF MASSACHUSETTS

CIVIL ACTION NO. 03-CV-12018-RGS

ARTHUR W. STRATTON, JR., DAVID N. HANSON, PAUL J. DIAZ,  
and DOUGLAS STONE

v.

NATIONAL UNION FIRE INSURANCE COMPANY OF PITTSBURGH, PA,  
and FEDERAL INSURANCE COMPANY

MEMORANDUM AND ORDER ON  
CROSS-MOTIONS FOR SUMMARY JUDGMENT

September 3, 2004

STEARNS, D.J.

On October 17, 2003, four former directors and officers of the now dissolved Mariner Health Group, Inc. (MHG) – Arthur Stratton, Jr., David Hanson, Paul J. Diaz, and Douglas Stone – filed this Complaint against MHG’s primary insurer, National Union Fire Insurance Company of Pittsburgh, PA (National Union), and MHG’s excess insurer, Federal Insurance Company (Federal). Plaintiffs seek a declaratory judgment that the defendant insurers are obligated under the terms of Directors and Officers Liability (D&O) policies issued to MHG, and to its successor-in-interest, Mariner Post-Acute Network, Inc. (MPAN), to pay defense costs and provide indemnity coverage in two Georgia state lawsuits.<sup>1</sup> The policies insured against “wrongful acts” by MHG’s officers and directors, but excluded coverage of claims brought by an insured against another insured or by the

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<sup>1</sup>Plaintiffs also seek costs in a countersuit filed in the Delaware Court of Chancery in response to the Georgia actions. That case was eventually removed to the Delaware Bankruptcy Court. Plaintiffs seek the costs associated with those proceedings as well.

company itself against an insured (the “insureds versus insureds” exclusion). On December 4, 2003, plaintiffs moved for summary judgment, arguing that the “insureds versus insureds” exclusion was inapplicable. On January 23, 2004, National Union responded with a cross-motion defending the exclusions. National Union also argues that the plaintiffs who did not serve as MPAN officers cannot claim coverage under the policy issued to MPAN and that the alleged wrongful conduct, in any event, falls outside the coverage period.

### FACTS

The undisputed facts are these. Arthur Stratton founded MHG (a provider of post-acute trauma healthcare) in 1988. He served as President, Chief Executive Officer, and Chairman of the Board of Directors of MHG until July 31, 1998, when MHG was acquired by Paragon Post Acute Network, Inc. (Paragon). After the acquisition, Paragon changed its name to MPAN. Stratton became MPAN’s President and a member of its Board of Directors.

In 1995, Douglas Stone was named MHG’s Senior Vice President, Reimbursement. He served in that position until Paragon acquired MHG in 1998. In 1997, Paul Diaz was named Executive Vice President of MHG, a post that he occupied until MPAN was formed. David Hansen’s association with MHG began during his tenure with Coopers & Lybrand (now PricewaterhouseCoopers (PwC)), where he was the partner responsible for MHG’s audits. In 1996, Hansen left PwC to become MHG’s Chief Financial Officer. In 1997,

Hansen became a member of MHG's Board of Directors. He served in both positions until the Paragon acquisition.<sup>2</sup>

In January of 1996, MHG acquired Convalescent Services, Inc., and Convalescent Supply Services, Inc. (the Convalescent companies). The Convalescent companies were owned by Stiles Kellett, Jr., and his brother Samuel, and by a consortium of Kellett family trusts and business enterprises.<sup>3</sup> Stiles Kellett served as a director of MHG from 1995 until Paragon acquired the company in 1998. Samuel Kellett was named a director of MHG in July of 1997 and survived the merger, becoming a director of MPAN in 1998. As part of the sale of the Convalescent companies, the Kelletts acquired control of a substantial block of MHG's voting stock.

In 1997, National Union sold MHG a \$10,000,000 D&O policy (the MHG policy) covering the period December 29, 1997 to December 29, 2000. The policy insured against wrongful acts committed by MHG's officers after May 14, 1993, and prior to July 31, 1998.<sup>4</sup> Exclusion 4(i) of the MHG policy, as amended by Endorsements 16 and 26, provided that:

[t]he Insurer shall not be liable to make any payment for Loss in connection with a Claim made against an Insured:

- (i) which is brought by any Insured or by the [Company, Paragon Health Network, Inc. or Mariner Post-Acute Network, Inc. or successor company

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<sup>2</sup>As will be apparent from these thumbnail sketches, Stone, Diaz, and Hansen never worked for MPAN.

<sup>3</sup>These included Kellett Family Partners, L.P. and SSK Partners, which are owned by the families of Stiles and Samuel Kellett, and four trusts created for the benefit of the Kellett children.

<sup>4</sup>The policy covered claims made from July 31, 1998, through July 31, 2004.

thereof or any Subsidiary or affiliate thereof];<sup>5</sup> or which is brought by any security holder of the Company . . . or successor company thereof . . . , whether directly or derivatively, unless such security holder's Claim(s) is instigated and continued totally independent of, and totally without the solicitation of, or assistance of, or active participation of, or intervention of, any Insured or the Company . . . or successor company thereof . . . .

The MHG policy defined an "Insured" as "any past, present or future duly elected or appointed directors or officers of the Company . . . or successor company thereof . . . ."

National Union later sold MPAN a \$15,000,000 D&O policy for claims made during the period from November 4, 2001 through November 4, 2002 (the MPAN policy).

Exclusion 4(i) of the MPAN policy, as amended by endorsements 6 and 13, provided that:

[t]he Insurer shall not be liable to make any payment for Loss in connection with a Claim made against an Insured:

- (i) which is brought by any Insured or by 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 independent of, and totally without the solicitation of, or assistance of, or active participation of, or intervention of, any Insured or the Company. . . .

While the MPAN policy provided coverage for insured officers or directors acting "in their respective capacities as Directors or Officers of the Company [MPAN] . . . ," under Endorsement 17 of the policy, coverage was limited to claims

alleging a Wrongful Act which occurred prior to the Transaction date [November 4, 1997] for the creation of Paragon Health Network, Inc. This policy only provides coverage for Loss arising from a Claim alleging a Wrongful Act occurring on or after the Transaction date for the creation of

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<sup>5</sup>Endorsement 25 amended the policy so that "[w]henver the term 'Company' appears, it is hereby substituted with the terms 'Paragon Health Network, Inc., or Mariner Post-Acute Network, Inc. or successor company thereof or any Subsidiary or affiliate thereof.'"

Paragon Health Network, Inc. and prior to the end of the Policy Period and otherwise covered by this policy. Loss(es) arising out of the same or related Wrongful Act(s) shall be deemed to arise from the first such same or related Wrongful Act.

An unrelated section of the MPAN policy defined the term “Company” to also mean “the Named Corporation that emerges from Bankruptcy.”<sup>6</sup>

In January of 2000, MPAN and MHG, and their respective subsidiaries, commenced Chapter 11 reorganization proceedings in the Bankruptcy Court for the District of Delaware. On April 3, 2002, the Bankruptcy Court approved a Plan of Reorganization, the stated purpose of which was to permit MPAN and MHG to continue as “ongoing businesses.” The Plan essentially required MPAN to surrender its interest in MHG and to reissue MHG’s stock to the creditors of MPAN and MHG. MPAN assumed MHG’s assets and its remaining liabilities and changed its name to Mariner Health Care, Inc. (MHC). MHC then assumed most of MPAN’s contractual, lease, indemnification, and pension obligations. Since its creation, MHC has held itself out as the successor to MPAN and MHG in court papers, Securities and Exchange Commission filings, on the Internet, and in press releases.<sup>7</sup>

On August 30, 2002, MHC sued PwC, Stratton, Hansen, Diaz, and Stone in the Georgia Superior Court, Mariner Health Care, Inc. v. Stratton, et al., C.A. No. 02VS037631F (the MHC action), alleging fraudulent misrepresentation and breaches of

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<sup>6</sup>National Union points out that the further elaboration of the term “Company” is explained by the fact that MHG and MPAN had filed bankruptcy petitions at the time the policy was issued.

<sup>7</sup>For example, in the MHC action, the company labeled itself as the “successor-in-interest” to MPAN and MHG and identified itself as the entity “formerly known as MPAN.”

fiduciary duty (to MPAN and MHG).<sup>8</sup> According to the Georgia Complaint, from 1996 to 1998, the four defendants (the present plaintiffs) made misleading and self-serving public statements to induce Paragon to purchase MHG.

On September 20, 2002, Stiles Kellett and Samuel Kellett, Kellett Family Partners, L.P., SSK Partners, L.P., and William Bassett as the Trustee of the Kellett Family Trusts brought a similar suit in the Georgia Superior Court against the present plaintiffs, Bassett as Trustee for Charlotte R. Kellett Irrevocable Trust v. Stratton, et al., C.A. No. 02A7637, alleging fraud, breach of fiduciary duty, and violations of the Georgia racketeering statute. The Kellett interests contend that the plaintiffs mismanaged MHG and misrepresented its financial condition both prior to and after the Convalescent companies acquisition in 1996, ultimately destroying the value of the Kelleths' investment in MHG.

On September 3, 2002, Stratton, Hansen, Diaz, and Stone answered the Georgia lawsuits in the Delaware Court of Chancery, Stratton v. Mariner Health Care, Inc., C.A. No. 198789. (According to plaintiffs, the forum selection clause in the MPAN merger agreement required them to assert their defenses in Delaware). On September 17, 2002, MHC removed the case from the Chancery Court to the Delaware Bankruptcy Court, and on September 25, 2002, filed an adversary proceeding entitled Mariner Health Care, Inc. v. Stratton, et al., Adv. Nos. 02-055998 and 02-055999 (D. Del. Bnkr. Sept. 25, 2002). Plaintiffs then sought defense costs and indemnity coverage under the MHG and MPAN

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<sup>8</sup>MHC also brought claims of professional negligence, negligent misrepresentation, fraudulent misrepresentation, and a claim of aiding and abetting breach of fiduciary duty against PwC.

policies. National Union denied coverage based on the “insureds versus insureds” exclusion and on two other grounds that do not figure in the instant cross-motions.

### DISCUSSION

National Union contends that the plaintiffs, as officers and directors of MHG, are excluded from coverage under the MHG policy because MHC is the successor to MHG and MPAN. Stratton, Hansen, Diaz, and Stone are therefore being sued by a fellow insured (the company), thus triggering Exclusion 4(i) of the policy, which states that “[t]he Insurer shall not be liable to make any payment for Loss in connection with a Claim made against an Insured . . . which is brought by any Insured or by the Company, Paragon Health Network, Inc. or Mariner Post-Acute Network, Inc. or successor company thereof . . . .”<sup>9</sup> Similarly, National Union argues that the Kellett action is excluded from coverage under both the MHG and MPAN policies, because Stiles and Samuel Kellett served as directors of MHG, and Samuel thereafter served as a director of MPAN. The Kellett action consequently pits one director against another, and therefore falls within the exclusion. Moreover, National Union argues that the MPAN policy does not provide coverage for Hansen, Diaz, or Stone, because only Stratton served as an officer or director of MPAN

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<sup>9</sup>National Union argues that the two Delaware actions are excluded from coverage for the same reason.

after the July 1998 merger. And finally, because Stratton's alleged wrongdoing commenced in 1996, he falls outside the covered period.<sup>10</sup>

Plaintiffs not unexpectedly see coverage under both policies for all purposes. Plaintiffs first argue that the MHG policy applies because MHC is not a successor to MHG and MPAN. The argument is not based on any factual reality, but on an ambiguity plaintiffs perceive in the word "successor" as it is used in the MHG policy. "Successor," plaintiffs maintain, is not defined in the MHG policy to specifically include "the Named Corporation that emerges from Bankruptcy," as it is in an unrelated section of the MPAN policy. Plaintiffs invoke the familiar rule that an ambiguity in an insurance policy will be construed against an insurer with a quivering pen. See Quincy Mut. Fire Ins. Co. v. Abernathy, 393 Mass. 81, 83 (1984). Hence, plaintiffs claim coverage and defense costs.

An insurer relying on a "separate and distinct" exclusion in a policy has the burden of proving that the exclusion applies. Great Southwest Fire Ins. Co. v. Hercules Building & Wrecking Co. Inc., 35 Mass. App. Ct. 298, 302 (1993). "Interpretation of the language of the exclusion presents a question of law. . . . In this interpretation, we are guided by three fundamental principles: (1) an insurance contract, like other contracts, is to be construed according to the fair and reasonable meaning of its words. . . . (2) exclusionary clauses must be strictly construed against the insurer so as not to defeat any intended coverage or diminish the protection purchased by the insured, . . . and (3) doubts created

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<sup>10</sup>Under Endorsement 17, the MPAN policy "provides coverage for Loss arising from a Claim alleging a Wrongful Act occurring on or after the Transaction date [November 4, 1997] for the creation of Paragon Health Network, Inc. and prior to the end of the Policy Period and otherwise covered by this policy. Loss(es) arising out of the same or related Wrongful Act(s) shall be deemed to arise from the first such same or related Wrongful Act."

by any ambiguous words or provisions are to be resolved against the insurer.” Camp Dresser & McKee, Inc. v. Home Ins. Co., 30 Mass. App. Ct. 318, 323-324 (1991) (citations omitted). See also Hanover Insurance Company v. Ramsey, 405 Mass. 1101, 1101 (1989). But “[w]here the terms of [the] exclusionary clause are plain and free from ambiguity, the words [will be] construed in their ‘usual and ordinary sense’ and not strictly against the insurer.” Farm Family Mut. Ins. Co. v. Whelpley, 54 Mass. App. Ct. 743, 745 (2002).

I disagree with the suggestion that there is any ambiguity in the use of the word “successor” in the MHG policy. National Union makes the perfectly reasonable point that a more expansive definition of an ordinary term of usage in a subsequent policy does not render the earlier term ambiguous where the enlarged definition is intended to recognize a change in circumstances, rather than to effect a change in meaning. There is, as National Union argues, nothing mysterious about the term “successor,” a word that has the same meaning in law as it does in ordinary speech. Compare Ballentine’s Law Dictionary (3d ed. 1969) (“[o]ne who follows another in interest”) with American Heritage Dictionary (4th ed. 2000) (“[o]ne that succeeds another”). Perhaps of greater interest from a legal perspective is the more comprehensive definition of a successor company set out in Black’s Law Dictionary (7th ed. 1999): “[a] corporation that, through amalgamation, consolidation, or other assumption of interests, is vested with the rights and duties of an earlier corporation.” Under any reasonable application of that definition, MHC is the fully feathered Phoenix arising from the ashes of MPAN’s and MHG’s Plan of Reorganization. MHC restated and integrated MPAN’s Certificate of Incorporation, retained MPAN’s

Internal Revenue Service number, established residence in MPAN's corporate headquarters, kept on MPAN's key employees, assumed MPAN's remaining obligations, and took control of MPAN's assets and subsidiaries. If this does not describe a "successor" company, it would be difficult to ascribe any legal meaning to the word at all.<sup>11</sup> Cf. Fashion House, Inc. v. K Mart Corp., 892 F.2d 1076, 1085 (1st Cir. 1989) ("[L]ack of ambiguity is a relative status, not an absolute one. The parties need not choose phraseology which invariably excludes every possible interpretation other than the one they intend . . . . [I]t [is] sufficient if the language employed is such that a reasonable person, reading the document as a whole and in realistic context, clearly points to a readily ascertainable meaning.").

Plaintiffs, while conceding similarities between MHC and the pre-petition companies, argue that because the creditors of MPAN and MHG are using MHC as a vehicle for their own financial interests, it is wrong to characterize the Georgia lawsuits as pitting "insureds against insureds." Plaintiffs maintain that the purpose of the "insureds versus insureds" exclusion is to protect insurers from collusive lawsuits by corporations trying to recoup corporate losses by attributing them to the wrongdoing of directors and officers who, if insured, have nothing to lose by taking the blame. This is an accurate description of the purpose of the exclusion. See Township of Center v. First Mercury

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<sup>11</sup>The best that plaintiffs can offer in rebuttal is a quotation from the sixth edition of Black's to the effect that a successor corporation "assumes burdens of the first corporation." Plaintiffs contend that because the bankruptcy proceeding discharged some of the debts of MPAN and MHG, MHC did not assume all of the obligations of the pre-petition companies and therefore cannot be a successor to MPAN and MHG. The word "all" does not appear in the Black's Sixth definition, nor is it even implied.

Syndicate, Inc., 117 F.3d 115, 119 (3d Cir. 1997). Cf. Nicholas E. Chemicles and M. Katherine Meermans, The Insured v. Insured Exclusion in D&O Insurance Policies, C938 ALI-ABA 749, 751 (June 17, 1994). Because here the real parties in interest are disgruntled creditors who blame plaintiffs for the precarious financial condition of the company they now own, there is no hint of the kind of collusion the exclusion is intended to address, or so plaintiffs argue.

Plaintiffs' point is not entirely accurate. MHC is the plaintiff and any recovery, while it may indirectly benefit the creditors to the extent that it contributes to the viability of MHC as a going enterprise, will nonetheless be paid into MHC. This is what distinguishes the cases relied on by plaintiffs: Narath v. Exec. Risk Indem., Inc., 2002 WL 924231 (D. Mass. Mar. 14, 2002); Lewis v. Executive Risk Indem., Inc., No. 00-11093-RWZ (D. Mass. Dec. 28, 2001); and In re Molten Metal Technology, Inc., 271 B. R. 711 (D. Mass. Bnkr. 2002). In these cases, while the lawsuits were brought nominally on behalf of a defunct entity, the real party-in-interest was the bankruptcy trustee and not an ongoing debtor company. Any proceeds in these cases were to be paid directly to the creditors, making the trustee a genuinely adverse party. This is the distinction that was made by Judge Zobel in Narath (and in Lewis): "As I described in Lewis, courts have generally found 'insured v. insured' exclusions inapplicable where, as here, one 'insured' is the trustee or receiver of an insolvent institution bringing claims against the management of that institution. . . . This is largely because the parties are adverse, and the purpose of the exclusion – to prevent collusion between insured parties – is defeated." Narath, at \*2.

To the extent plaintiffs are arguing that despite formal appearances, an examination of the underlying facts would reveal the absence of any actual collusion between MHC and its former directors and officers, the argument founders on the rule of contract interpretation that precludes a court from looking to extrinsic evidence to contradict and defeat the meaning of plain language in a contract. Snider v. Deban, 249 Mass. 59, 61 (1924). Only when the judge finds that a contract provision, “in some material respect [is] uncertain or equivocal in meaning, [may] ‘all the circumstances of the parties leading to its execution . . . be shown for the purpose of elucidating, but not of contradicting or changing its terms.’” Boston Edison Co. v. F.E.R.C., 856 F.2d 361, 365 (1st Cir. 1988), quoting Robert Indus., Inc. v. Spence, 362 Mass. 751, 754 (1973).<sup>12</sup> See also Utica Mutual Ins. Co. v. Weathermark Investments, Inc., 292 F.3d 77, 80 (1st Cir. 2002). Because MHC is the successor to MPAN and MHG in the plain meaning of the term, the lawsuits between MHC and the plaintiffs fall within Exclusion 4(i) of the policies and National Union has no duty to defend or provide coverage.<sup>13</sup>

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<sup>12</sup>The parties argue over whether Massachusetts or Georgia law should apply, but in the end agree that there are no material differences between the two.

<sup>13</sup>National Union makes the point that the plaintiffs have not objected to MHC’s claim to be the successor-in-interest to MPAN and MHG in the underlying state lawsuits and at times have adopted the assertion when it serves their purposes. National Union argues that the plaintiffs should be judicially estopped from engaging in “cynical self-contradiction” by now arguing to the contrary. While judicial estoppel “precludes a party from asserting a position in one legal proceeding which is contrary to a position it has already asserted in another,” Patriot Cinemas, Inc. v. General Cinema Corp., 834 F.2d 208, 212 (1st Cir. 1987), “[j]udicial estoppel is not implicated unless the first forum *accepted* the legal or factual assertion alleged to be at odds with the position advanced in the current forum.” Gens v. RTC, 112 F.3d 569, 572 (1st Cir. 1997). There is no evidence that any prior court has affirmatively based a decision on the plaintiffs’ failure to object to MHC’s self-description or on its adoption.

The issues relating to the Kellett lawsuit are even more straightforward. Stiles and Samuel Kellett were directors of MHG and Samuel was a director of MPAN. Plaintiffs concede that in that context Exclusion 4(i) defeats coverage for any claims brought by Stiles and Samuel Kellett. Plaintiffs argue, however, that the lawsuit, insofar as it affects the other Kellett entities, should be covered by the policies and that defense costs should be tendered until the last covered claim is resolved. Plaintiffs argue that any other result would be unfair, because coverage under a D&O policy would be completely avoided whenever a lawsuit brought by an uninsured party was consolidated with one brought by a covered plaintiff. The argument once again ignores the strict language of the policies.<sup>14</sup> Both state that “[t]he Insurer shall not be liable . . . for Loss in connection with a Claim made against an Insured . . . which is brought by any Insured or by the Company, . . . or which is brought by any security holder of the Company . . . , whether directly or derivatively, unless such security holder’s Claim(s) is instigated and continued totally independent of, and totally without the solicitation of, or assistance of, or active participation of, or intervention of, any Insured or the Company . . . .”<sup>15</sup> The Kellett plaintiffs (those separate from Stiles and Samuel) are security holders in MHC and their claims are brought, without differentiation, as part of the claims of Stiles and Samuel. The claims thus cannot be said to be “instigated and continued totally independent of, and

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<sup>14</sup>Plaintiffs suggestion that in some circumstances the “insureds versus insureds” exclusion could cause an “unfair” result would appear to be an attack on the exclusion as contrary to considerations of the public interest. If so, the short answer is that a court will not invalidate on public policy grounds a limitation in an insurance policy that an insurer is not required to offer or a company required to purchase.

<sup>15</sup>While the wording of the MPAN policy is slightly different, the intent is the same.

totally without the solicitation of, or assistance of, or active participation of, or intervention of, any Insured.” Consequently, the claims of the Kellett lawsuits are not covered by either policy.

Given this ruling, the court need not address the additional arguments over the MPAN policy other than to note that because the underlying complaints allege malfeasance beginning in 1996, Endorsement 17 of the policy operates to exclude coverage in any event.<sup>16</sup>

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<sup>16</sup>Plaintiffs devote much of their brief to the proposition that the duty to defend a claim is broader than any duty of an insurer to indemnify in an effort to salvage their considerable defense costs. See Liberty Mutual Ins. Co. v. SCA Services, Inc., 412 Mass. 330, 335 n.4 (1992); W.R. Grace & Co. v. Maryland Casualty Co., 33 Mass. App. Ct. 358, 364 (1992). However, there is no duty to defend a claim that is specifically excluded from coverage. Metropolitan Prop. & Cas. Ins. Co. v. Fitchburg Mut. Ins. Co., 58 Mass. App. Ct. 818, 820 (2003). See also HDH Corp. v. Atlantic Charter Ins. Co., 425 Mass. 433, 437 (1997).

ORDER

For the foregoing reasons, plaintiffs' motion for partial summary judgment is DENIED. National Union's motion for summary judgment is ALLOWED. Judgment will enter for National Union.

SO ORDERED.

/s/ Richard G. Stearns

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UNITED STATES DISTRICT JUDGE