

ALERT

Professional Liability Policy Proceeds Not Property of Bankruptcy Estates

June 23, 2011

The United States Bankruptcy Court for the District of Nevada has held that proceeds from a professional liability policy were not property of the insured-debtors' bankruptcy estate because the proceeds were payable only for the benefit of third party claimants and could not be accessed by the debtors directly. *In re Endoscopy Center of Southern Nevada*, Nos. BK-S-09-22780-MKN, S-09-22776-MKN, S-09-22784-MKN, 2011 WL 2184387 (Bankr. D. Nev. May 23, 2011).

The insureds, who performed endoscopy procedures at out-patient clinics before filing for bankruptcy, were named as defendants in numerous lawsuits alleging that they exposed plaintiffs to or transmitted to plaintiffs communicable diseases. The insurer, which had issued a medical professional liability policy to the insureds, filed a motion for relief from the bankruptcy stay so that it could pay certain settlement amounts out of the policy proceeds to various plaintiffs in the underlying lawsuits. However, the bankruptcy trustee opposed relief from the stay, causing the insurer to commence an adversary proceeding against the trustee. In connection with the resolution of that matter, the bankruptcy court had to evaluate whether the proceeds of the insurance policy constituted property of the estate.

In resolving that issue, the court first noted that proceeds from indemnity policies can be property of the estate if made payable to the insured directly, but the proceeds from liability policies like the one at issue did not belong to the estate. According to the court, under a typical liability policy, the insured does not have a cognizable interest in the proceeds because such proceeds generally are payable only for the benefit of those harmed by the insured. The

Practice Areas

Insurance

D&O and Financial Institution Liability

E&O for Lawyers, Accountants and Other Professionals

Professional Liability Defense

court further stated that other factors weighed against determining the policy proceeds to be property of the estate. Specifically, the court noted that, among other things, the insureds could not ask the insurer to distribute proceeds to the estate, could not determine how the policy proceeds would be distributed, and could not seize the policy proceeds from the insurer to satisfy a claim that was outside the scope of coverage.

The court also dismissed the argument that the policy proceeds were property of the estate because they would be used to pay claims that would otherwise need to be paid from estate assets. The court explained that, even if this "secondary impact" analysis were relevant, it did not apply to the instant case because the remaining estate had only minimal remaining assets that could be protected. Accordingly, the court held that the insured debtors had no interest in the policy proceeds and that such proceeds were therefore not property of the bankruptcy estate.