

Washington Bankruptcy Court Holds that Insurance Proceeds Are Property of the Estate; Refuses to Lift Automatic Stay

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The U.S. Bankruptcy Court for the Eastern District of Washington has held that proceeds of separate D&O and E&O policies issued to the debtors are property of the bankruptcy estate. *In re Metropolitan Mortgage & Securities Co., Inc.*, 325 B.R. 851 (Bankr. E.D. Wash. June 20, 2005). In so determining, the court explained that the debtors and the other insureds have "undivided, unliquidated interests in the identical asset, *i.e.*, the policy proceeds" and refused to lift the automatic stay to allow reimbursement of defense costs of certain co-insureds from policy proceeds.

The debtors were named insureds under two D&O policies and two E&O policies, each of which provided for payment of defense costs within policy limits. During the bankruptcy case, non-debtor co-insureds sought to lift the stay and to be reimbursed for defense costs from the policy proceeds in order to defend themselves in underlying lawsuits and arbitrations.

The debtors then filed the current action for injunctive relief, asking the court to stay the underlying litigation and arbitrations. The court entered a preliminary injunction enjoining litigation by third parties against the named insureds and between the named insureds. As the preliminary injunction lapsed, the debtors again argued that the insurance proceeds were property of the estate and sought to stay the litigation and arbitrations.

The court first noted that Ninth Circuit law is unsettled with respect to whether policy proceeds are "property of the [bankruptcy] estate." The court then stated that the status of the debtors as named insureds under the policies provided them with the right to receive policy proceeds in a variety of situations, including to satisfy judgments and to indemnify defense costs incurred by the debtors' directors and officers.

The court then concluded that "the proceeds are [] property of the estate because the estate is worth more with [the insurance proceeds] than without them and because the debtors hold claims payable from the proceeds." The court so held even though "[r]ealization of the debtors' legal interest is contingent upon the debtors meeting conditions established by the policy for the bringing of claims and these legal interests are not yet in the form of monetary recovery."

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WRF's Insurance Group, working together with the firm's Bankruptcy & Financial Restructuring Group, has represented insurers in numerous policyholder bankruptcy proceedings and in coverage litigation and counseling relating to insolvent insureds.

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