

Priority of Payments Provision Allows Insurer to Make Settlement Payments on Covered Claims Against Directors and Officers

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The United States Bankruptcy Court for the District of Nebraska has held that an insurer may make settlement payments for claims against a debtor's directors and officers where any claims of the debtor are subordinate to those of the directors and officers under the terms of the policy. The court stated that under these circumstances "the issue of whether the policies are property of the bankruptcy estate is irrelevant." *In re TierOne Corp.*, 2012 WL 4513554 (Bankr. D. Neb. Oct. 2, 2012).

In 2010, the insured corporation filed a voluntary petition for Chapter 7 bankruptcy relief. At that time, the corporation's directors and officers were defendants in several pending or threatened lawsuits and investigations. In response to the individual defendants' various motions for relief from the bankruptcy stay, the bankruptcy court issued an order providing that the insurer was authorized to make immediate payments to the individuals, including for covered defense costs. The individuals subsequently agreed to settle claims brought against them by certain equity holders of the corporation and sought an order from the bankruptcy court confirming that the insurer was authorized to make the agreed settlement payments. The Chapter 7 trustee and the Federal Deposit Insurance Corporation (FDIC) as receiver opposed the individuals' request arguing that the policy proceeds were property of the debtor's estate and that the settlement payments would completely exhaust the coverage available under the primary policy, eliminating a potential source of recovery for their claims against the directors and officers.

Rejecting the arguments of the trustee and the FDIC, the court held that the insurer was authorized to make the settlement payments. Noting the policy's priority of payment provision, the court found that "[t]he directors and officers have a right to make claims under the policies and to receive payment of the policy proceeds to the exclusion of the bankruptcy estate since they are first in line." According to the court, it was "irrelevant" whether the policy was property of the bankruptcy estate under these circumstances: "When a liability policy provides the debtor with indemnification coverage but indemnification either has not occurred, is hypothetical, or speculative, the proceeds are not property of the bankruptcy estate." The court refused to "hold up the payment of benefits under an insurance policy issued for the benefit of non-debtor third parties," pointing out that the trustee and FDIC did not have "direct claims against the insurance policy."