When Two Worlds Collide: Understanding D&O Coverage in the Bankruptcy Setting

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Corporations purchase directors' and officers' liability insurance in an effort to recruit and/or retain top executives. Indeed, the fundamental purpose of D&O insurance is to protect directors and officers from personal loss for claims that are not indemnified by the corporation. Despite the fact that, at its core, a D&O policy is intended to protect a corporation's directors and officers, many D&O policies also afford coverage to the corporation itself, either in the form of reimbursement coverage for its indemnification obligations or direct coverage for its own liabilities. Increasingly, corporations are attempting to access the proceeds of D&O policies, causing the dilution or even complete depletion of policy limits, thereby leaving the directors and officers exposed to personal liability. And, in some instances, corporations are actively seeking to prevent a director or officer from obtaining coverage under D&O policies in order to preserve the proceeds for their own use.

The conflict between the corporation, on the one hand, and directors and officers, on the other hand, over policy limits is being played out in bankruptcy courts across the country wherein judges are increasingly being called upon to resolve these disputes.[1] In this forum, fundamental principles of insurance contract law and bankruptcy law collide, often leaving directors and officers wondering what happened to the D&O policy they bargained for.

Understanding how this collision occurred requires an understanding of certain Bankruptcy Code provisions that, under certain circumstances, trump the express language of a D&O policy. By way of example, Section 362 (automatic stay) and Section 541 (property of the estate) of the Bankruptcy Code bear directly on the parties' competing interests in the policy and its proceeds.[2] This article addresses the intersections between the Bankruptcy Code and a D&O policy, as well as the result of efforts to avoid the application of Bankruptcy Code provisions to a D&O policy.

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The Automatic Stay & Property of the Estate

Section 362 of the Bankruptcy Code provides, among other things, that the filing of a bankruptcy petition operates as a stay of "any act to obtain possession of property of the estate or of property from the estate or to exercise control over property of the estate."[3] The Bankruptcy Code defines property of the estate as including "all legal or equitable interests of the debtor in property as of the commencement of the estate."[4] Thus, to the extent an insurance policy or its proceeds constitute property of the estate, the automatic stay provisions of the Bankruptcy Code are implicated, prohibiting an insurer from making *any* payments—including defense expenses payments—under the policy.[5]

> *"The distinction between the policy and the proceeds of the policy is critical in understanding and evaluating a debtor's potential ability to thwart a director's or officer's access to a D&O policy."*

Courts generally agree that insurance policies that are owned by the debtor are property of the estate.[6] Courts disagree, however, as to whether the *proceeds* of those policies are also property of the estate.[7] Ownership of a policy "does not inexorably lead to ownership of the proceeds."[8] As the Bankruptcy Court in *In re Louisiana World Exposition, Inc.*, explained, "[t]he question is not who owns the policies, but who owns the liability proceeds."[9] The distinction between the policy and the proceeds of the policy is critical in understanding and evaluating a debtor's potential ability to thwart a director's or officer's access to a D&O policy. While the ownership of the proceeds is a factually intensive inquiry,[10] courts often consider whether the debtor's estate is worth more with the proceeds than without them.[11] A related consideration is whether the debtor has a legal interest in the proceeds.[12] Broadly put, proceeds of a policy do not constitute property of the estate if the debtor lacks any "direct" interest in those proceeds. Thus, the first step in this analysis is understanding the debtor's interests, if any, in the coverage afforded under a D&O policy.[13]

D&O Policies: Side A, Side B and Side C Coverages

Directors' and officers' liability policies typically contain three separate grants of coverage:

- Side A Coverage: coverage directly afforded to directors and officers for non-indemnifiable claims;
- Side B Coverage: reimbursement coverage afforded to the company for any indemnification obligations to the directors and officers; and
- Side C Coverage: direct coverage to the company for its own liabilities.[14]

Whether a debtor has an interest in the D&O policy turns, in large measure, on whether the company, i.e., the debtor in the bankruptcy proceeding, is afforded coverage under the policy.

Under a policy containing Side A only coverage, such as a Difference in Conditions Policy or Independent Directors Liability Policy, the directors and officers are the named insured(s) and the policy only provides coverage to the directors and officers (or independent directors as the case may be). Under Side A policies, a debtor has no interest—direct or indirect—in the policy's proceeds because the proceeds are *only* payable for claims made against the directors and officers. As Side A policies do not implicate any interests of the debtor, they are not property of the bankruptcy estate.[15] Accordingly, the automatic stay should not be implicated and therefore, the insurer can pay the directors and officers pursuant to the policy's terms without violating statutory provisions of the Bankruptcy Code.[16] Indeed, this is one of the primary reasons for purchasing Side A coverage.[17]

Where a D&O policy affords both Side A and Side B coverage, courts are divided as to whether the inclusion of Side B coverage renders the proceeds property of the estate. One line of cases holds that, where a debtor's indemnification obligation to the directors and officers has been established, the proceeds of the policy are available to reimburse the debtor and, therefore, property of the estate.[18] Another line of cases holds that because the proceeds are a means to satisfy the debtor's indemnity obligations to the directors and officers, there is no harm in paying the proceeds to the directors and officers; the insurer is merely satisfying the debtor's obligation to indemnify the directors and officers.[19] That said, where the debtor has *not* indemnified the directors and officers or where the debtor's indemnity obligations are speculative, courts have declined to consider the proceeds property of the estate.[20]

The proceeds of a D&O policy containing all three coverages—Side A, Side B, and Side C—are more apt to be considered property of the bankruptcy estate and, therefore, subject to the automatic stay.[21] As one court has explained, "in such situations, the debtor's entity coverage competes for proceeds with the officer and director liability portion of the insurance policy. For every dollar paid out to the officers and directors there is one less dollar of coverage protecting the debtor's estate."[22] Accordingly, any payment made on behalf of the directors and officers—either defense or indemnity—depletes the proceeds available to defend and/or indemnify the debtor for its own liabilities. More often than not, bankruptcy courts find that in these situations, the proceeds are property of the estate and subject to the automatic stay.[23] Notably, a handful of courts have gone so far as to hold that since the proceeds may be payable to the debtor, its interest not only necessitates protection of the assets from depletion, but overrides the interests of the officers and directors.[24]

Having said that, the inquiry does not—and should not—end simply because a debtor may be afforded entity coverage under a D&O policy. "[T]he mere appendage of entity coverage to this Policy by way of a rider, providing the Debtor with protection from securities claims, does not provide sufficient predicate, *per se*, to metamorphose the proceeds into

estate property."[25] Where claims have not been asserted against the debtor, any harm to the debtor by depleting or diminishing the policy limits may only be speculative.[26] In such circumstances, many courts have found that, because the debtor's need for entity coverage is speculative, the proceeds are not property of the estate. Illustrating this point in *First Central Financial Corp.*, the Bankruptcy Court explained:

> In this case, the estate is in no need of protection. During the eighteen months this bankruptcy case has been pending, there have been no claims filed against the Debtor which would implicate the narrow scope of the Policy's entity coverage. Indeed, no one has stepped forward to express any interest in suing the Debtor for a violation of securities laws. Nor has the Trustee intimated that any action against the Debtor is imminent or likely. We are skeptical that any individual or entity will ever emerge to assert such claims prior to the expiration of the discovery period in December, 1999. If entity coverage is hypothetical and fails to provide some palpable benefit to the estate, it cannot be used by a trustee to lever himself into a position of first entitlement to policy proceeds.[27]

"Where a D&O Policy contains Side C coverage, that fact alone should not render the proceeds property of the estate."

Likewise, in *Adelphia II*, the federal district court explained:

> Claiming the debtors now have a property interest in those proceeds makes no sense at this juncture. Such argument would be akin to a car owner with collision coverage claiming he has the right to proceeds from his policy simply because there is a prospective possibility that his car will collide with another tomorrow, or a living person having a death benefit policy, and claiming his beneficiaries have a property interest in the proceeds even though he remains alive. No cognizable equitable and legal interest in the proceeds from the D&O policies has arisen here.[28]

Thus, where a D&O Policy contains Side C coverage, that fact alone should not render the proceeds property of the estate. Instead, the bankruptcy court should assess the very real likelihood—not merely the speculative possibility—that a claim will be made against the debtor. Absent such a claim, the debtor has little, if any, interest in the proceeds.

When analyzing claims, or potential claims, against the debtor, the pleadings in the bankruptcy case may contain useful information. In that regard, the Bankruptcy Code and Bankruptcy Rule 3003 provide for a specific procedural mechanism to assert pre-petition claims against a debtor. A party asserting a claim[29] against a debtor must file, prior to the applicable bar date, a Proof of Claim in the debtor's bankruptcy case.[30] The failure to do so precludes any such claim against a debtor. As such, a determination as to whether the policy's Side C coverage renders the proceeds property of the estate can be influenced by the Proofs of Claim filed against the debtor.

The Debtor or Bankruptcy Trustee as Claimant

In a bankruptcy case, it is not unusual for the debtor—or a bankruptcy trustee—to assert claims for, or on behalf of, all creditors against the directors and officers. In so doing, the bankruptcy trustee becomes a claimant and, as a result, may have certain contingent beneficiary rights under the policy. In this situation, the bankruptcy trustee may attempt to block a director's and officer's access to the policy proceeds on the grounds that those very proceeds will ultimately be paid to the debtor to satisfy any resulting judgment. For example, assume that a bankruptcy trustee sues the debtor's directors and officers for mismanagement of corporate funds and breach of fiduciary duty. In the event the bankruptcy trustee's claims are successful, the value of the bankruptcy estate increases. Because the bankruptcy trustee will look to the D&O policy to satisfy any judgment against the directors and officers, any reduction in the available limits directly impacts the bankruptcy trustee's ability to satisfy the judgment. In other words, to the extent the policy's liability limits are depleted by payment of defense costs, the amount of coverage available to satisfy the judgment is correspondingly reduced on a dollar-for-dollar basis. Relying on an expansive view of property of the estate, bankruptcy trustees have argued that, because the proceeds are necessary to satisfy a judgment, the proceeds constitute property of the estate.

Courts have split on this issue. Some bankruptcy courts have found that where the depletion of policy proceeds will impact a bankruptcy trustee's ability to collect a judgment, the proceeds constitute property of the estate.[31] Other bankruptcy courts have correctly rejected this principle on the grounds that the bankruptcy trustee is merely a claimant and, as such, is the equivalent of any third-party plaintiff suing a defendant covered by a policy whose limits are impaired by the payment of defense costs.[32] Indeed, the interest that a bankruptcy trustee has in the policy's proceeds is the interest that any third-party plaintiff has in the proceeds of an insurance

policy that affords coverage for the defendant. It is simply not enough that the proceeds affect the value of the bankruptcy assets. Rather, the test is whether the proceeds protect the estate's other assets from being diminished. If the bankruptcy trustee's argument were to prevail, then, based on that reasoning, any liability policy that covers a defendant sued by the bankruptcy trustee would be transformed into property of the estate. The Bankruptcy Code is simply not that expansive; the proceeds must be available to satisfy claims made *against* the debtor.

Additionally, at least one bankruptcy court has rejected a bankruptcy trustee's efforts to preclude a director or officer from obtaining policy proceeds to defend against the bankruptcy trustee's claims on the grounds that the bankruptcy trustee, by asserting claims against the directors and officers, should have been fully aware that defense expenses would deplete the available proceeds to satisfy a judgment.[33]

> The bottom line is that the Trustee seeks to protect the amount he may receive in his suit against the directors and officers while limiting coverage for the defense costs of the directors and officers. This is not what the directors and officers bargained for. In bringing the action against the directors and officers, the Trustee knew that the proceeds could be depleted by legal fees and he took that chance. The law does not support the Trustee's request to regulate defense costs.[34]

Relief from the Automatic Stay

Assuming that the proceeds are deemed property of the estate and subject to the automatic stay, directors and officers may decide to seek relief from the stay in order to authorize payments by the D&O insurer. Section 326(d)(1) of the Bankruptcy Code provides that the court shall grant relief from the automatic stay "for cause."[35] The party seeking relief from the automatic stay bears the burden of proof.[36] In determining whether cause exists to grant relief from the automatic stay, bankruptcy courts examine the terms and conditions of the policy at issue, as well as balance the relative harm to both the debtor and the directors and officers.

First, with respect to the terms and conditions of the policy, many D&O policies contain a "priority of payments" (sometimes referred to as an "order of payments") provision which expressly provides that directors and officers have priority over the company—or in the bankruptcy context, the debtor—in receiving the proceeds of the policy. By way of example, D&O policies may include the following provision:

> it is understood and agreed that if Loss, including Defense Expenses, shall be payable under more than one of the Insuring Agreements, then the Insurer shall, to the maximum extent practicable and subject at all times to the Insurer's maximum aggregate Limit of Liability as set forth in ITEM 3 of the Declarations, pay such Loss as follows:
>
> (1) first, the Insurer shall pay that Loss, if any, which the Insurer may be liable to pay on behalf of the Insured Persons under Insuring Agreement (A);
>
> (2) second, the Insurer shall pay that Loss, if any, which the Insurer may be liable to pay on behalf of the Company under Insuring Agreement (B) and
>
> (3) third, the Insurer shall make such other payments which the Insurer may be liable to make under Insuring Agreement (C) or otherwise.

The intended effect of such language is to subordinate the debtor's interests in the policy to those of the directors and officers. As a result, there are questions as to whether such pre-petition policy language is enforceable in the bankruptcy context.

To date, only a handful of bankruptcy courts have analyzed priority of payments provisions. Those decisions are, for the most part, contained in hearing transcripts, as opposed to published decisions. By way of example, at an April 11, 2002 hearing in the Enron bankruptcy case pending in the Bankruptcy Court for the Southern District of New York, Judge Gonzalez stated that

> the parties are bound by the contractual provisions of the [directors and officers'] policy. The Debtors' interest in the policy is limited by its contractual provisions including a priority advancement and payment obligations contained in those policies. The Court cannot rewrite the provisions of the contract.[37]

Likewise, at a May 8, 2001 hearing in the Lernout & Hauspie Speech Products bankruptcy case pending in Bankruptcy Court for the District of Delaware, Judge Wizmur stated

> I am convinced that [the insurer's argument] that the directors and officers have an independent right to assert their present interest in the proceeds on the face of the policy must be recognized, and that [the insurer] is under a contractual obligation to act in conformance with that contract . . . that the outcome of that action will be to reduce the pool available to [the debtor] is understood, is inevitable, is the reality of this kind of coverage, and cannot bar the relief that is requested.[38]

In *Adelphia I*, the bankruptcy court expressly noted that the D&O policy at issue did not have "what is sometimes referred to as a 'priority of payments'

endorsement, providing in substance that payments on account of the defense costs of directors and officers come ahead of payments for indemnification coverage and/or entity coverage."[39] Thus, while not at issue in *Adelphia I*, the bankruptcy court implicitly recognized the importance of the provision.

> ***"The Bankruptcy Code should not be used as a tool to rewrite contractual provisions that subsequently become unfavorable to the company in the bankruptcy setting."***

As Judge Gonzalez noted in Enron, a bankruptcy court should not rewrite the parties' contract. The extent of the debtor's interest in property is determined under the applicable state law. While federal law—such as the Bankruptcy Code—defines what property comprises the debtor's estate, state law determines the existence, if any, and the scope of the debtor's rights in that property.[40] Thus, if state law does not recognize a debtor's interest or rights, then the estate acquires no additional rights, i.e., the contract is not rewritten. Applying this principle here, the Bankruptcy Code should not be used as a tool to rewrite contractual provisions that subsequently become unfavorable to the company in the bankruptcy setting.

Nonetheless, the Supreme Court has held that where there is an overriding federal principle of law, the application of that principle may result in the unenforceability of contractual provisions.[41] While Judge Gonzales and others have enforced the priority of payments provisions, other judges could determine that such provisions are contrary to principles of federal law found in the Bankruptcy Code, rendering these provisions unenforceable. Thus, applying a federal principle of law, bankruptcy courts could simply choose to ignore state-law governed priority of payments provisions.

Moreover, in a recent case, a debtor sought to avoid the priority of payments provision by settling with the insurer. In *In re Suprema Specialties*, a trustee and insurers were alleged to have entered into a collusive settlement to circumvent the D&O policy's priority of payments provision.[42] More specifically, pursuant to the terms of the settlement agreement, two insurers rescinded their policies, which contained combined limits of $25 million, in exchange for a payment to the bankruptcy trustee of approximately $14 million. The directors and officers objected to the settlement on the grounds that it eviscerated their D&O insurance coverage. The bankruptcy court rejected the directors and officers' argument and approved the settlement. On appeal, the directors and officers argued that the rescission of the policies in exchange for a payment by the insurers nullified the priority of payments language.[43] While the appeal in the *Suprema Specialties* case was subsequently dismissed, this decision is illustrative of a debtor's attempt to scuttle the priority of payments provision.[44]

Second, many D&O policies contain certain bankruptcy-related provisions that are designed to address (or avoid) the automatic stay requirements. By way of example, a D&O policy may include language providing:

> Bankruptcy or insolvency of any Organization or any Insured Person shall not relieve the Insurer of any of its obligations hereunder.
>
> It is further understood and agreed that the coverage provided under this policy is intended to protect and benefit the Insured Persons. Further, if a liquidation or reorganization proceeding is commenced by the Named Entity and/or any other Organization (whether voluntarily of involuntarily) under Title 11 of the United States Code (as amended), or any similar state, local or foreign law (collectively "Bankruptcy Law") then, in regard to a covered claim under this policy, the Insureds hereby:
>
> (a) waive and release any automatic stay or injunction to the extent it may apply in such proceeding to the proceeds of this policy under such Bankruptcy Law; and
>
> (b) agree not to oppose or object to any efforts by the Insurer or any Insured to obtain relief from any stay or injunction applicable to the proceeds of this policy as a result of the commencement of such liquidation or reorganization proceeding.

Broadly put, bankruptcy courts are highly skeptical of pre-petition agreements waiving bankruptcy rights resulting in a split of authority as to whether such pre-petition waivers are enforceable.[45] While the rationale for rejecting these pre-petition waivers varies, the factor most commonly discussed relates to a party's inability to waive a bankruptcy right prior to the filing of a bankruptcy petition. In this regard, the emerging trend is that such provisions are *per se* unenforceable.[46] In certain discrete circumstances, such as in a pre-bankruptcy work out scenario, a borrower may waive its rights to contest a motion for relief. In this specific circumstance, a bankruptcy court may consider this as one of many factors that it will consider in determining whether cause exists for relief from the stay.[47] In the insurance context, however, it is unlikely that a bankruptcy court will consider the pre-petition waiver in determining whether relief from the stay should be granted. The reasoning is that, notwithstanding the policy language, the automatic stay provisions of the Bankruptcy Code override contractual language to the contrary.

Separate and apart from whether the pre-petition waiver provision is enforceable against the debtor, the provision does not prohibit a creditors' committee, equity committee, or other party with standing from contesting a motion for relief from stay. By way of example, it is not uncommon for a creditors' committee to object to motions for relief from the automatic stay to permit the insurer to make certain defense payments under a D&O policy. In these circumstances, waiver provisions afford little, if any, protection to the debtor, directors and officers, or the insurer.

Showing "Cause" and Related Issues

Even where the debtor has an interest in the proceeds, upon a showing of good cause, bankruptcy courts will generally grant relief from the automatic stay to allow for payments of defense and/or settlement costs to directors and officers.[48] Often, the "cause" shown is the harm the directors and officers would suffer absent the insurer's payment of defense expenses. However, while bankruptcy courts have been willing to lift the automatic stay to allow such payments, the payments can be limited and based on a comparison of the policy limits to the amount of defense expenses sought. For example, in *In re Boston Regional*, the court authorized the payment of expert costs not to exceed $600,000 of a $20 million policy limit.[49] Similarly, in *Adelphia I*, the court authorized $300,000 per insured under policies with an aggregate limit of $50 million.[50]

Related to this issue, where relief from the automatic stay was granted, certain bankruptcy courts have found that the payment of defense expenses may be subject to Federal Rule of Bankruptcy Procedure 2016 which provides:[51]

> Any entity seeking interim or final compensation for services, or reimbursement of necessary expenses, from the estate shall file an application setting forth a detailed statement of (1) the services rendered, time expended and expenses incurred, and (2) the amounts requested . . . . The requirements of this subdivision shall apply to an application for compensation for services rendered by an attorney or accountant even though the application is filed by a creditor or other entity . . . .

This Rule requires counsel to submit their invoices to the court for a "reasonableness" evaluation. Where counsel is being paid out of the estate assets, a motion must be filed seeking approval of the reasonableness of the payment. Thus, when payment of defense expenses reduces the policy's proceeds—property of the estate—a bankruptcy court must approve the payment as reasonable. Significantly, this permits *anyone*, including the bankruptcy trustee or creditors' committee, to review and examine defense counsel's invoices. To avoid this result, defense counsel should consider seeking relief to submit the invoices for an *in camera* review. At least one bankruptcy court has found, however, that this review is preliminary and that, at the conclusion of the case, a party may have unfettered access to the invoices and challenge the reasonableness of those invoices.[52]

Conclusion

While entity coverage may be included in a company's D&O insurance program, D&O policies are primarily intended to protect the directors and officers from personal loss. This serves the company's goal of recruiting and retaining top-notch directors and officers. As the *Adelphia I* court noted, "if directors and officers are to serve, they need to have comfort in knowing that bankruptcy courts will be slow in depriving them of contractual rights under the D&O policies upon which they may have relied in agreeing to serve."[53] In the bankruptcy context, however, expansive definitions of "property of the estate" and expansive protections of a debtor can have a profound effect on the coverage that the directors and officers bargained for. While a company in good financial health does not expect to file for bankruptcy, the impact such a filing may have upon the coverage afforded to that company's directors and officers can not—and should not—be underestimated. Directors and officers should, thus, prepare for the unexpected both in terms of negotiating for unequivocal language reflecting the intent of the policy and strong indemnification agreements. Likewise, when underwriting a risk, D&O insurers do not expect that the company will file for bankruptcy. To avoid being caught in an untenable position between the debtor and the directors and officers, D&O insurers should also be mindful of the Bankruptcy Code's impact upon the policies and consider crafting language or, even separate liability limits, to address bankruptcy considerations. By doing so, the policy is more likely to reflect the true intent of insureds and insurers while simultaneously avoiding the harsh result that can result from a court's application of the Bankruptcy Code.

[1] *See, e.g.*, *In re* Adelphia Commc'ns Corp. v. Assoc. Elec. & Gas Ins. Serv., Ltd. ("*In re* Adelphia Commc'ns Corp."), 285 B.R. 580, 596 (Bankr. S.D.N.Y. 2002) ("Adelphia I"), *vacated by In re* Adelphia Commc'ns Corp., 298 B.R. 49 (Bankr. S.D.N.Y. 2003) ("Adelphia II").

[2] 11 U.S.C. §§ 362, 541.

[3] 11 U.S.C. § 362.

[4] 11 U.S.C. § 541(a)(1).

[5] 11 U.S.C. § 362(a)(3). This places the insurer in the untenable situation of being caught between the debtor (who is seeking to prevent depletion of the policy) and the directors and officers (who are seeking to obtain the coverage that they bargained for). In the event an insurer makes such payments, regardless of whether the payments were properly made under the policy and/or benefited the directors and officers, in the absence of relief from the automatic stay, *see* discussion *infra*, such payments violate the automatic stay and could be found to be voluntary, without any concomitant reduction in policy limits.

[6] *See, e.g.*, La. World Exposition, Inc. v. Fed. Ins. Co. ("*In re* La. World Exposition"), 832 F.2d 1391, 1399 (5th Cir. 1987); A.H. Robins Co., Inc. v. Piccinin ("In re A.H. Robins"), 788 F.2d 994, 1001 (4th Cir. 1986); *In re* CyberMedica, Inc., 280 B.R. 12, 16 (Bankr. D. Mass. 2002); Ochs v. Lipson (*In re* First Cent. Fin. Corp.), 238 B.R. 9, 16 (Bankr. E.D.N.Y. 1999), *aff'd in unreported opinion*, No 99-CV-6730 (TCP), 2000 U.S. Dist. LEXIS 22005 (E.D.N.Y. March 2, 2000).

[7] *In re* Medex Reg'l Laboratories, LLC, 314 B.R. 716, 720 (Bankr. E.D. Tenn. 2004) ("Although the courts readily agree that directors' and officers' insurance policies themselves are property of a debtor's estate, there is more discord regarding the question of whether proceeds of such policies constitute estate property.").

[8] *In re* La. World Exposition, 832 F.2d at 1401.

[9] *In re* La. World Exposition, 832 F.2d at 1399.

[10] *In re* CyberMedica, Inc., 280 B.R. at 16; ("Whether the proceeds of a D & O liability insurance policy are property of the estate must be analyzed in light of the facts of each case."); *In re* First Cent. Fin. Corp., 238 B.R. at 21 (court concluding policy proceeds were not estate property but noting that it might reach a different result given different facts).

[11] *In re* Arter & Hadden, L.L.P., 335 B.R. 666, 671 (Bankr. N.D. Ohio 2005). Another factor that some courts consider is whether the debtor will receive the proceeds as payment of its own claim against the directors or officers. As discussed *infra*, this reasoning is unsound. *In re* Allied Digital Technologies Corp., 306 B.R. 505, 513–514 (Bankr. D. Del. 2004) (where trustee sought to protect the amount he might receive against directors and officers in adversary proceeding by limiting their coverage for defense costs, court held that trustee was no different from any third-party plaintiff and allowed directors and officers access to the policy proceeds).

[12] *See, e.g.*, Houston v. Edgeworth, ("*In re* Edgeworth"), 993 F.2d 51, 56 (5th Cir. 1993) ("when the debtor has no legally cognizable claim to the insurance proceeds, those proceeds are not property of the estate.").

[13] *See In re* Allied Digital Technologies Corp., 306 B.R. at 509–510 (citing *In re* Minoco Group of Cos., Ltd., 799 F.2d 517, 519 (9th Cir. 1986)).

[14] The Side C coverage can take a variety of forms from full entity coverage to limited entity coverage for securities claims only.

[15] *In re* La. World Exposition, 832 F.2d at 1400–1401 (holding that, where the policy's proceeds were not payable to anyone but the directors and officers, the proceeds were not property of the estate).

[16] *See generally In re* Allied Digital Technologies Corp., 306 B.R. at 513 (concluding that proceeds were not part of estate and that the D&O insurer was authorized to advance defense costs to the individual defendants in accordance with the terms of the policy). Additionally, although beyond the scope of this article, if the policy is not property of the estate, the bankruptcy court may lack subject matter jurisdiction to make any substantive rulings relating to it. Jurisdiction of the bankruptcy court is grounded in and limited by statute. Section 1334(b) provides that "the district courts shall have original but not exclusive jurisdiction of all civil proceedings arising under title 11, or arising in or related to cases under title 11." 28 U.S.C. § 1334(b). The bankruptcy court's jurisdiction is derivative of, and solely dependent upon, these three bases. To the extent the proceeds of the policy are not property of the estate, a bankruptcy court lacks jurisdiction over any coverage disputes arising under policy.

[17] Nevertheless, the Ninth Circuit Court of Appeals found, as a general proposition, that a D&O policy was property of the estate because, among other reasons, it was a means to attract and retain competent directors and officers. *See In re* Minoco Group of Cos., Ltd., 799 F.2d at 518. The *Minoco* court did not, however, expressly consider a Side A or DIC policy and thus the case is distinguishable.

[18] *See, e.g.*, Aetna Cas. & Surety Co. v. Jasmine, Ltd. (In the Matter of Jasmine, Ltd.), 258 B.R. 119, 128 (D.N.J. 2000) (debtor's indemnification duty "was established and not merely speculative," thereby entitling debtor to the proceeds and making them property of the estate); *In re* Minoco Group of Cos., Ltd., 799 F.2d at 518 (finding that the policies were property of the estate because they insured the debtor against indemnity claims); Circle K Corp. v. Marks (*In re* Circle K Corp.), 121 B.R. 257, 261 (Bankr. D. Ariz. 1990) (finding that, because the D&O policies provided indemnification coverage, the proceeds were property of the bankruptcy estate).

[19] *In re* La. World Exposition, 832 F.2d at 1400 ("any payment under the liability coverage reduces the amount of the potential indemnification claim to the same extent that policy amounts available for indemnification are thus reduced."); *In re CHS Electronics, Inc.*, 261 B.R. 538, 542 (Bankr. S.D. Fla. 2001) (holding that, because the indemnification coverage was payable only for the benefit of the directors and officers, the proceeds were not property of the estate); *In re* Imperial Corp. of America, 144 B.R. 115, 118–119 (Bankr. S.D. Cal. 1992) (although policy provided indemnification coverage, relying on *La. World Exposition*, the proceeds were not estate property).

[20] *See, e.g.*, Youngstown Osteopathic Hosp. Ass'n v. Ventresco ("*In re* Youngstown Osteopathic Hosp. Ass'n"), 271 B.R. 544, 550 (Bankr. N.D. Ohio 2002) (although policy provided indemnification coverage to debtor in addition to coverage to the directors and officers, where debtor was not required to indemnify the directors and officers and, therefore, was not entitled to reimbursement under the policy, the proceeds were not property of the estate); *In re* Adelphia Commc'ns Corp., 302 B.R. 439, 448 (Bankr. S.D.N.Y.

2003) ("Adelphia III") (on remand, holding that D&O policy proceeds were not part of the bankruptcy estate because, although had indemnification coverage, there was no evidence that the debtors had made any payments for which they would be entitled such coverage, that any such payments were contemplated, or that debtors had committed themselves to make any payments using this coverage).

[21] *See In re* Sacred Heart Hosp. of Norristown, 182 B.R. 413, 419–420 (Bankr. E.D. Pa. 1995) (where the D&O insurance policy provided direct coverage and indemnification coverage to the debtor, court held that debtor was an insured under the policy that had sufficient interest in proceeds as a whole to bring such proceeds into the bankruptcy estate); *In re* Allied Digital Technologies Corp., 306 B.R. at 512 (if the insurance policy provides direct coverage to the debtor, the proceeds will be property of the estate; and if there is coverage for both the directors and officers and the debtor, the proceeds will be property of the estate "if depletion of the proceeds would have an adverse effect on the estate to the extent the policy actually protects the estate's other assets from diminution").

[22] *In re* First Central Fin. Corp., 238 B.R. at 17.

[23] *In re* First Central Fin. Corp., 238 B.R. at 17; *see also In re* Arter & Hadden, L.L.P., 335 B.R. at 672 (where any direct claim against the debtor would compete for coverage under the policy limits, proceeds were part of the bankruptcy estate).

[24] *In re* Arter & Hadden, L.L.P., 335 B.R. at 672 ("a debtor's interest in the proceeds requires protection from depletion and overrides the interest of the directors and officers") (quoting *In re* Allied Digital Technologies Corp., 306 B.R. at 511).

[25] *In re* Arter & Hadden, L.L.P., 335 B.R. at 672 (quoting *In re* First Cent. Fin. Corp., 238 B.R. at 18 n.11).

[26] *In re* CHS Electronics, Inc., 261 B.R. 538 (Bankr. S.D. Fla. 2001) (granting relief from automatic stay where there is no evidence that direct coverage for the debtor will be necessary); *In re* First Cent. Fin. Corp., 238 B.R. at 18 (holding that, where the estate was not in need of entity coverage, the proceeds were not property of the estate).

[27] *In re* First Central Fin. Corp., 238 B.R. at 17–18 (endnote omitted).

[28] *In re* Adelphia II, 298 B.R. at 53.

[29] The term "claim" is defined as a "right to payment, whether or not such right is reduced to judgment, liquidated, fixed, contingent, matured, unmatured, disputed, undisputed, legal, equitable, secured or unsecured." 11 U.S.C. § 101(4).

[30] Unless the debtor has listed that claim on its schedules as not disputed, contingent or unliquidated.

[31] *In re* Edgeworth, 993 F.2d at 56 ("Proceeds of [the] insurance policies, if made payable to the debtor rather than a third party such as a creditor, are property of the estate and may inure to all bankruptcy creditors."); *In re* Metro. Mortg. & Sec. Co., Inc., 325 B.R. 851 (Bankr. E.D. Wash. 2005) (same). This issue has also arisen in the contest of jurisdictional disputes where a debtor (or bankruptcy trustee) asserts that, because the policy's proceeds will satisfy its claims against the directors and officers, the bankruptcy court has subject matter jurisdiction over coverage disputes under that policy. The jurisdictional hook used by the debtor or bankruptcy trustee is "property of the estate."

[32] *See In re* Allied Digital Technologies Corp., 306 B.R. at 513.

[33] *See In re* Allied Digital Technologies Corp., 306 B.R. at 513.

[34] *In re* Allied Digital Technologies Corp., 306 B.R. at 513.

[35] 11 U.S.C. § 362(d)(1). Notably, however, the Bankruptcy Code does not define "cause." The scope of "cause" is determined on a case-by-case basis and has been the subject of significant motion practice.

[36] *In re* Arter & Hadden, L.L.P., 335 B.R. at 674.

[37] April 11, 2002 Ruling in reference to: One, the schedules; two, exclusivity; and three, the D&O insurance issue, at 14, *In re* Enron Corp., No. 01-16034 (Bankr. S.D.N.Y. 2002).

[38] May 8, 2001 Transcript of Proceedings, at 48–49, *In re* Lernout & Hauspie Speech Prods., No. 00-4397 (JHW) through 00-4399 (JHW) (Bankr. D. Del. 2001).

[39] *Adelphia I*, 285 B.R. at 586–587.

[40] Butner v. United States, 440 U.S. 48 (1979) ("Unless some federal interest requires a different result, there is no reason why such interests should be analyzed differently simply because an interested party is involved in a bankruptcy proceeding. Uniform treatment of property interests by both state and federal courts within a State serves to reduce uncertainty, to discourage forum shopping, and to prevent a party from receiving a 'windfall merely by reason of the happenstance of bankruptcy.' ") (quoting Lewis v. Manufacturers Nat'l Bank, 364 U.S. 603, 609 (1961)); La. World Exposition v. Fed. Ins. Co., 858 F.2d 233, 252 (5th Cir. 1988).

[41] Central Jersey Freightliner, Inc. v. Freightliner Corp., 987 F. Supp. 289, 299–300 (D.N.J. 1997) (citing Perry v. Thomas, 482 U.S. 483, 490 (1987)).

[42] *In re* Suprema Specialties, Inc., No. 05 Civ. 208 (TPG), 2005 U.S. Dist. LEXIS 18550 (S.D.N.Y. 2005).

[43] *In re* Suprema Specialties, Inc., 2005 U.S. Dist. LEXIS 18550, at *8.

[44] This has also occurred in other cases. An instructive discussion on two recent decisions where the debtor tried to circumvent or cut-off a director's and officer's rights under a D&O policy by settling certain claims can be found in an article authored by Dan Bleck and Scott Moskol, see *supra* at n.1. Dan Bleck and Scott Moskol, *Post-Confirmation Settlement Agreements: The Implications on Insurance Proceeds*, The Insurance Coverage Law Bulletin, June 2007, at 3.

[45] *Compare In re* Virginia Frye, 320 B.R. 786 (Bankr. D. Vt. 2005); *In re* Excelsior Henderson Motorcycle Mfg. Co., 273 B.R. 920 (Bankr. S.D. Fla. 2002); *In re* Shady Grove Tech Center Assoc. Ltd. Partnership, 216 B.R. 386 (Bankr. D. Md. 1998); *with* Southwest Georgia Bank v. Desai ("*In re* Desai"), 282 B.R. 527 (Bankr. M.D. Ga. 2002); *In re* Deb-Lyn, Inc., No. 03-00655-GVL1, 2004 Bankr. LEXIS 200 (Bankr. N.D.Fla. Feb. 20, 2004).

[46] The Bankruptcy Code also prohibits contract termination or modification merely because of a bankruptcy filing or a debtor's insolvency. 11 U.S.C. § 365(e)(1). These provisions are commonly referred to as "*ipso facto*" clauses. Recently, insurers have included, within the D&O policy's definition of Change of Control, the filing of a bankruptcy petition. Although outside the scope of this article, there is a significant issue as to whether such provisions are enforceable. Moreover, to the extent that an insurer exercises its Change of Control rights under the policy, absent court approval, this action could likely be in violation of the automatic stay.

[47] *In re* Shady Grove Tech Center Assoc. Ltd. Partnership, 216 B.R. at 390.

[48] *See, e.g., In re* Arter & Hadden, L.L.P., 335 B.R. at 674 (court found cause to lift the automatic stay even though proceeds were part of estate because the Executive and Management Committee members could suffer substantial and irreparable harm if prevented from exercising their rights to defense payments to fund their defense against trustee's complaint, but subjecting payment to court's approval); *In re* CyberMedica, Inc., 280 B.R. at 19 (granting directors' and officers' motion for stay relief for payment of defense expenses to avoid irreparable harm); *In re* Allied Digital Technologies Corp., 306 B.R. at 513 (concluding that proceeds were not part of estate but stating that, even if they were, cause existed for stay relief and the D&O insurer was authorized to advance defense costs to the individual defendants in accordance with the terms of the policy); *In re* Reliance Group Holdings, Inc. Sec Litig., No. 00-CV-4653 (TPG), 2004 US. Dist. LEXIS 7666, at *12, 13 (S.D.N.Y April 30, 2004) (although motions presented did not require court to rule on whether or not the policies and proceeds were assets of the estate, court permitted parties to proceed based upon their joint assertion that the proceeds were to be distributed on a first-come, first-served basis).

[49] Executive Risk Indem. Inc. v. Boston Reg'l Med. Ctr., Inc. ("*In re* Boston Reg'l"), 285 B.R. 87 (Bankr. D. Mass. 2002).

[50] *Adelphia I*, 285 B.R. at 600. While *Adelphia I* was vacated on other grounds, this decision is illustrative of a bankruptcy court's limitation of defense expenses payments.

[51] *In re* Arter & Hadden, L.L.P., 335 BR. at 674.

[52] *In Re* Jon F. Conant, No. 04-18542 (Bankr. D. Mass. Mar. 16, 2005) (order granting relief from stay motion).

[53] *Adelphia I*, 285 B.R. at 598.