

# Shareholder Action Not Subject to Stay during Bankruptcy

August 1999

The United States District Court for the District of Delaware recently determined, in *In re Reliance Acceptance Group*, No. 98-MC-103-RRM, 1999 U.S. Dist. LEXIS 8589 (D. Del. June 2, 1999), that a shareholder action against the directors and officers of Cole Taylor Financial Group ("CTFG") should not be stayed during bankruptcy proceedings despite arguments that CTFG's estate was pursuing allegedly similar claims against its former directors and officers and despite the fact that the availability of coverage for the claims against former CTFG directors and officers had yet to be determined in the bankruptcy proceeding.

CTFG was created by the Cole and Taylor families as a banking and consumer loan business in the early 1980s. In early 1996, the Taylor family proposed a transaction wherein they would exchange their shares in CTFG for the company's stock in two wholly-owned subsidiaries. CTFG's board and shareholders approved the transaction (the "Taylor transaction"). Subsequently, CTFG's share price plummeted, and investors filed several securities suits against the Taylors, the Coles, the former officers and directors of CTFG, CTFG's accountants and its investment bankers, alleging that the shareholders were deceived by a false and misleading proxy statement prior to the vote on the Taylor transaction. CTFG soon filed for bankruptcy relief under Chapter 11.

CTFG's estate sought to enjoin the putative class action lawsuits and to pursue its own claims against the Taylors, CTFG's directors, officers, accountants, lawyers and others based on the Taylor transaction. The bankruptcy court enjoined the shareholder litigation and the shareholders appealed.

The district court reversed the grant of the injunction, citing multiple differences with the bankruptcy court's decision. CTFG's estate argued, in part, that the shareholder litigation should be enjoined because the claims would diminish the proceeds available to them under CTFG's D&O policies. Further, according to the estate, if the shareholders were successful, but their claims were not covered under the D&O policies, the former officers and directors nevertheless could file claims for indemnification with the estate, thereby depleting its available assets in a different way.

The court agreed with the estate about the possibility of depletion of CTFG's insurance and other assets through the shareholder litigation. The court nevertheless opined that the shareholder litigation did not impact the D&O policies sufficiently to support the need for an injunction. First, the court reasoned that the shareholders themselves had not pursued the D&O carriers, so the shareholder litigation would not directly

affect the determination whether coverage was available under the D&O policies. In that regard, the estate had filed a separate adversary proceeding against CTFG's D&O carriers seeking a declaration that the policies were the property of the estate. Second, the court reasoned that, if the shareholders prevailed in their separate litigation, the availability of coverage for any judgment could be resolved among the insurers, the directors and officers and the estate at that time.

With regard to defense costs that might be sought under the policies in advance of any adjudication in the shareholder suit, the court merely concluded that "those are matters that can be resolved between the insurers and the insured, without enjoining the Shareholders from proceeding with their claims." *Id.* at 24. The opinion is unclear regarding how the court envisioned that payments for defense costs would be handled in advance of the coverage determination.

The court also rejected the estate's argument that a stay should be applied on the grounds that the directors and officers could seek indemnification from the estate, thereby depleting its assets, if the shareholders were successful and no insurance coverage were available. The court agreed that the estate was "probably correct" about this potential depletion of its assets, but stated, without analysis or citation to authority, that this depletion itself "does not appear to be a basis for permanently enjoining the Shareholders' Litigation." *Id.*