UNITED STATES BANKRUPTCY COURT
NORTHERN DISTRICT OF OHIO
EASTERN DIVISION


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| In re: | ) | Case No. 04-25167 |
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| KISMET PRODUCTS, INC., | ) | Chapter 11 |
| | ) | |
| Debtor. | ) | Judge Pat E. Morgenstern-Clarren |
| _____ | ) | |
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| KISMET PRODUCTS, INC., | ) | Adversary Proceeding No. 05-1465 |
| | ) | |
| Plaintiff, | ) | |
| | ) | |
| v. | ) | |
| | ) | |
| HCC BENEFITS CORPORATION, et al., | ) | |
| | ) | |
| Defendants. | ) | |

**PROPOSED FINDINGS OF FACT AND CONCLUSIONS OF LAW REGARDING CROSS MOTIONS FOR SUMMARY JUDGMENT – RECOMMENDING THAT THE DISTRICT COURT GRANT TRAVELERS'S MOTION FOR SUMMARY JUDGMENT AND DENY THE PLAINTIFF'S MOTION FOR SUMMARY JUDGMENT**

Plaintiff chapter 11 debtor Kismet Products, Inc. asks for a declaratory judgment that defendant Travelers Casualty and Surety Company of America is required to defend, indemnify, and reimburse Kismet with respect to employee medical benefit claims filed in Kismet's bankruptcy case.[1] Travelers's counterclaim requests the opposite declaration. Each party moves for summary judgment.[2]

[1] Kismet's claims against Travelers are stated in count one and count two of the complaint. In addition to declaratory relief, Kismet asks for money damages, interest, and legal fees. Count three requests a similar determination against defendants HCC Benefits Corp. and HCC Life Insurance Co. with respect to a different insurance policy.

[2] *See* docket 71, 72, 73, 83, 90, 92, 97, 103, and 104.

This is a non-core, related proceeding and Travelers did not consent to entry of a final judgment by this court.[3] The court, therefore, submits these proposed findings of fact and conclusions of law to the district court with a recommendation that the district court enter summary judgment for defendant Travelers and deny plaintiff Kismet's motion for summary judgment. *See* 28 U.S.C. § 157(c); FED. R. BANKR. P. 9033.

## I. SUMMARY JUDGMENT STANDARD

Summary judgment is appropriate only where there is no genuine issue as to any material fact and the moving party is entitled to judgment as a matter of law. *See* FED. R. CIV. P. 56(c) (made applicable by FED. R. BANKR. P. 7056); *see also Celotex Corp. v. Catrett*, 477 U.S. 317 (1986); *Anderson v. Liberty Lobby, Inc.*, 477 U.S. 242 (1986); *Matsushita Elec. Indus. Co. v. Zenith Radio Corp*., 475 U.S. 574 (1986). The movant must initially demonstrate the absence of a genuine issue of material fact. *Celotex Corp.*, 477 U.S. at 323. The burden is then on the non-moving party to show the existence of a material fact which must be tried. *Id.* The non-moving party may oppose a proper summary judgment motion "by any of the kinds of evidentiary material listed in Rule 56(c), except the mere pleadings themselves. . . ." *Id.* at 324. All reasonable inferences drawn from the evidence must be viewed in the light most favorable to the party opposing the motion. *Hanover Ins. Co. v. Am. Eng'g Co.*, 33 F.3d 727, 730 (6th Cir. 1994). Summary judgment may be granted when "the record taken as a whole could not lead a rational trier of fact to find for the non-moving party." *Northland Ins. Co. v. Guardsman Prods., Inc.*, 141 F.3d 612, 616 (6th Cir. 1998) (internal citations and quotation marks omitted). Where

[3] *See* memorandum of opinion and order at docket 52, 53 (determining that this adversary proceeding is not a core proceeding).

multiple parties file summary judgment motions, the court must evaluate each on its merits and "draw all reasonable inferences against the party whose motion is under consideration." *Lansing Dairy, Inc. v. Espy*, 39 F.3d 1339, 1347 (6th Cir. 1994) (internal citation and quotation marks omitted).

## II. FACTS

### A. The Kismet Health Care Benefit Plan

The parties agree that the material facts are not disputed.[4]

Kismet Products, Inc. filed its chapter 11 case on November 30, 2004. Kismet, which has now sold substantially all of its assets with court approval, remains in chapter 11 to pursue this litigation. Kismet recently filed a plan of liquidation that has not been confirmed.

Kismet maintained a Health Care Benefit Plan (the plan) for its employees and their dependents and served as the plan administrator and fiduciary. The self-insured plan provided benefits under the Employee Retirement Income Security Act of 1974 (ERISA).[5] Kismet and the qualifying employees shared the plan costs, with the employee contributions withheld from their pay. North American Benefits Network, Inc. (NABN) administered the plan. Plan participants and providers submitted claims to NABN for audit and processing. NABN would approve and summarize the reimbursable claims, Kismet would issue a check to NABN, and NABN would then pay the reimbursable amounts to either the providers or the participants.

Problems arose during the period October 1, 2003 through September 30, 2004. Specifically, Kismet withheld employee contributions from employees' paychecks, but admits that it did not use the "withholding for payment of Excess Loss Premiums, reimbursement of

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[4] The parties did not expressly stipulate to any facts. The court draws the undisputed facts from the joint pretrial statement, admissions in the briefs, and evidence submitted with the motions. The insurance policy at issue is attached as an exhibit to both motions.

[5] 29 U.S.C. § 1001 *et seq.*

qualified medical expenses, and administrative costs for the Plan."[6] According to Kismet, this problem is traceable to Karen Corum, Kismet's former controller. Dennis Lawrence, Kismet's then-president, learned of the failure after Kismet filed its bankruptcy case.[7] Plan participants filed approximately 90 proofs of claim in the chapter 11 case seeking to recover medical expenses that should have been, but were not, reimbursed under the plan.[8]

B. The Travelers Management Liability Policy

Travelers issued a management liability policy to Kismet which was in effect for the period July 13, 2004 through July 13, 2005.[9] The policy includes coverage for (1) wrongful employment practices, and (2) wrongful acts by management, as defined in the policy.

C. Kismet's Demand Under the Policy

Kismet timely demanded, based on the management liability policy, that Travelers defend against and pay any liability arising out of the proofs of claim. Despite the demand to defend, Kismet does not argue that any proof of claim should be challenged on the merits. Instead, Kismet's real demand is that Travelers pay the amounts stated in the proofs of claim. Travelers declined and this adversary proceeding followed.

## III. ISSUE

The issue is whether the Travelers policy covers the unreimbursed medical expenses of individuals who participated in Kismet's plan.

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[6] Kismet motion, Affidavit of John Fennessy at ¶ 5. (Docket 103, 104). Kismet paid all premiums owed to Travelers. The unpaid premiums were owed to a different insurer.

[7] Kismet motion, Affidavit of Dennis Lawrence at ¶ 32. (Docket 83).

[8] *See* Travelers's motion, exh. A. (Docket 73). Kismet filed many of these claims itself on the ground that it is the plan administrator and has a duty to insure that plan participants receive the benefits due under the plan.

[9] The policy is an exhibit to both motions. *See* Kismet's motion, exh. 1 (Docket 83), and Travelers's motion, exh. B (Docket 73).

## IV. DISCUSSION

The interpretation of an insurance policy is an issue of law. *See Golden v. Kelsey-Hayes Co.*, 73 F.3d 648, 653 (6th Cir. 1996) (stating that "[q]uestions of contract interpretation are generally considered questions of law"); *see also* 11 JAMES WM. MOORE, et al., MOORE'S FEDERAL PRACTICE - CIVIL § 56.31[2] (3d ed. 1997) (noting that a contract case which turns on the interpretation of a document as a question of law is particularly suited to determination on summary judgment). In interpreting a contract, the usual starting point is to identify the state law applicable to the agreement. The parties' briefs do not address this issue, presumably because there are no issues raised that would require the court to apply state law. In particular, neither party argues that the terms of the policy are ambiguous, that special contract rules of interpretation apply, or that extrinsic evidence should be considered.

Kismet relies on two different sections of the policy to show that Travelers has a duty to defend against and pay any liability arising out of the proofs of claim: the employment practices liability coverage and the fiduciary liability coverage.

### A. Employment Practices Liability Coverage

Under the employment practices liability coverage portion of the policy, Travelers agreed to pay loss resulting from claims[10] made against the insured[11] for wrongful employment

[10] A claim includes, among other things, "a written demand for monetary or non-monetary relief " and a "civil proceeding commenced by complaint or similar pleading," seeking to hold an insured liable for a wrongful employment practice. Employment Practices Liability Coverage Part at II(A)(1) and (2).

[11] The "insured" under this coverage means Kismet, and its present and former employees, board members, and directors. Employment Practices Liability Coverage Part at II(C), (D).

practices.[12] Wrongful employment practices include a "breach of [an] oral, implied, or written employment agreement[.]"[13]

The policy specifies that Travelers does not have a duty to defend or to pay any claim:

> (6) for any actual or alleged violation of responsibilities, duties or obligations imposed upon [Kismet] under ERISA or any similar or related federal, state or local law, or for [Kismet']s failure or refusal to establish, contribute to, pay for, insure, maintain, provide benefits pursuant to, enroll or maintain the enrollment of an Employee or dependent in, any Employee Benefit Plan, fund or program, including contracts or agreements which are not subject to the provisions of ERISA[.][14]

Kismet argues that it is covered under this reasoning: (1) Kismet had employment covenants with its employees that Kismet would use withheld employee plan contributions to pay plan premiums and to reimburse claims made under the plan; (2) Kismet, through its officers and directors, breached those covenants; and (3) the breaches amount to wrongful employment practices under the policy. Travelers, on the other hand, argues that the exclusion cited above applies because the proofs of claim are based on Kismet's obligation to pay employee medical benefits under the plan.

Kismet's argument for coverage is precluded by the plain terms of the policy. The policy states that Travelers does not have a duty to pay any claim for Kismet's failure to "contribute to [or] provide benefits pursuant to . . . any Employee Benefit Plan[.]" The proofs of claim filed in this case are based on (1) Kismet's; (2) failure to contribute to and provide benefits under; (3) an

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[12] Employment Practices Liability Coverage Part at I.

[13] Common Terms and Conditions at II(AA)(6).

[14] Employment Practices Liability Coverage Part at III(A)(6).

employee benefit plan.[15] As such, coverage is expressly excluded by the policy terms.

Kismet's argument that its failures should be characterized as breaches of employment contracts does not change this result. There are two steps to the analysis: do the proofs of claim allege a wrongful employment practice (as, for example, by alleging breach of an employment contract) and, if so, does the exclusion apply? In this case, even if Kismet brings itself within the definition of a wrongful employment practice by showing breach of an employment agreement, coverage is still expressly excluded because the breach is the failure to pay medical expenses, an excluded event. Consequently, Travelers does not have the duty to pay Kismet's liability to its former employees under this part of the policy.

B. Fiduciary Liability Coverage

Under this coverage, Travelers agreed to pay loss resulting from claims[16] made against the insured[17] for wrongful acts.[18] Wrongful acts are defined as "any actual or alleged breach of fiduciary duty by the Insured with respect to an Employee Benefit Plan, including but not limited to:

> 1. any actual or alleged breach of duties, obligations and responsibilities imposed by ERISA or by COBRA, or by any related or similar state, local or foreign law or regulation, in the discharge of the Insured's duties as respects an Employee Benefit Plan;

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[15] This is consistent with Kismet's statements that it filed the proofs of claim based on its fiduciary duty as plan administrator "to ensure that benefits due to Participants pursuant to claims submitted are paid in accordance with the Plan." *See* Kismet brief in opposition to Travelers's motion at 11, docket 92.

[16] A claim includes a "civil proceeding commenced by . . . complaint or similar pleading" against an insured for a wrongful act. A claim also includes "a written demand for monetary or non-monetary relief." Fiduciary Liability Coverage Part at II(B)(1).

[17] "Insured" means Kismet, the plan, and any natural person who was or is an employee, officer, or director of Kismet or the plan. Fiduciary Liability Coverage Part at II(D) and (E).

[18] Fiduciary Liability Coverage Part at I.

> 2. any other matter claimed against an Insured solely because of the Insured's status as a fiduciary as respects an Employee Benefit Plan; and
>
> 3. any actual or alleged negligent acts, errors or omissions of the Insured's in the administration of Employee Benefits.[19]

Loss is defined to include "damages (including any punitive or exemplary damages, where insurable under applicable law), judgments, settlements, pre-judgment interest, post-judgment interest, or other amounts that an Insured is legally obligated to pay as a result of a [c]laim," but is defined to exclude:

> payment of medical, pension, severance or Employee Benefits which are or may become due, **except to the extent that such sums are payable as a personal obligation of a natural person who is an Insured Person**, because of such Insured Person's Wrongful Act; provided, however, that this exclusion shall not apply to the Company's obligation to defend any Claim, if applicable, or to pay, advance or reimburse Defense Expenses, regarding a Claim seeking such benefits.[20]

In sum, the policy provides that covered losses exclude claims for payment of medical benefits, unless they are the personal obligation of a natural person who is an insured. This seemingly disposes of the matter because the proofs of claim seek (1) payment of medical expenses; (2) which are Kismet's obligation; and (3) Kismet is not a natural person.

Kismet acknowledges that it is not a natural person, but contends that coverage nevertheless exists. Kismet's argument starts from the premise that, as plan administrator, it seeks indemnification with respect to the employee proofs of claim.[21] From there, Kismet argues that (1) Corum and Lawrence, acting as plan fiduciaries, breached duties imposed by ERISA; (2) the proofs of claim that arise out of this breach amount to judgments against Kismet based on the

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[19] Fiduciary Liability Coverage Part at II(G).

[20] Fiduciary Liability Coverage Part at II(F)(2) (emphasis added).

[21] Neither party briefed the law of indemnification and so the court need not address it.

breaches and establish Kismet's liability for the employee claims; and (3) the judgments have res judicata effect and establish liability which Travelers has agreed to cover under the terms of the policy.

Travelers contends that Kismet's coverage claim fails because no claim has been made for a wrongful act under the policy or, stated differently, that no claim has been made that Kismet breached any duty to a plan participant that would trigger Travelers's obligation to insure Kismet. Travelers argues further that even if Kismet breached its fiduciary duties by failing to pay the employee medical claims, such a breach does not change the nature of the relief sought here—the payment of the medical claims—into an insurable event.

Once again, a plain reading of the policy results in the conclusion that Travelers is not required to provide coverage to Kismet because the proofs of claim do not assert claims under the terms of the policy. Claims must be based on wrongful acts, a term which is defined as an actual or alleged breach of a fiduciary duty by the insured. The proofs of claim filed in the chapter 11 case do not allege or assert any breach of a fiduciary duty by Kismet (or its officers). Instead, the claims address Kismet's liability to provide medical benefits under the plan, not Kismet's liability for breach of fiduciary duties with respect to the plan. In short, these are all claims for medical benefits under the plan, and nothing more.

Kismet makes several arguments that do not lead to a different conclusion. Kismet argues that a proof of claim (as opposed to a lawsuit) can trigger liability under the policy. This is procedurally true, but not substantively dispositive. The policy defines a claim to include a demand for monetary payment and the proofs of claim come within this definition. The demands made, however, are to pay medical benefits, which means that they still fall squarely within the exclusion. Kismet relies on *Amatex Corp. v. Aetna Cas. & Sur. Co. (In re Amatex*

*Corp.)*, 107 B.R. 856 (E.D. Pa. 1989) to support this argument. That reliance is misplaced because the decision deals with a different policy with entirely different coverage terms.

Kismet also argues that the res judicata effect of the allowance of the proofs of claim in its chapter 11 case applies in its favor in this proceeding, but does not explain how applying the doctrine would advance its case. Kismet seems to argue that the proofs of claim (deemed to be final judgments) establish that its officers breached their fiduciary duties and that the claims are, therefore, payable as a personal obligation of the officers (as natural persons who are insureds) invoking the "natural person" coverage. The court will proceed under the assumption that this is the argument being made.

Under the doctrine of res judicata, a claim is barred by a prior action if four elements are present:

> (1) a final decision on the merits by a court of competent jurisdiction; (2) a subsequent action between the same parties or their 'privies'; (3) an issue in the subsequent action which was litigated or which should have been litigated in the prior action; and (4) an identity of the causes of action.

*Bittinger v. Tecumseh Prods. Co.*, 123 F.3d 877, 880 (6th Cir.1997). This doctrine does not apply in this case.

First, there is no order allowing or disallowing any of the claims and so there is no final judgment on the merits with respect to any of the claims. Kismet relies on bankruptcy code § 502 to provide the functional equivalent of a final order. That section states that a proof of claim is deemed allowed unless a party in interest objects to it. 11 U.S.C. § 502(a). An allowed proof of claim in bankruptcy is treated as a final judgment for purposes of res judicata. *See Stearns Salt & Lumber Co. v. Hammond*, 217 F. 559, 564 (6th Cir. 1914) ("It is well settled that the action of a referee in bankruptcy allowing or disallowing a claim is a judgment, final in the

absence of review. . . ."). Since no party has yet objected to any of the plan participants' proofs of claim, Kismet argues that each proof of claim is allowed as filed and each proof of claim stands as a judgment.

In support, Kismet relies on *Siegel v. Federal Home Loan Mortgage Corp.*, 143 F.3d 525, 529–32 (9th Cir. 1998). The *Siegel* decision stands for the proposition that the deemed allowance of a claim under bankruptcy code § 502(a) is a final judgment giving rise to res judicata, even though there is no "actual separate order of some kind regarding the claim in question." *Id*. at 530. *See also EDP Med. Computer Sys., Inc. v. United States*, 480 F.3d 621 (2d Cir. 2007). Other courts question the soundness of that proposition. *See County Fuel Co. v. Equitable Bank Corp.*, 832 F.2d 290, 292 (4th Cir. 1987) ("[I]t is doubtful that the 'automatic allowance under 11 U.S.C. § 502(a) of a claim not objected to constitutes a 'final judgment' of the type that gives rise to 'bar' or 'claim preclusion' under strict res judicata principles."). Regardless of the merits of the *Siegel* decision, that case found that the automatic claim allowance was the equivalent of a final judgment only *after* the debtor received a discharge. *Siegel*, 143 F.3d at 531. The holding of that decision does not extend to the proofs of claim at issue here because Kismet's chapter 11 case is still pending and a plan has not been confirmed. As a result, there is no final order entered in this case that would transform the proofs of claim into final judgments.

Second, even if the proofs of claim were final judgments, those judgments would not resolve any of the critical issues raised in this adversary proceeding. A proof of claim is a procedural vehicle by which a creditor asserts a claim against the debtor or the estate; there is no provision permitting a proof of claim against an individual officer. *See* 11 U.S.C. § 501(a) – (c) (providing for the filing of a creditor's claim) and § 101(10) (defining the term "creditor" to

mean an entity that has a claim against either the debtor or the estate). The individuals filing the claims recognized this, because they do not assert that any individual officer is liable for the medical debts. Therefore, even if a judgment existed finding the proofs of claim to be valid, that judgment cannot be viewed in any fashion as a finding that Corum, Lawrence, or any other plan fiduciary is personally liable for breaching duties imposed by ERISA. Consequently, the proofs of claim do not constitute claims made against Corum and Lawrence individually for wrongful acts under the policy.

Finally, even if res judicata applied, it would not help Kismet's coverage claim. The existence of a final judgment finding that each proof of claim for medical benefits is allowed would only preclude Travelers from challenging the amount of the debt and Kismet's liability to the claimants (which Travelers does not contest in any event). It would not preclude Travelers from litigating the issue of coverage because coverage is not an issue raised in the proofs of claim. *See* 42 C.J.S. *Indemnity* § 56 (June 2007) (noting that when a judgment in an action brought against an indemnitee by a third person is conclusive in a subsequent suit by the indemnitee against the indemnitor, the judgment "binds the indemnitor as to the liabilty of the indemnitee to the former plaintiff and generally as to matters necessarily litigated and determined in such former suit; but it is not necessarily conclusive of the indemnitor's liability to the indemnitee[.]").

Alternatively, Kismet posits that it is not required to show that there is a direct claim against the officers before coverage exists. Kismet states that it has indemnified Corum and Lawrence for their wrongful acts and breaches of fiduciary duties, and Kismet's indemnification obligation to the officers is insured by the policy. This argument is not set out in great detail, but in any event the argument fails because there is no judicial finding that any officer breached a

fiduciary duty or committed a wrongful act. Kismet cannot have an obligation to indemnify the officers absent a determination that the officers are individually liable and that determination has not been, and cannot be, made in this proceeding because Corum and Lawrence are not parties to it.

## CONCLUSION

For the reasons stated, this court recommends that the district court (1) deny plaintiff Kismet's motion for summary judgment, and (2) grant defendant Travelers's motion and enter summary judgment for Travelers on counts one and two of the complaint.

Pat E. Morgenstern-Clarren
United States Bankruptcy Judge