

# Illinois District Court Affirms Bankruptcy Court's Injunction of Nationwide Securities Class Action

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A federal district court in Illinois has affirmed a bankruptcy court's order temporarily enjoining a shareholder securities class action lawsuit against a bankrupt company's directors and officers pursuant to Section 105(a) of the Bankruptcy Code pending the completion of competing litigation filed by the bankruptcy trustee against the same defendants. *Megliola v. Maxwell*, 293 B.R. 443 (N.D. Ill. 2003). The court held that the class action litigation affected the amount and allocation of property among creditors because the class action plaintiffs and the trustee were both seeking to recover the same pool of limited assets—the proceeds of the debtor's D&O policy.

Prior to the debtor filing for bankruptcy, shareholders filed a class action lawsuit against the company and its directors and officers, alleging violations of federal securities laws. After the company filed for bankruptcy, the bankruptcy trustee filed an adversary proceeding against the directors and officers, alleging breaches of state law fiduciary duties owed to the debtor and its creditors. Both suits potentially implicated the debtor's \$50 million D&O liability program. After filing suit against the directors and officers, the bankruptcy trustee initiated an adversary proceeding against the shareholders, seeking to enjoin them from pursuing their litigation and seeking to recover under the debtor's D&O policies.

The bankruptcy court enjoined the class action litigation under Section 105(a) of the Bankruptcy Code, which provides that the "court may issue any order, process, or judgment that is necessary or appropriate to carry out the provisions of this title." The court reasoned that the litigation was sufficiently related to the trustee's administration of the estate because the shareholders' suit could potentially reduce the amount of D&O insurance proceeds that the trustee would be able to recover in his adversary proceeding against the directors and officers. The shareholders appealed, arguing that the bankruptcy court did not have the authority to "block adjudication of a nationwide class action lawsuit, brought by non-creditors against non-debtors," under Section 105(a).

The district court upheld the injunction under Section 105(a), reasoning that the class action litigation would affect the bankruptcy estate or the allocation of property among creditors because the trustee and the class action plaintiffs were competing for the same limited amount of insurance proceeds. Relying on the decision

in *Fisher v. Apostolou*, 155 F.3d 876, 882 (7th Cir. 1998), the district court explained that a bankruptcy court may temporarily enjoin litigation that is "related to" a bankruptcy case or a trustee's work on behalf of an estate, including actions between third parties that "have an effect on the bankruptcy estate." The class action litigation was sufficiently "related to" the bankruptcy at issue, the district court opined, because "the dispute 'affects the amount of property for distribution [i.e., the debtor's estate] or the allocation of property among creditors.'" In so holding, the court rejected the shareholders' attempts to distinguish *Fisher* on the grounds that the plaintiffs in that case were creditors of the debtor, determining that there is no factual distinction between litigation brought by shareholders and creditors.

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