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NEWSLETTER

Two Courts Reject Claim That D&O Policy Proceeds Are Part of Bankruptcy Estate

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A court has held that the proceeds of a D&O policy are not the property of a corporate bankruptcy estate even though the policy included entity coverage for securities claims. The court also refused to stay a securities suit against the bankrupt corporation's directors and officers in favor of the trustee's own mismanagement claims. *First Central Fin. Corp. v. Lipson*, Case No. 198-12848-353, 1999 Bankr. LEXIS 1104 (Bankr. S.D.N.Y. Sept. 3, 1999).

First Central Financial Corporation ("FCFC") filed for bankruptcy protection under Chapter 7. Thereafter, FCIC shareholders brought suit against FCIC's directors and officers under Sections 10(b) and 20(a) of the Securities Exchange Act of 1934 (the "*Lipson* suit"). FCIC was not named as a defendant. Several months later, the Chapter 7 trustee filed an adversary proceeding against the directors and officers on behalf of the estate for alleged mismanagement and corporate waste.

The trustee sought to enjoin the distribution of any of the D&O policy's proceeds for the defense of the directors and officers or payments to the *Lipson* plaintiffs. He argued that the proceeds of the policy were the property of the estate and therefore subject to an automatic stay. He also sought to enjoin the shareholder suit.

The court first rejected the trustee's argument that the proceeds of the D&O policy were the property of the estate. It noted that "D&O policies are obtained for the protection of the individual directors and officers." Although the policy included entity coverage, the "mere appendage of entity coverage [for securities claims] to [the] Policy by way of a rider . . . does not provide sufficient predicate, *per se*, to metamorphose the proceeds into estate property." The court stressed that the estate was not a party to the shareholder suit and appeared to face no other securities claims. "If the entity coverage is hypothetical and fails to provide some palpable benefit to the estate, it cannot be used by a trustee to lever himself into a position of first entitlement to policy proceeds."

The court also refused to stay the shareholder suit. It reasoned that the suit posed no serious threat to FCIC's reorganization efforts, and the mere possibility that the directors and officers might pursue an indemnification claim did not constitute harm to the debtor. The court further opined that the issues in the mismanagement suit and shareholder suit were sufficiently distinct that findings in the shareholder action could not harm the

trustee's own claim.

Finally, the court noted that the trustee offered no evidence that the directors and officers would be unable to satisfy a judgment in the mismanagement suit.