

Former Director's Bankruptcy Estate Has No Claim to Amounts Payable as Defense Costs under D&O Policy

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The United States District Court for the Eastern District of Pennsylvania has held that the Chapter 7 bankruptcy estate of an insured former director has no claim to D&O policy proceeds that otherwise are payable as defense costs in connection with a covered claim against the former director. *In re Leonard A. Pelullo*, No. 98-6181, 1999 U.S. Dist. LEXIS 14920 (E.D. Pa. Sept. 29, 1999).

Debtor Leonard Pelullo was a director of now-bankrupt P-I-E Nationwide, Inc. ("PIE"). Civil and criminal proceedings had been initiated against Pelullo, and the Central States, Southeast and Southwest Areas Pension Fund ("Central States") held a \$45 million judgment against him. Pelullo ultimately filed for bankruptcy under Chapter 7 in the United States Bankruptcy Court for the Eastern District of Pennsylvania.

National Union Fire Insurance Company of Pittsburgh, Pa. ("National Union") had issued a D&O policy to PIE. In order to resolve conflicting claims to the policy proceeds, it filed an interpleader action in the United States District Court for the Northern District of Georgia. That court ultimately determined that Pelullo was entitled to coverage under the D&O policy for defense costs incurred in connection with one of the criminal proceedings against him, and that the defense costs under the policy were to be paid as directed by the court in which Pelullo's bankruptcy was pending.

The trustee for Pelullo's bankruptcy estate and Central States asserted that the covered defense costs were the property of Pelullo's bankruptcy estate and should be held for eventual payment to Pelullo's creditors. The district court disagreed, affirming the bankruptcy court's conclusion that the fees were not the property of the estate under 11 U.S.C. Section 541(a) because Pelullo did not have a right to receive and keep the fees when the insurer paid on the claim. Because Pelullo was not seeking reimbursement for fees that already had been paid by him, the policy proceeds were "payable for the sole benefit of those who have performed work in defense of Pelullo's [criminal] action."

According to the court, the proceeds could not "possibly benefit the unsecured creditors of the estate" so they had "only inconsequential value, if any, to the estate. . . ." The court therefore ordered the Trustee to abandon any asserted interest in the proceeds of the D&O policy.