

D&O Policy Proceeds Not Property of Estate; Shareholder Suit Related to Bankruptcy Action Preliminarily Enjoined under Section 105(a)

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A bankruptcy court has held that D&O policy proceeds are not property of a bankruptcy estate, and that the automatic stay therefore did not bar the continued litigation of a shareholders suit pending in district court that implicated a debtor's D&O policies. The bankruptcy court did, however, stay the litigation pursuant to Section 105(a) of the Bankruptcy Code because the trustee was pursuing an action against the same defendants that could implicate the same insurance policies. *See Maxwell v. Megliola, et al. (In re marchFIRST)*, No. B 2472, 02 A 00589, 2002 WL 31957768 (N.D. Ill. Bankr. Dec. 16, 2002).

The debtors were a group of affiliated companies that were in chapter 7 bankruptcy. The debtors had a \$50 million D&O liability program that included entity coverage. Prior to the debtors' bankruptcy, shareholders filed a class action against the debtors and their directors and officers, alleging violations of federal securities laws. Subsequently, the bankruptcy trustee filed an adversary proceeding against the directors and officers, alleging breaches of state law fiduciary duties owed to the debtors and their creditors. Both suits potentially implicated the debtors' D&O policies. After filing against the directors and officers, the bankruptcy trustee initiated an adversary proceeding against the shareholders, seeking to enjoin them from pursuing their litigation.

Reasoning that Section 362 of the Bankruptcy Code applies only to property of the estate, the court rejected the trustee's argument that the shareholders suit should be stayed because it violated the automatic stay under Section 362(a)(3). The court held that, while "[t]here is no question that the policies themselves are estate property," the proceeds of the policies are not property of the estate. The court reasoned:

When an insurer pays for the defense of an action against the directors and officers, it does so with a reservation of its rights. No one has a property interest in the proceeds of the insurance policies unless and until there is a judgment requiring that the insurers issue payment. Any property interest in the proceeds has not yet matured and may never mature.

The court did, however, preliminarily enjoin the shareholders suit, relying on Section 105(a) of the Bankruptcy Code, which provides that the "court may issue any order, process, or judgment that is necessary or appropriate to carry out the provisions of this title." The court relied on the decision in *Fisher v. Apostolou*, 155 F.3d 876, 882 (7th Cir. 1998), in which the 7th Circuit held that "in limited circumstances, the trustee may temporarily block adjudication of claims that are not property of the estate by petitioning the bankruptcy court to enjoin the other litigation, if it is sufficiently 'related to' [] her own work on behalf of the estate." The bankruptcy court reasoned that the suit between the shareholders and the directors and officers was sufficiently related to the trustee's administration of the estate because the shareholders suit could potentially reduce the amount of D&O insurance proceeds that the trustee would be able to recover in his adversary proceeding against the directors and officers. The court therefore preliminarily enjoined the shareholders from pursuing their action, with the exception of discovery, until the trustee had completed his adversary proceeding, at which point the shareholders would be permitted to proceed with their district court action.

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