

Bankruptcy Court Authorizes Interim Payment of Limited Expert Costs to Directors and Officers

November/December 2002

A Massachusetts bankruptcy court has denied an insurer's summary judgment motion, which sought assurance that it was not prohibited from paying the defense costs of the former officers and directors of a debtor in the process of liquidating, but granted its motion for leave to make an interim payment of expert costs to the officers and directors under their D&O policy. *In re Boston Regional Medical Center, Inc.*, No. 99-10860, 2002 Bankr. LEXIS 866 (Bankr. D. Mass. April 2, 2002).

A medical center filed for bankruptcy under chapter 11. Subsequently, the bankruptcy court confirmed a Joint Liquidating Plan of Reorganization pursuant to which all property of the bankruptcy estate was reverted in the debtor and was to be liquidated for benefit of the creditors. As part of the liquidation, the unsecured creditors sued some of the medical center's officers, directors and trustees for acts they committed in their official capacities. In defending those suits, the officers, directors and trustees incurred defense costs that they contended were covered by a D&O policy with a policy limit of \$20 million. The insurer was willing to provide coverage, and brought this adversary proceeding, seeking a declaration from the court that by providing coverage, "it would not be violating (a) a property interest of the [d]ebtor in the proceeds and (b) injunctions (contained in the [reorganization] plan and in the order confirming it), including the automatic stay."

The medical center argued that the aggregate claims for coverage exceeded the policy limit and, thus, payment of the officers' and directors' defense costs could potentially deplete the medical center's property interests by reducing the amount available to pay potential claims for indemnification. The insurer contended that the debtor has no interest in the proceeds because the defense costs that the insurer sought to pay were among the claims for which the officers and directors would seek indemnification coverage. Thus, according to the insurer, payment of those costs directly to the officers and directors would reduce the debtor's indemnification obligations. The court disagreed with the insurer, reasoning that the medical center might ultimately not be found liable to indemnify the directors and officers for that money paid by in the insurer, in which case payment by the insurers from a limited pool of money would be to the center's detriment.

In addition to seeking summary judgment, the insurer also moved for an order authorizing it to pay between \$500,000 and \$600,000 for officers' and defendants' expert costs in the underlying action. The officers and directors claimed that an advancement of the proceeds was immediately needed to secure the services of the experts in time to meet discovery deadlines in the underlying action. The medical center opposed the action, arguing again that the disbursement of the proceeds would diminish the amount of the proceeds available to it.

The court decided to evaluate the motion using the standards for a preliminary injunction, and held that the "proposed payments for expert costs may be made without (apparently) violating" the automatic stay or the injunctions and the order under the reorganization plan. The court first noted that the insurer would be likely to prevail in defending its payments because the "[c]ourt is likely to hold that, upon distribution to the proceeds up to the policy limit, [the insurer] would have no further obligation to any insured, regardless of whether the proceeds have been equitably distributed among the various insureds." It then reasoned that neither the automatic stay nor the plan injunction precluded the payment of the proceeds. The "automatic stay enjoins acts against 'property of the estate,' but here the property at issue-[the debtor's] right as an insured to a *pro rata* share of the policy proceeds-has been revested by the plan in the debtor and no longer belongs to the bankruptcy estate." Finally, the court noted that because the officers and directors needed the insurance proceeds to procure the services of experts for an effective defense in the underlying action, irreparable harm to the officers and directors from their failure to secure expert testimony outweighed the harm to the debtor from the minimal reduction of the insurance proceeds. In weighing the relative irreparable harm, the court pointed to the small amount of money being paid relative to the size of the policy limits.

The court limited its holding, however, stating that "[a]lthough the [c]ourt has determined that [the insurer] is likely to prevail on those issues, [it] cannot provide final assurance that the payment (1) may be applied in full to the policy limit and (2) will not give rise to a claim in favor of [the debtor] for breach of obligations under the policy...[since] the [c]ourt cannot provide final assurance on an interim motion, before full consideration of the evidence and the law." Thus, the court noted that it "will not 'authorize' the payment in this sense but will grant [the insurer the] leave to make the payment."

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