

ALERT

Trustees Have No Standing To Object to Disbursement of Policy Proceeds in Interpleader Action

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The United States Bankruptcy Court for the District of Delaware, applying federal law, has held that a Liquidation Trustee and a Litigation Trustee (the Trustees) did not have standing to object to the disbursement of policy proceeds in an insurer's interpleader action because they had no existing claims or realistic potential claims for coverage under the policy. *Federal Insurance Co. v. DBSI, Inc.*, 2012 WL 2501090 (Bankr. D. Del. June 27, 2012).

An insurer issued a D&O policy to an insured that subsequently filed for bankruptcy. The insurer filed an interpleader action in the bankruptcy proceeding for the court to determine the allocation of policy proceeds among several claims that the insurer believed were reasonably likely to exceed the policy's limit of liability. The court ordered all parties who sought coverage for an existing claim to file a motion for summary adjudication by February 16, 2010. The Trustees sought coverage for multiple matters, including a civil action (the Action) and a motion seeking the appointment of a bankruptcy examiner (the Examiner Motion). The Action was stayed indefinitely, and later rendered moot, after the parties agreed to the appointment of an examiner. The court awarded coverage for defense costs incurred in connection with the Action and but held there was no coverage for defense costs in connection with the Examiner Motion. The Trustees received a disbursement of policy proceeds in connection with the Action.

In connection with additional pending motions for summary judgment on coverage filed by other insureds, the court considered whether the Trustees had standing to participate in the interpleader coverage

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dispute and to object to the disbursement of policy proceeds. To have standing, the Trustees were required to demonstrate a “legally protected interest” in the policy proceeds that had been or was in actual danger of being adversely affected. The court rejected each of the arguments raised by the Trustees.

First, the court concluded that the policy proceeds, in this context, were not the property of the estate because the debtor did not have existing claims under the policy. The Trustees argued that they had an interest in the proceeds because the funds could be payable to the estate in connection with several claims, including numerous miscellaneous proofs of claim that had not yet been resolved. The court examined matters that the Trustees contended were potential Claims of the debtors to be covered by the D&O policy and found that coverage for some matters, including the miscellaneous proofs of claim, was barred by the Trustees’ failure to seek coverage by filing a motion for summary adjudication by the court’s February 16, 2010 deadline. The court also held that another matter did not constitute a “Claim” as defined in the policy. In addition, the court concluded that the Trustees had no ongoing claim to policy proceeds with respect to the stayed Action because they had already received a disbursement for the only defense expenses that would be incurred in connection with the matter.

Second, the court rejected the argument that an appeal of the order denying coverage for the Examiner Motion served to give the Trustees sufficient interest in the remaining policy proceeds. The court stated that its order was the law of the case and, if the order were to be reversed on appeal, then the Trustees’ standing could be reinstated.

Finally, the court decided that the Trustees’ status as plaintiff in certain actions filed against individual insureds did not give the Trustees a legally protected interest in the policy proceeds. The court agreed with authority that stated that a trustee was no different than any other third-party plaintiff suing defendants covered by a wasting limits policy and that the Trustees’ argument would allow any plaintiff suing an insured to intervene in an interpleader action. The court noted that the Trustees had in fact opposed motions to intervene in the interpleader action previously filed by other third-party plaintiffs with suits against individual insureds.

The court therefore concluded that the Trustees had no standing to object to the disbursement of policy proceeds in the interpleader action.

The opinion is available [here](#).