

Proceeds of D&O Policy Are Not Property of the Estate Despite Entity Coverage

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In two related actions, the United States Bankruptcy Court for the District of Delaware ruled that the proceeds of a D&O policy are not property of the debtor's estate and refused to grant an injunction requested by a trustee to prevent the directors and officers from consummating a settlement that would exhaust the policy limits. Separately, the United States District Court for the Western District of Pennsylvania, presiding over the shareholder suit involving the directors and officers, agreed that the proceeds were not assets of the estate and therefore refused to grant the trustee standing to challenge the settlement. *Miller v. McDonald (In re World Health Alternatives, Inc.)*, 2007 WL 1670357 (Bankr. D. Del. June 8, 2007); *In re World Health Alternatives, Inc. Sec. Lit.*, 2007 WL 1670180 (W.D. Pa. June 8, 2007).

The policy at issue was a D&O policy that provided three different types of coverage. "Coverage A" provided coverage directly to the officers and directors of the debtor company. "Coverage B" provided coverage to the debtor for amounts it paid to indemnify the directors and officers. "Coverage C" provided coverage directly to the debtor for certain types of claims. The policy contained a priority of payments provision, which provided that payments under Coverage A had priority over payments under Coverages B and C.

These two rulings both centered on the ability of the debtor's trustee to challenge a settlement agreed to by the directors and officers that would exhaust the D&O policy through payments under Coverage A. The settlement was to resolve an action by the debtor's shareholders against the directors and officers for violations of various securities laws. The debtor was not a named defendant in that suit. After the shareholder suit was filed, the debtor entered bankruptcy, and the trustee then brought a similar action against the directors and officers on behalf of the debtor's creditors. After instituting his own suit, and upon learning of the settlement that would exhaust all coverage under the D&O policy, the trustee filed an objection to the settlement in the district court and moved the bankruptcy court to enjoin any payment of policy proceeds on the grounds that such proceeds were property of the estate. Both courts rejected the trustee's position and permitted the directors and officers to consummate the settlement that would exhaust the D&O policy.

The bankruptcy court stated that the threshold issue in ruling on the injunction was whether the proceeds were property of the estate. The court first explained that where an insurance policy provides coverage directly to directors and officers, it is not property of the estate. The court noted that there is some disagreement when

the policy provides for some coverage to the debtor, such as the policy at issue, but it ruled that "policy proceeds are not property of the estate where a debtor is covered for indemnification, but indemnification 'either has not occurred, is hypothetical, or speculative.'" Based on this rule of law and the lack of any pending claims against the debtor that would be covered by the policy, the court held that the policy proceeds were not property of the estate.

The district court held that the trustee did not have standing to challenge the settlement, because he was not a party to the suit and did not meet the "extraordinary circumstances" generally required for a non-party to gain standing. The court also held that even if the trustee did have standing, the policy proceeds were not assets of the estate for the reasons stated by the bankruptcy court, and that the priority of payments provision would also grant the directors and officers a priority claim to the policy proceeds.