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"THE EFFECTS OF BANKRUPTCY ON DIRECTORS' AND OFFICERS' INSURANCE"

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INTRODUCTION

The number of companies facing financial collapse has been on the rise recently. According to a March 8, 2002, Wall Street Journal article at C14, "PricewaterhouseCoopers has forecast that about 200 public companies will seek Chapter 11 bankruptcy protection this year, off only slightly from the record level of business failures of 2001." In 2001 257 public companies with $256 billion in assets sought bankruptcy protection, up 46% from 2000, and more than twice as many as at the peak of the previous recession, 125 in 1991, according to BankruptcyData.com, a tracking service.

This article raises a number of questions relating to the effects of bankruptcy on directors' and officers' ("D&O") insurance coverage and offers insight with regard to such issues. One of the first questions asked when learning a corporate client, defendant or potential defendant has filed for bankruptcy is – what type of insurance coverage is involved? Is it entity coverage, D&O liability coverage, or both? Does the corporation have the obligation to indemnify its directors and officers?

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Second, are the insurance proceeds an asset of the bankruptcy estate and therefore subject to the automatic stay provision under 11 U.S.C. § 362? Can the D&O insurance proceeds be used to pay the defense costs of the directors and officers sued in a derivative action or securities class action? Can the D&O insurance proceeds be used to fund a settlement of a securities fraud class action pending against the debtor corporation's officers and directors?

Finally, what are the pitfalls for (i) shareholder plaintiffs when suing a bankrupt company or its officers and directors; and (ii) director and officer defendants in derivative or securities fraud actions?

I. WHAT IS THE NATURE OF THE INSURANCE COVERAGE?

Most standard D&O policies offer two types of insurance coverage. The first type provides liability coverage directly to the officers and directors of a corporation for claims asserted against them for wrongful acts, errors, omissions, or breaches of duty. In re First Central Financial Corp., 238 B.R. 9, 13 (Bankr. E.D.N.Y. 1999). Frequently, legal expenses are included in this coverage, with defense costs often paid on an ongoing basis. Id. at 13. "Unlike an ordinary liability insurance policy, in which a corporate purchaser obtains primary protection from lawsuits, a corporation does not enjoy direct coverage under a D&O policy." Id. at 16.

The second type of coverage, indemnity coverage, provides indirect coverage to the corporation for reimbursement of any monies expended to indemnify the corporation's officers and directors either by operation of state law or under the corporate bylaws. Id. at 13-14.

Although not standard in most D&O policies, there may also be a third clause or endorsement to the policy, "entity coverage," which insures the corporation in the event the corporation is sued.

II. ARE THE PROCEEDS OF D&O INSURANCE POLICIES PROPERTY OF THE BANKRUPTCY ESTATE?

A majority of the courts that have addressed the issue of whether liability policies are the property of the bankruptcy estate have concluded that such policies fall within the definition of "property of the estate."[2] See In re Louisiana World Exposition, Inc., 832 F.2d 1391, 1399 (5th Cir. 1987); In re Sfuzzi, Inc., 191 B.R. 664, 666 (Bankr. N.D. Tex. 1996) ("Courts are generally in agreement that an insurance policy itself will be considered property of the estate.").[3] The inquiry does not end at this point though. "[A] distinction must be made between the Policy itself and the proceeds payable thereunder, as ownership of one does not necessarily entail ownership of the other." In re Goodenow, 157 B.R. 724, 725 (Bankr. D. Me. 1993).

Some courts have held that the D&O insurance policies *and* the proceeds of such insurance policies are part of a debtor corporation's estate.[4] Other courts have held that

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[2] "Property of the estate," as defined in 11 U.S.C. § 541(a)(1), includes "all legal or equitable interests of the debtor in property as of the commencement of the case." According to 11 U.S.C. § 541(a)(6), a bankruptcy estate includes "proceeds, product, offspring, or profits of or from property of the estate".

[3] See also In re Edgeworth, 993 F.2d 51, 55 (5th Cir. 1993) ("Insurance policies are property of the estate because, regardless of who the insured is, the debtor retains certain contract rights under the policy itself."); MacArthur Co. v. Johns-Manville Corp., 837 F.2d 89, 92 (2d Cir.), cert. denied, 488 U.S. 868 (1988); A.H. Robins Co. v. Piccinin, 788 F.2d 994, 1001-02 (4th Cir. 1985), cert. denied, 479 U.S. 876 (1986).

[4] See In re Minoco Group of Cos., Ltd., 799 F2d 517, 519 (9th Cir. 19986 (D&O policies also benefit the debtor because the policies insure the debtor against indemnity claims made by officers and directors); A.H. Robins, 788 F.2d at 1001-02 (worth of bankruptcy estate increased by including proceeds); In re Circle K Corp., 121 B.R. 257, 260-61 (Bankr. D. Ariz. 1990).

the D&O insurance proceeds are not property of the debtor's estate.[5] The discussion that follows notes the factual distinctions among cases where courts have held that D&O proceeds *are* and *are not* property of the bankruptcy estate.

The Fourth Circuit in A.H. Robins stated "[u]nder the weight of authority, insurance contracts have been said to be embraced in this statutory definition of 'property.'" Id. at 1001-02 (citing In re Davis, 730 F.2d 176, 184 (5th Cir. 1984)). The insurance policy in A.H. Robins was a products liability policy that insured the debtor against claims by consumers. A.H. Robins, 788 F.2d at 1001.

The Ninth Circuit adopted the reasoning in A.H. Robins and applied it to a D&O indemnity policy. In re Minoco Group of Cos., Ltd., 799 F.2d 517, 519 (9th Cir. 1986). The Minoco court stated that the insurance policies met the "fundamental test of whether they are 'property of the estate' because the debtor's estate is worth more with them than without them." Id.

The Fifth Circuit distinguished between ownership of insurance policies and ownership of the proceeds. Louisiana World, 832 F.2d at 1399-1400. In In re Edgeworth, the Fifth Circuit clarified the definition of when insurance proceeds are property of the debtor's estate. Id. at 55.

In Louisiana World the company purchased several insurance policies providing liability coverage for its directors and officers for liabilities and related legal expenses they personally might incur in connection with their positions. Louisiana World, 832

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[5] See Louisiana World, 832 F.2d at 1398-1400 (holding D&O insurance proceeds are not part of the debtor's estate even though D&O policies were purchased and owned by the debtor); In re Daisy Sys. Sec. Litig., 132 B.R. 752, 755 (Bankr. N.D. Cal. 1991) (holding that proceeds of D&O policies were not assets of the estate because the directors and officers were the primary beneficiaries of the policies).

F.2d at 1393. The insurance policies also provided indemnification coverage for the company to the extent it might, pursuant to the requirement of a statute or its charter or by-laws, reimburse its directors or officers for such legal expense or liability. Id. Each policy, however, provided a single total amount of coverage that was applicable to both the indemnification and the liability protections jointly, so that payment under either reduced the amount of coverage remaining available under both. Id. at 1398.[6] The Fifth Circuit concluded:

> this case does not involve the indemnification proceeds, and in any event, we do not believe the existence of *indemnification* coverage affects the answer to the sole and narrow question here, which is whether the *liability proceeds* are part of [Louisiana World's] estate in bankruptcy.

Id. at 1399 (footnote omitted). The Fifth Circuit also concluded that the debtor had no ownership interest in the proceeds of the liability proceeds given the obligation of the insurance companies was only to the directors and officers. Id. at 1399.

In In re Edgeworth, 993 F.2d 51 (5th Cir. 1993), the Fifth Circuit noted:

> The overriding question when determining whether insurance proceeds are property of the estate is whether the debtor would have a right to receive and keep those proceeds when the insurer paid on the claim. When a payment by the insurer cannot inure to the debtor's pecuniary benefit, then that payment should neither enhance nor decrease the bankruptcy estate. In other words, when the debtor has no legally cognizable claim to the insurance proceeds, those proceeds are not property of the estate.

Id. at 55-56 (footnotes omitted).

According to Edgeworth, the question to be answered is whether the debtor would have a right to receive and keep those proceeds when the insurer paid on the claim: (1) if

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[6] It is not unusual for indemnification and liability coverage to be provided in a single package. 832 F.2d 1398-99 (citing 13 *Fletcher Cyclopedia of the Law of Private Corporations* 6054.4 (1984); Note, *Liability Insurance for Corporate Executives*, 80 Harv. L. Rev. 648 (1967)).

the answer to that question is "yes," then the proceeds of the liability insurance policy are property of the estate; (2) if the answer is "no," then the proceeds are not property of the estate and they cannot increase the bankruptcy estate for other creditors. Id. at 55.

The court in In re Circle K Corp., 121 B.R. 257, 260 (Bankr. D. Ariz. 1990) distinguished Louisiana World based on its focus on liability rather than indemnification coverage. In Circle K, the debtor requested a preliminary injunction against continued litigation of securities fraud actions against the debtor, its officers and directors. Circle K, 121 B.R. at 258. The court found that the debtor's insurance policies, which provided indemnity coverage to the debtor for reimbursement of litigation expenses of the directors and officers, were property of the debtor's estate. Id. at 261. The court reasoned that continued securities litigation against the directors and officers would result in additional litigation expenses which, if the insurer failed to pay, the directors and officers will look to the debtor for reimbursement under the company bylaws. Id. at 262. In granting the requested injunction, the court continued:

> In any event, the policies have specific dollar limits beyond which debtor must pay. To the extent expenditures exhaust policy limits, an estate asset is diminished ….

Id. The Circle K court did concede, however, that "[i]f the instant policies only provided coverage for directors and officers, and not indemnification coverage for debtor, the Louisiana World case could perhaps be on point." Id. at 260.

Similarly, in In re Sacred Heart Hospital of Norristown, 182 B.R. 413, 419-20 (Bankr. E.D. Pa. 1995) the court reasoned that where payment to the directors and officers would diminish the pot of proceeds available to cover insured claims against the debtor, the proceeds were property of the estate. Id. at 420. The Sacred Heart court

criticized the reasoning of Louisiana World and held that "an indemnification interest in proceeds [of a D&O liability policy] is sufficient to bring those proceeds into the estate". Id. at 419-21.

The court in In re The Leslie Fay Companies, Inc., 207 B.R. 764 (Bankr. S.D.N.Y. 1997) also distinguished Louisiana World. In Leslie Fay, shareholders brought a class action lawsuit against the directors and officers, and there was also a stockholder derivative action pending against the directors and officers. Leslie Fay, 207 B.R. at 768. The court held that as long as there was a pending derivative action, the debtor would have an "interest in any insurance proceeds available as a result of its officers' or directors' wrongful acts." Id. at 785 (footnote omitted). The reason the debtor has an interest in the proceeds is "because of the possibility that the class action might deplete the policy and theoretically force claims for indemnification to fall upon the estate." Id. The court also found, however, that the "intended beneficiaries of the policy are both the individuals and the corporation, and not solely the corporation." Id. at 786. As such, the directors and officers could still claim a substantial portion of the insurance proceeds. Id. See In re Jasmine, Ltd., 258 B.R. 119, 128 (Bankr. D.N.J. 2000) (holding debtor had an indemnification interest in the proceeds, the proceeds are property of the estate and the proceeds are subject to the authority of the trustee); Minoco Group, 799 F.2d at 519 ("First State argues on appeal that the excess officers and directors liability policies are not 'property of the estate' … because the policies benefit only the officers and directors, not Minoco. We disagree. As the bankruptcy court found, the policies also benefit Minoco because the policies insure Minoco against indemnity claims made by officers and directors.").

The court in In re First Central Financial Corp., 238 B.R. 9 (Bankr. E.D.N.Y. 1999) noted, however, that indemnification coverage does not change the fundamental purpose for obtaining D&O policies – the protection of individual directors and officers. Id. at 16. The mere appendage of entity coverage to a D&O policy "does not provide sufficient predicate, *per se*, to metamorphose the proceeds into estate property." Id. at 17. The First Central court continued:

> There is an important distinction between the individual liability and the reimbursement portions of a D&O policy. The liability portion of the policy provides coverage directly to officers and directors, insuring the individuals from personal loss for claims that are not indemnified by the corporation. Unlike an ordinary liability insurance policy, in which a corporate purchaser obtains primary protection from lawsuits, a corporation does not enjoy direct coverage under a D&O policy. It is insured indirectly for its indemnification obligations. In essence and at its core, a D&O policy remains a safeguard of officer and director interests and not a vehicle for corporate protection.

Id. at 16.

In sum, "the question of whether the [D&O insurance] *proceeds* are property of the estate must be analyzed in light of the facts of each case." In re Sfuzzi, Inc., 191 B.R. at 668. The question may turn on whether the liability policy *exclusively* covers the directors and officers, whether the policy provides indemnity coverage, whether the indemnity coverage is triggered by outstanding litigation defense costs, and whether the litigation expenses have the potential to exhaust the policy limits.

III. WHAT ARE THE PITFALLS FOR SHAREHOLDER PLAINTIFFS AND DIRECTOR AND OFFICER DEFENDANTS?

1. The D&O Policy May Be Deemed Void *Ab Initio*

One danger for shareholder plaintiffs and for director and officer defendants exists when a corporate officer makes a fraudulent misrepresentation on the debtor's

application for D&O insurance. Fraud in the application for D&O insurance raises questions such as whether the misrepresentations will void the policy as to all directors and officers, or whether directors and officers who had no knowledge of the wrongdoing at the time the application was made will be protected with D&O coverage. "Relieving the insurer of all liability under the policy because of misrepresentations made by the insured significantly undercuts the protection that directors may derive from D&O insurance." Shapiro v. American-Home Assurance Co., 584 F. Supp. 1245, 1251 (D. Mass. 1984).

In Bird v. Penn Central Co., 334 F. Supp. 255 (E.D. Pa. 1971), the insurer sued to rescind a D&O policy on the grounds that one insured made a false statement in the D&O application. The Bird court rejected the "innocent" insureds' motion for summary judgment on the grounds that the officer who made the false statement was acting as an agent for the others and thus his fraud was binding on all. Id. at 262.

The Shapiro court, in discussing the Bird decision, noted that "[t]he agency analysis relied on in Bird presents a problem, however, since an innocent director or officer, particularly an 'outsider,' may have no control over the individual who applies for insurance coverage. Thus, binding the directors as principals is somewhat fictional." Shapiro, 584 F. Supp. at 1251. In responding to this same objection, the Bird court reasoned that in asserting their rights under the policy, the innocent insureds were affirming the contract procured by the fraudulent director and thus were ratifying his actions as agent on their behalf. Bird, 334 F. Supp. at 262.

Again though, the Shapiro court noted that "[r]atification analysis, if applied to this case, would also be an extension of agency doctrine beyond its usual scope.

Ratification does not create an agency where none existed, but instead can be used to make a principal responsible for unauthorized acts performed by one who was in fact acting as an agent." Shapiro, 584 F. Supp. at 1251.

The Shapiro court concluded, under contract interpretation, that the insurer could avoid responsibility for all insureds on the basis of the misrepresentation in the D&O application. Shapiro, 584 F. Supp. at 1252. The D&O application form in Shapiro had as Question No. 14: "Does any Director or Officer have knowledge or information of any act, error or omission which might give rise to a claim under the proposed policy?" To this question, the corporation's president, plaintiff Shapiro, answered "No." Id. at 1247. Shapiro was later indicted for securities fraud and convicted after a jury-waived trial. Id.

The Shapiro court further noted that the parties could have negotiated a provision of the D&O policy to protect "innocent" insureds. Id. at 1252. "[T]here is no legal barrier to the making of contracts of insurance that would protect innocent insureds against loss of coverage because of the fraud of another. Various commentators have suggested procedures by which this end could be accomplished." Shapiro, 584 F. Supp. at 1253 (citing M. Schaeftler, *The Liabilities of Office: Indemnification and Insurance of Corporate Officers and Directors*, 153, 171 (1976)).

In International Insurance Co. v. McMullan, No. J84-0760(W), 1990 WL 483731 (S.D. Miss. Mar. 7, 1990), the plaintiff sought rescission of liability insurance policies based upon material misrepresentations in the D&O application by the insured's chief executive officer and chairman of the board of directors who filled out the application on behalf of all directors and officers covered under the policies. Id. at *5. The court noted that in Mississippi "absent an insurance policy excluding coverage to both co-insureds

because of the deliberate wrongful act of one co-insured, an innocent insured may recover." Id. at *8 (citing McGory v. Allstate Ins. Co., 527 So. 2d 632, 638 (Miss. 1988)). The International Insurance court noted that "[t]hough McGory dealt with arson by one co-insured and not [a D&O] application misrepresentation, it adds additional weight to this court's conclusion." Id. The International Insurance court held that "[defendant's] self-dealing will not be imputed to innocent officers and directors as a matter of law, but that factual issues remain whether the other directors knew, or should have known, of [defendant's] self-dealing." Id. at *9 (citing FDIC v. Lott, 460 F.2d 82, 85-86 (5th Cir. 1972)).

The court in Wedtech Corp. v. Federal Ins. Co., 740 F. Supp. 214 (S.D.N.Y. 1990), found that directors listed as insureds under the plaintiff's liability insurance contract were entitled to coverage, regardless of the fact that some of the defendants made material misrepresentations when applying for the insurance coverage. Id. at 222 ("the policies are not void *ab initio* with respect to each and every director regardless of whether he participated in the alleged fraudulent inducement"). The Wedtech court noted that an insurance policy may be found void *ab initio* and rescission may be appropriate when a policy is obtained through material misrepresentations, even when other officers and directors do not have knowledge of the fraud. The insurance application at issue in Wedtech, however, contained a severability provision which provided that "no statement in the application or knowledge on the part of one insured is to be imputed to another insured in determining the availability of coverage." Id. at 219. The provision also indicated that "the written application for coverage is to be construed as a separate application by each insured." Id.

2. The Directors and Officers May Be Denied Indemnification

Federal courts disfavor indemnity for federal securities law violations and call into question the enforceability of such obligations. See Eichenholtz v. Brennan, 52 F.3d 478, 484-86 (3d Cir. 1995) (holding that the district court did not abuse its discretion in extinguishing indemnification claims running counter to policies underlying securities laws); In re Livent Sec. Litig., Nos. 98 Civ. 5686(VM), 99 Civ. 2292(VM), 98 Civ. 7161(VM), 99 Civ. 9425(VM), ___ F. Supp. 2d ___, 2002 WL 376911, at * 3 (S.D.N.Y. Mar. 5, 2002) ("With respect to defendants' claims of indemnification, the Court concurs with the long line of cases which hold that a defendant in a securities fraud action is prohibited from availing himself of indemnification. Permitting claims of indemnification by alleged perpetrators of fraud would run counter [to] the paramount policy objectives of the securities laws to punish violators and to deter fraudulent conduct."); DS Bond Fund, Inc. v. Gleacher NatWest Inc., No. 99-116, 2001 WL 1168809, at * 6 (D. Minn. May 1, 2001) ("[C]ourts that had found that there is an implied right to contribution under the federal securities laws nonetheless refused to find an implied right to indemnity exists for the simple reason that indemnity allows a wrongdoer to completely evade liability . . . ."); Gabriel Capital v. Natwest Finance, Inc., 137 F. Supp. 2d 251, 267 (S.D.N.Y. 2000) ("Because indemnification shifts the cost of tortious conduct to another party, it cannot apply when the party seeking the indemnification knowingly and willfully violated federal securities laws."); In re Motel 6 Sec. Litig., No. 93 Civ. 2183, 2000 WL 322782, at *7 (S.D.N.Y. Mar. 28, 2000) ("Indemnification is not available where a party has knowingly violated the federal securities laws."); Fromer v. Yogel, 50 F. Supp. 2d 227, 237-38 (S.D.N.Y. 1999) ("Indemnification shifts the cost of

tortious conduct to another party. It is not available in a case where the party seeking indemnification has knowingly and wilfully violated the federal securities laws . . . Such a remedy would allow a tortfeasor to shift liability for intentional misconduct onto another joint tortfeasor and thereby undercut the deterrence goals of the securities laws.").[7] Thus, depending on the facts specific to each case, the directors and officers may be denied indemnification.

3. The Directors and Officers May Face Challenges to Using D&O Proceeds To Settle Securities Fraud Class Actions

In In re CHS Electronics, Inc., 261 B.R. 538 (Bankr. S.D. Fla. 2001), the bankruptcy trustee opposed the Motion For Approval to Use Directors and Officers Insurance Policy Proceeds to Fund Proposed Class Action Settlement (the "Motion") filed by the Lead Plaintiffs in the pending securities fraud class action. The court granted the Motion and concluded:

> Neither the Bankruptcy Code nor applicable case law gives [the trustee] any right to delay the settlement of a lawsuit by third parties against a debtor's former officers and directors merely because [the trustee] also has presently unliquidated claims against those officers and directors.

Id. at 540.

[7] See also Laventhol, Krekstein, Horwath & Horwath v. Horwitch, 637 F.2d 672, 676 (9th Cir. 1980) (upholding district court's dismissal of indemnity claim, which "would undermine the statutory purpose of assuring diligent performance of duty and deterring negligence"); Globus v. Law Research Serv. Inc., 418 F.2d 1276, 1288 (2d Cir. 1969) (agreeing with the lower court that "to tolerate indemnity under these circumstances would encourage flouting the policy of the common law and the Securities Act"); Raychem Corp. v. Federal Ins. Co., 853 F. Supp. 1170, 1176 (N.D. Cal. 1994) ("Federal courts have held that those *held liable* for violations of certain provisions of the federal securities laws, including the anti-fraud provisions of the 1934 Act, may not recover indemnification"); Greenwald v. American Medcare Corp., 666 F. Supp. 489, 493 (S.D.N.Y. 1987) (interpreting Delaware law, stating that "no party who has himself knowingly and wilfully violated the federal securities laws may obtain indemnity from another violator of those laws," but finding that party should have opportunity to show whether he was at fault).

The CHS court noted that the debtor's entity coverage was inapplicable to the issues raised in the Motion since there were no securities claims against the debtor. Id. at 540. The court also noted that with regard to the indemnity provision of CHS's insurance policy, "the Debtor submitted claims of approximately $458,000 for fees and expenses incurred on behalf of the directors and officers which [would] result in a $258,000 indemnification claim under the Policies, after application of a $200,000 'retention' (essentially, a deductible)." Id. at 541.

While noting that the Eleventh Circuit has not addressed the issue, the CHS court expressly agreed with and adopted the Fifth Circuit's holding in Louisiana World "that where the liability coverage covers the exposure of the directors and officers of the Debtor, and only is payable for the benefit of those directors and officers, it is they, and not the estate, that have a property interest in the liability proceeds for bankruptcy purposes." 261 B.R. at 542 (citing Louisiana World, 832 F.2d at 1400).

The CHS court stressed that there is no entity coverage in the case because all securities claims against the debtor were discharged. 261 B.R. at 543. "[W]ith respect to Entity Coverage for indemnification claims, counsel [for the insurer] advised … that the total amount of claims which the Debtor may have under the Policies' indemnification provisions will not exceed $258,000. Id. at 543. The D&O insurance proceeds remaining after settlement of the CHS securities class action lawsuits, however, was approximately $8,750,000. Id.

In rejecting the trustee's arguments to thwart the Motion, the CHS court stated: "Simply because [the trustee] is a trustee in bankruptcy does not arm him with super-plaintiff powers in causes of actions between third parties." 261 B.R. at 544. In

conclusion, the CHS court ordered "[t]o the extent that a relatively small portion of [the insurance] Proceeds subject to the indemnification claims are property of the estate, the Court, for cause, grants stay relief to the Lead Plaintiffs." Id. at 544.

4. The Action May Be Subject To The Automatic Stay Provision Of § 362

Lawsuits initiated against officers and directors of a corporate debtor are usually not stayed under § 362. See Bedel v. Thompson, 103 F.R.D. 78, 80-83 (S.D. Ohio 1984) (holding that the automatic stay was inapplicable to an action for violations of securities laws instituted against former directors because the debtor was not deemed an indispensable party).[8] Even when an action is pending as of the date a corporation files for bankruptcy, the lawsuit is typically stayed only as to the debtor and not the codefendant officers and directors. See Wedgeworth v. Fibreboard Corp., 706 F.2d 541, 544 (5th Cir. 1983) (ruling that a debtor may be severed from an action, which may then be continued against the other named defendants – "we conclude that § 362 does not operate as an automatic stay of claims against the co-defendants"). Basically, "where a non-debtor codefendant may be held independently liable of the debtor, then there is no compelling basis by which a court must extend the automatic stay provisions of § 362 to the non-debtor codefendants." Duval v. Gleason, No. C-90-0242-DLJ, 1990 WL 261364, at *4 (N.D. Cal. Oct. 19, 1990). But see In re Johns-Manville Corp., 26 B.R. 420 (Bankr. S.D.N.Y. 1983), aff'd 40 B.R. 219, 230-31 (S.D.N.Y. 1984) (extending automatic stay to enjoin a federal securities action against certain officers and defendants of the debtor);

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[8] See also Credit Alliance Corp. v. Williams, 851 F.2d 119, 121 (4th Cir. 1988) (stating that the plain language of § 362 does not apply to non-debtors and will not be applied absent "unusual circumstances"); In re Crazy Eddie Sec. Litig., 104 B.R. 582, 583 (E.D.N.Y. 1989) (ruling that "stays pursuant to § 362(a) are limited to debtors and 'do not encompass non-bankrupt co-defendants'") (quoting Teachers Ins. & Annuity Ass'n v. Butler, 803 F.2d 61, 65 (2d Cir. 1986)).

Circle K, 121 B.R. at 262 (granting debtor's preliminary injunction against continued litigation of securities fraud actions against debtor and two former chief executive officers of the debtor. Court was "convinced that, at this stage of these complex cases, it benefits debtor, its estate and thousands of creditors not to divert management's attention or resources into equally complex issues involving securities law.").

5. The D&O Policy May Be Cancelled

The Ninth Circuit in In re Minoco Group of Cos., Ltd., 799 F.2d 517 (9th Cir. 1986) addressed the issue of whether an insurance company can cancel a policy post bankruptcy petition. The Minoco court was concerned with the impact of canceling the policies:

> [Debtor] would be required to indemnify present and former officers and directors for legal expenses and judgments which arise from their activities as officers and directors. The bankruptcy court also found that cancellation of the policies would render reorganization of Minoco more difficult, if not impossible, for two reasons: (a) the difficulty of attracting and retaining competent personnel to serve as officers and directors, and (b) the increase in claims against the debtor's estate resulting from claims for indemnification by present and former officers and directors.

799 F.2d at 518.

The Ninth Circuit in Minoco affirmed the bankruptcy court's finding that cancellation of the policies was stayed noting that the policies met the fundamental test of estate property because "the debtor's estate is worth more with them than without them." 799 F.2d at 519.

CONCLUSION

In determining the ownership of D&O policy proceeds, courts must undertake a fact-intensive analysis. If the D&O policy provides *exclusive* coverage to the directors and officers, the weight of authority supports the conclusion that the debtor's estate has no interest in the D&O proceeds. The waters get murky when the D&O policy provides indemnity coverage. Some courts conclude that the mere presence of indemnity coverage pulls the D&O policy into the debtor's estate. An analysis of the facts specific to each case is more appropriate though. The amount for which the directors and officers may seek indemnification from the debtor may equal only a fraction of the entire insurance policy. A more appropriate resolution, rather than automatic inclusion of the D&O proceeds in the debtor's estate, may be to set aside an amount for which the directors and officers may potentially seek reimbursement in the debtor's estate, but not the entire policy. Finally, if entity coverage exists, the legal strategy for the shareholders in a pending securities class action against the debtor and its directors and officers may be to dismiss the action against the debtor thus eliminating any potential claim by the bankruptcy trustee to the D&O policy proceeds. The shareholder plaintiffs and director and officer defendants would then be able to use the D&O proceeds to fund a settlement of the pending securities class action. All the while, however, the shareholder plaintiffs and the director and officer defendants must keep in mind the potential land mine if there was fraud in the application for D&O coverage.

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