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NEWSLETTER

Bankruptcy Appellate Panel Affirms Relief from Automatic Stay for Payment of Director's Defense Costs

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The Bankruptcy Appellate Panel of the Ninth Circuit has affirmed the bankruptcy court's grant of a motion by a debtor's sole director to modify the automatic stay to allow payment of defense costs under the A-side coverage of the debtor's directors and officers liability insurance policy. *In re MILA, Inc.*, 2010 WL 455328 (B.A. P. 9th Cir. Jan. 29, 2010). The panel reasoned that, assuming that the proceeds of the policy were property of the estate, it was proper for the bankruptcy court to balance the harm to the debtor if the stay were modified with the harm to directors and officers if they were prevented from executing their rights to defense costs.

Here, the panel bankruptcy court had rejected the chapter 11 trustee's argument that payment of defense costs under the policy's A-side coverage might exhaust B-side policy limits, potentially jeopardizing the estate's right to be indemnified. Because the insured director was likely to be the only director or officer to receive payments, the bankruptcy court found the possibility that exhaustion would leave insufficient proceeds to pay claims for which the estate might seek B-side coverage to be remote. The panel held that the bankruptcy court's conclusion was not clearly erroneous. The panel stated further that courts consider whether a debtor's indemnification claims under the B-side coverage are "real and actual, or whether the likelihood of any such claims are hypothetical or speculative." Here, the director had not asked the debtor for payments, and the debtor had not made and is unlikely to make any indemnification payments to the director. Neither could the chapter 11 trustee point to anything in the record to support its assertion that other officers may be "out there" with potential indemnification claims. Accordingly, the panel held that the bankruptcy court did not abuse its discretion in granting the insured director relief from the automatic stay.