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Bankruptcy Court Lifts Automatic Stay to Allow Insurers to Pay Defense Costs

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The United States Bankruptcy Court for the Southern District of New York has lifted the automatic stay in bankruptcy to permit D&O and E&O insurers to advance or reimburse insured directors,' officers' and employees' reasonable defense costs incurred in underlying litigation arising out of the insured company's collapse. *In re MF Global Holdings Ltd., et al.*, No. 11-15059 (MG) (Bankr. S.D.N.Y. Apr. 10, 2012)

Following the insured company's bankruptcy, numerous directors, officers and employees of the company were named as defendants in lawsuits brought by securities holders, commodity customers and other plaintiffs. These lawsuits alleged a variety of different causes of action and resulted in substantial defense costs. Many of these defendants, therefore, submitted notices of claims seeking coverage under the bankrupt company's D&O and E&O insurance policies. In response, the insurers sought a judicial determination that the proceeds of the policies at issue were not property of the debtors' estates, which would then allow the insurers to advance and reimburse defense costs even while the automatic stay was in place. In the alternative, the insurers sought to lift the automatic stay to allow them to advance or reimburse defense costs on behalf of the individual insureds. Certain customers of the company objected to the motion for relief from the stay, arguing that the use of policy proceeds to pay certain individual's defense costs would diminish the funds available to pay claims against the debtors.

Finding that sufficient cause existed to lift the automatic stay, the bankruptcy court concluded that it did not need to address whether the proceeds of the policies were property of the debtors' estates. In concluding that there was cause to lift the stay, the court first explained that the need of the individual insureds—who had a

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present need for payment of their defense costs—far outweighed the debtors' hypothetical or speculative need for coverage. The court further reasoned that lifting the automatic stay to advance defense costs to the individual insureds would not severely prejudice the debtors' estates, but that failure to do so would significantly injure the individual insureds.

The court also noted that certain of the policies included a "priority of payments" provision, which provided that coverage potentially afforded to individual insureds for non-indemnifiable losses must be paid before any payments made to the debtors for amounts they might pay as indemnification to the individual insureds or for covered claims against the debtors themselves. According to the court, these provisions established that individual insureds had priority to any interest that may be asserted by the debtors. The court explained that debtors' interests in insurance policies are limited by the terms of those policies, and that excising the priority of payment provisions would amount to an improper rewriting of the policies.

Relying on New York Insurance Law Section 3420(a)(1), the bankruptcy court determined that the filing of a bankruptcy petition does not change the scope or terms of a debtor's insurance policy. The court therefore held that insurers must abide by the terms of the policies, notwithstanding any other provision of the Bankruptcy Code. Finally, the court concluded that the objectors did not have a vested right in the proceeds of the policies because the objectors had not conclusively established that the debtors or individual insureds were liable for any wrongdoing covered by the policies.

The opinion is available here.