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D&O Insurance & Insolvency: Navigating the Intersection

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The primary purpose of procuring insurance coverage for a company's directors and officers (D&O Insurance) is to protect the personal assets of directors and officers from lawsuits arising out of their service to the company. Unfortunately, D&O Insurance might not protect directors and officers in their time of greatest need: when their company files for bankruptcy. At the same time the company is least likely to be able to honor its indemnity or reimbursement obligations, its directors and officers are most likely to face lawsuits and investigations.

Unsurprisingly, insurers sometimes seek to limit or evade their liability during an insured company's bankruptcy proceedings. For example, by arguing that the insurance policy is property of a debtor's estate, and therefore subject to the automatic stay provisions of Section 362 of Title 11 of the US Code (Bankruptcy Code), an insurer might refuse to indemnify directors and officers for claims made against them.

Likewise, the statutory committee of unsecured creditors appointed in a Chapter 11 case (Creditors' Committee) or other stakeholders may seek to limit payouts to individual directors and officers from D&O Insurance in order to preserve what they may view as an important estate asset.

An examination of bankruptcy-related obstacles to collection under D&O Insurance is especially timely. Regulatory authorities are more closely scrutinizing the conduct of directors and officers, and management may find itself increasingly at risk for claims brought by frustrated stakeholders. Directors and officers should be particularly careful to ensure that their insurance coverage is an accessible resource in bankruptcy.

D&O Insurance policies are often complex documents, the terms of which vary by insurer and by policy. However, companies approaching renewals of their policies or purchasing insurance for the first time are often able to negotiate favorable changes or endorsements if they know what to target. This article addresses several key insolvency-related issues that should be considered by companies negotiating D&O Insurance policies, even if insolvency seems unlikely. Indeed, waiting until the risk or advent of insolvency to focus on insurance coverage will hinder negotiations and will increase the cost and substantially decrease the likelihood of obtaining favorable terms. Thus, directors and officers should evaluate their policies regularly and consider the issues discussed in this memorandum well before the issues arise.

General Structure of D&O Insurance

Three primary types of coverage are available to companies. Side A provides direct coverage for directors and officers for loss (including defense costs[1]) from claims made against them. It is intended to protect directors and officers when the company does not or may not (either by law or under its charter or bylaws) indemnify them.

Under Side B coverage, the insurer agrees to reimburse the company for indemnity payments made to directors and officers, but usually only after the company has already paid a "retention," a specified amount of the claim itself (and similar to a deductible).[2]

Side C coverage (or "entity" coverage) is generally defined as coverage for the company itself relating to claims brought by third parties

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against the company. For publicly traded companies, Side C coverage usually extends only to securities claims.[3]

Insurance Proceeds as Property of the Estate

The Problem

Many companies purchase a single insurance policy that provides for Side A, Side B, and Side C coverage within a single aggregate policy limit, and a company should keep in mind that, if its policy has one aggregate limit then directors and officers share in the same pool as the company. When a company with this type of comprehensive insurance policy (often referred to as an "ABC tower") enters bankruptcy, creditors or other stakeholders of the debtor may argue that the policy and its proceeds are property of the debtor's estate because the company paid for the policy and has rights under it.

If the policy and its proceeds are found to be property of the debtor's estate, the automatic stay provisions of the Bankruptcy Code may prevent directors and officers from accessing the proceeds outside of the general bankruptcy claims allowance process. Parties in interest, such as the Creditors' Committee, have strong incentives to argue for maintaining the automatic stay because payments made to directors and officers under the policy could "deplete the pot" available to all creditors. If directors and officers receive proceeds of Side A coverage, then the amount available to the company under its Side B (and in some cases Side C) coverage drops dollar for dollar.

As an initial matter, the insurance policy itself is almost always considered part of a debtor's bankruptcy estate.[4] However, the case law is far from settled as to when insurance policy *proceeds* are part of a debtor's estate.[5] Courts undertake a fact-intensive analysis to determine whether D&O Insurance policy proceeds are property of the estate, generally focusing on whether the policy proceeds are for the debtor's benefit.[6]

For example, if a D&O Insurance policy includes only Side A coverage, courts are likely to find that the policy proceeds are not property of the estate, because the coverage is available only for directors and officers; similarly, if Side B coverage exists but provides only hypothetical benefits to the company, courts have found that policy proceeds do not generally benefit the company enough to place the proceeds within the estate.[7]

However, when directors and officers incur actual indemnification claims, for which they are entitled to reimbursement by the company, a court may view policy proceeds as part of the debtor's estate. Courts taking this approach reason that a direct payout under Side A to directors and officers would deplete the funds otherwise available to the company to reimburse the outstanding indemnification claims, and, thus, the company benefits from access to the policy.[8]

When the insurance policy includes Side C coverage, in addition to Side A or Side B, courts are more likely to find that the proceeds are part of the debtor's estate.[9] Side C coverage almost always inures to the debtor's benefit, because it protects the company from direct claims, rather than merely providing derivative coverage for claims against directors and officers. Nevertheless, when Side C protection does not, in practice, provide a genuine benefit to the estate, courts sometimes conclude that Side A or B proceeds from insurance policies with Side C coverage are not property of the estate.

This occurs when, for example, the bankruptcy court has extinguished all of the potential securities litigation claims against the company that might have been covered by Side C coverage or when, after distribution to directors and officers, there remains a sufficient reserve for potential Side C claims.[10] A court may also decide that, if all cases against the debtor have been stayed, then the debtor does not have any covered claims and therefore lacks a property interest in insurance proceeds.[11]

Further complicating this area of the law, some courts do not explicitly reach the property of the estate question. Rather, they permit the directors and officers to access the D&O Insurance based on a conclusion that the harm to the directors and officers in having to advance their own defense costs outweighs the potential harm to the estate.[12] Given the uncertainty in this area of the law, careful drafting of a company's D&O Insurance policy is necessary to ensure that insurance coverage is available to directors and officers when the company is in bankruptcy or otherwise unable or unwilling to pay.

Solutions

Stand-Alone Side A Coverage

To mitigate the risk that a D&O Insurance policy or its proceeds are found to be "property of the estate" in an insolvency proceeding, companies should consider purchasing, in addition to the tower policy, non-rescindable, stand-alone Side A coverage for the exclusive benefit of directors and officers. Such coverage would be available if directors and officers are unable to access coverage under the primary policy, if the primary policy limits are insufficient, or if there is a gap in coverage. Such stand-alone coverage generally is rescindable only for non-payment of premiums.

Additional Side A coverage can be either excess "follow the form" insurance or "difference in conditions" coverage. Excess "follow the form" insurance provides additional insurance that conforms to the terms of the primary policy. Usually, a "follow the form" policy will not pay out until the insured has exhausted all of the limits on the underlying policy.[13] This structure provides an insured with seamless coverage for the same set of potential losses.

Alternatively, "difference in conditions" coverage typically provides a broader base of coverage by, among other things, covering situations in which the primary insurer refuses to pay under the policy or cannot pay due to insolvency. Thus, "difference in condition" coverage can insure a director or officer against the risk that a primary D&O policy will be unavailable in bankruptcy.

When stand-alone Side A coverage exists, the proceeds from the insurance policy will almost surely not be property of the debtor's estate if the company files for bankruptcy because the company is not insured by the policy for either its own liability or its indemnification of its directors and officers and, therefore, has no legal or equitable interest in the insurance proceeds. Moreover, when separate Side A coverage is purchased, its limits cannot be depleted by the company as a co-insured.

The primary disadvantage to this approach is the added cost of purchasing a stand-alone Side A policy in addition to the tower. A further consideration when purchasing stand-alone Side A coverage is whether to select an insurance carrier separate from the company's primary insurance provider. On the one hand, selecting a different insurance carrier hedges against insurer credit and insolvency risk, barring a more general major downturn in the insurance industry. On the other hand, dealing with multiple insurers may lead to higher costs and burden for the company.

Independent directors should also consider insisting that the company provide separate independent directors' liability (IDL) insurance for their exclusive benefit, as shared D&O Insurance, including shared stand-alone Side A coverage, may be quickly consumed by management or interested directors, who may be more likely defendants. IDL coverage may be portable across an individual's service on several boards; it typically does not require a retention, and often covers a broader range of events than shared D&O Insurance policies.

Priority of Payments Provision

If procuring separate Side A coverage proves to be too costly or impractical, then including in the primary policy a well-drafted "priority of payments" provision that prioritizes Side A coverage over all other types of coverage is the next best solution.[14] Such a provision provides that the proceeds of the policy are first paid to directors and officers before becoming available for other forms of coverage, as in the following example.[15]

> In the event of Loss arising from any Claim(s) for which payment is due under the provisions of this policy, then this policy shall: (i) first pay such Loss for which coverage is provided under Coverage A of the policy (ii) then, solely with respect to whatever remaining amount (if any) of the Limit of Liability is available after payment in full of such Loss under Coverage A, pay such Loss for which coverage is provided by Coverage B of the policy.

Further language can be added (1) confirming that the company has rights to coverage and proceeds only after all claims against directors and officers have been fully resolved and (2) providing that no Side B or Side C coverage shall be available unless and until the board of directors so certifies in writing. This approach is materially better than a formulation that gives the board the right to send a notice cutting off (in some cases temporarily) Side B or Side C coverage. Such a notice may violate the automatic stay and possibly raise fiduciary duty issues.[16]

Allocation of Costs Provision

A final approach, though less ideal, is to create separate limits for the directors and officers and for the company, in order to avoid a coverage conflict between the two types of insureds. The advantage of this approach is that, even when the company is in bankruptcy, the directors and officers should be able to access their portion of the policy proceeds without diminishing the amount available to the estate.

The more serious disadvantage—whether a company is in bankruptcy—is that the directors and officers may run out of Side A coverage before the policy as a whole is consumed. Thus, an underlying policy with a pre-determined allocation for directors and officers works best in conjunction with sufficient stand-alone Side A coverage, which provides a reserve for directors and officers if the tower's Side A coverage is exhausted.

Retentions and Financial Impairment

The Problems

A retention (or deductible) is the amount that the company must pay before the insurer's obligation arises with respect to a particular claim. When the company pays its Side B retention, the Side B policy may require the insurer to pay directors and officers *directly* for any amount that the company would be permitted or required to indemnify, or the Side B policy may require the insurer only to reimburse the company for amounts that the company actually pays to directors and officers.

A bankrupt company may be unable or unwilling to pay its retention. For example, if a claim arose before the company filed for bankruptcy, bankruptcy law may forbid the company from paying the pre-petition unsecured retention expense without court approval. If the company cannot or will not pay the retention, then directors and officers may be forced to pay the retention themselves before they receive coverage,[17] although the result may depend on a close reading of the policy language.

For example, in *Republic Technologies International, LLC v. Maley*, the court noted that the D&O policy provided for either the company *or* the insureds to pay the retention, and therefore required the individual insureds to pay the retention before collecting on the policy.[18] By contrast, in *Bernstein v. Genesis Insurance Co.*,[19] the insurance contract stated that the retention applied only when the company actually indemnified the directors. Thus, the directors did not have to advance a retention once the company decided not to indemnify them, even though the company was legally obligated both to indemnify the directors and to pay the retention.

Even if retention is satisfied or waived, the insurer may also argue that it has no obligation to pay Side B coverage. When the policy provides coverage for certain obligations that the company is "required or permitted to pay as indemnification to any of the Insured Persons," insurers may assert that a Chapter 11 filing obviates the company's requirement or permission to indemnify.

This scenario could occur in circumstances in which, under a plan of reorganization, director and officer indemnification claims are classified in a subordinated class that receives no distribution. If a plan of reorganization bars the debtor from honoring the indemnification claims of the directors and officers, then an insurer may argue that it is similarly relieved of the obligation to satisfy directors' and officers' indemnification claims.

Solutions

The aforementioned issues can be solved by expressly making Side A coverage fully available to directors and officers in the event of "Financial Impairment," either with no retention or deductible or with a retention of $0. For example:

> In the event of any Financial Impairment, the retention shall be permanently waived with respect to all claims by or on behalf of each of the insured persons. Notwithstanding any Financial Impairment, the insurer shall pay on behalf of each of the insured persons, loss for which the insured person is not indemnified by the company and which the insured person becomes legally obligated to pay.

Additionally, the following protective language clarifies that the insurer is not relieved of its obligations because of a company's insolvency proceeding:

> No Financial Impairment of the company shall relieve the insurer of any of its obligations hereunder. In the event of Financial Impairment of the company, the insurer shall pay on behalf of the Directors and Officers for Ultimate Net Loss that the Directors and Officers become legally obligated to pay that would have been payable by the company and reimbursable by the insurer but for such Financial Impairment; provided however, that the insurer shall be subrogated, to the extent of any payment, to the rights of the Directors and Officers to receive indemnification from the company.

It is also critical to review (and amend as necessary) the definition of "Financial Impairment" to ensure that it covers the various possibilities under which the company may be unable to indemnify its directors and officers or satisfy the retention. This definition should cover all types of insolvency proceedings, regardless of the venue or source of law. An example is as follows:

> Financial Impairment means the Company:
>
> (a) having an order of relief entered with respect to it, commencing any case, proceeding or other action, or receiving a decree or order against it under any law of any jurisdiction relating to bankruptcy, insolvency, judicial management, reorganization, administration or relief of debtors seeking (x) adjudication of the Company as bankrupt or insolvent, (y) reorganization, judicial management, administration, arrangement, adjustment, winding up, liquidation, dissolution, composition or similar relief with respect to the Company or its debts; (z) appointment of a receiver, interim receiver, manager, monitor, trustee, custodian, liquidator, sequestrator or other similar official for it or for any substantial part of its assets;
>
> (b) making a general assignment for the benefit of creditors;
>
> (c) having commenced against it any action of a nature referred to in clause (a) or (b) that remains undismissed or undischarged for a period of 45 days;
>
> (d) having commenced against it any action

seeking issuance of a warrant of attachment, execution, distraint or similar process against all or any substantial part of its assets, which results in the entry of an order for such relief that is not dismissed or discharged within 45 days from entry;

(e) taking any action in furtherance of, or indicating its consent to, approval of, or acquiescence in, any of the acts referred to in clauses (a) through (d);

(f) being authorized by its board of directors to perform any of the actions referred to in clauses (a) through (e); or

(g) the Company failing to pay, or admitting in writing its inability to pay, its debts generally as they become due.

Finally, it is not ideal for a policy to state that Side A coverage is unavailable when the company is "permitted or required" to indemnify directors and officers. The better formulation is for Side A coverage to be available unless the company has "actually indemnified" the directors and officers. Thus, regardless of whether Side B coverage is available in bankruptcy, Side A coverage should be available to protect directors and officers who do not receive indemnification.

'Insured vs. Insured' Exclusion

The Problem

Almost every insurance policy contains an "insured vs. insured" exclusion. Such a provision excludes from coverage claims "brought by or on behalf of" one insured against another insured under the policy, such as those brought by the company against the directors and officers of the company or vice versa.[20] The exclusion stems from the desire to avoid collusion between, for example, the company and its directors and officers.[21]

Although the insured vs. insured exclusion is a well-established and appropriate component of D&O Insurance, it raises potential issues for a company in bankruptcy and often needs corrective drafting. For example, if a bankruptcy or litigation trustee or Creditors' Committee (or the Federal Deposit Insurance Corporation (FDIC) as receiver for a distressed bank)[22] brings suit against directors or officers on behalf of the debtor company, insurers may seek to rely on the insured vs. insured exclusion to avoid indemnification on the theory that such entities have stepped into the company's shoes.[23]

Courts are split on whether the insured vs. insured exclusion in a D&O Insurance policy precludes directors and officers from seeking coverage for claims brought against them by a trustee on behalf of the company.[24] Absent clear drafting, a bankruptcy court will sometimes, but not always, require an insurer to indemnify in respect of claims by the bankruptcy trustee or the Creditors' Committee against the debtor's directors and officers.[25]

For example, in *Reliance Insurance Co. v. Weis*,[26] the court upheld the insured vs. insured exclusion when the trustee filed claims against the former officers of the debtor company. The court determined that "there is no significant legal distinction between [the company] and [the trustee for the] bankruptcy estate," and the suit brought by the bankruptcy trustee qualified under the policy's insured vs. insured exclusion language as a suit brought "on behalf of" the company.[27] The court further justified its holding by reasoning that the insurer had addressed the issue of bankruptcy elsewhere in the policy, but not in the insured vs. insured exclusion.[28]

In contrast, the court in *In re County Seat Stores, Inc.*[29] aligned itself with courts in other circuits by interpreting "company" as excluding the bankruptcy trustee.[30] Cases tend to turn on whether the judge views the trustee as a separate entity from the company in question and whether the trustee is in a genuine adversarial relationship with the officers and directors.[31] Thus, an ambiguous "insured vs. insured" exclusion may leave officers and directors at risk that their D&O Insurance will not cover a suit brought by a trustee, Creditors' Committee or similar entity.

Solutions

Because courts disagree on whether certain parties are considered "insureds" in the bankruptcy context, it is crucial that a company's insurance policy state clearly when the exclusion should not apply. Companies should therefore negotiate with their insurers to add language that makes the insured vs. insured exclusion inapplicable in certain insolvency-related contexts.

Insurers often agree to carve out suits brought by at least some bankruptcy-related representatives of or successors to the company. The following is an illustrative provision:

> The insurer shall not be liable to make any payment for Loss in connection with a Claim made against an Insured that is brought by or on behalf of any Insured, the company, or any security holder of the company, whether directly or derivatively; provided, however, this exclusion shall not apply to any Claim brought by or on behalf of the company or any Subsidiary **in or in connection with any bankruptcy, insolvency or reorganization proceeding**, including by any **debtor-in-possession, examiner, trustee, receiver or liquidator of the company or any Subsidiary, any official or other committee or any post-bankruptcy or post-reorganization litigation-empowered entity, or any assignee of any of the above-listed entities**.

By carving out bankruptcy suits from the policy's insured vs. insured exclusion, companies can better protect directors and officers in the event they are sued on the company's or the estate's behalf in insolvency proceedings.

Prior Knowledge

The Problem

In reviewing D&O Insurance with an eye towards possible bankruptcy or restructuring proceedings, companies should also consider renegotiating several other common insurance policy provisions that may place pressure on a financially distressed business even if the provisions would not be directly implicated by a bankruptcy.

One such provision is a "prior knowledge" provision. Prior knowledge provisions permit an insurer to deny coverage if the company makes a material misstatement or omission in the application process about facts or circumstances that might give rise to a claim. The language of some policies may allow the insurance company to deny coverage to all of the insureds by imputing a misstatement or omission to all of them—even when only a subset of the insureds knew the relevant information.[32] An insurer may also deny coverage for wrongful acts, such as the neglect or breach of duty of a single director or officer. This can be a serious problem for innocent insureds who were not part of the alleged fraudulent or illegal acts but who risk losing coverage on account of the wrongdoing or knowledge of their fellow insureds.

Solution

In order to prevent innocent insureds from being denied coverage, the company should negotiate with the insurer to avoid imputing wrongdoing from one insured to the others. Specifically, the company should obtain a full severability provision, which specifies that an insurer can rescind coverage only for the insured who had actual prior knowledge of material facts giving rise to a claim or who committed the wrongdoing. Companies should also take particular care to ensure that severability provisions precluding imputation are identical in all of their insurance policy documents.[33]

Change in Control

The Problem

The vast majority of D&O Insurance policies contain a "change in control" provision that determines how coverage changes when a company experiences a change in control. Although the filing of bankruptcy alone may not trigger a change in control clause, an insolvency proceeding that fundamentally alters the voting power within the company may trigger this provision. For example, the appointment of a new board of directors or the sale or distribution of all of the company's stock or assets to creditors may trigger a change in control clause.

D&O policies typically state that, in the event of a change in control, the insurance policy will remain in effect for the remainder of the policy period, but that coverage will apply only to claims for wrongful acts that occurred *prior* to the change in control. In this case, additional coverage would need to be obtained for the reorganized company and its new board for acts occurring subsequent to the change in control. Further, some policies may actually terminate coverage *completely* upon a change in control. Therefore, it is crucial for a company to be aware of how its D&O Insurance would be affected by a change of control (including how a change of control is defined in the policy).

Solutions

Though some scenarios would clearly trigger a change in control, other situations may be more difficult to discern, such as when a trustee takes control of the corporation in a reorganization. A company, therefore, should ensure at the outset that the D&O Insurance policy contains a clear and appropriate definition of "change in control" that, for example, carves out the commencement of a bankruptcy proceeding.

Furthermore, because coverage often applies only to claims for acts that occurred prior to the change in control, a company should obtain coverage for events occurring subsequent to the change in control. In Chapter 11 cases, directors and officers may be able to obtain some additional protection from future claims through releases, exculpations, or indemnifications often included in a plan of reorganization.[34]

A final related issue is the insurance policy's "tail" coverage—the time period following the policy's termination when the company may continue to report claims for potential coverage to the insurer based on conduct that occurred prior to termination. Most D&O policies contain one year of "tail" coverage that allows the board and management of the company to submit claims for one year following the date of termination in connection with claims arising out of conduct that occurred prior to termination.

In addition to this restrictive one-year time limit, the company must typically pay a supplemental premium for "tail" coverage, which it may be unable to pay after it has filed for bankruptcy. A company's management should consider extending the time period of tail coverage (ideally to extend beyond the statute of limitations for breach of fiduciary duty) and should consider requiring the company to prepay the premiums for tail coverage. Six years is not uncommon.

Notes

1. Companies should establish that, under Side A coverage, the insurer will advance defense costs to directors and officers for claims prior to their final disposition to prevent directors and officers from having to pay such costs out of pocket and then seek reimbursement.

2. A "retention" is the amount paid by or on behalf of an insured before the insurer's obligation to provide coverage arises. A "deductible," on the other hand, is simply subtracted from the amount due from the insurer. Arguably, until the "retention" is paid, the insurer is absolved from any payment. *See* Don A. Lesser & Howard M. Garfield, *Impact of the Corporation's Bankruptcy on the Defense of D&O Claims*, 692 PLI/Comm 277, 285 (1994).

3. John C. Tanner & Anthony P. Tatum, "10 Issues to Consider When Negotiating Your Company's D&O Coverage," ACC Docket, 99–100 (July/Aug. 2007) (describing coverage for securities claims). Some policies also include separate coverage for specific losses (*e.g.*, costs associated with public relations firms in connection with the company's "crisis management").

4. *See MacArthur Co. v. Johns-Manville Corp.* (*In re Johns-Manville Corp.*), 837 F.2d 89, 92 (2d Cir. 1988); *La. World Exposition, Inc. v. Fed. Ins. Co.* (*In re La. World Exposition, Inc.*), 832 F.2d 1391, 1399 (5th Cir. 1987).

5. *Compare In re Adelphia Commc'ns Corp.*, 298 B.R. 49, 53 (S.D.N.Y. 2003) (holding that the proceeds of a

D&O policy were not property of the estate, even though it indemnified the debtor, because the debtor had not yet made or even contemplated making any payments entitling it to indemnification), *and In re MF Global Holdings Ltd.*, 515 B.R. 193 (Bankr. S.D.N.Y. 2014) (holding that D&O insurance policy proceeds are not property of the estate when, among other things, a reserve is established for the debtors for estimated indemnification claims), *with In re Equinox Oil Co.*, 300 F.3d 614, 620 (5th Cir. 2002) (holding that proceeds of an insurance policy covering oil rig accidents that named the debtor as the insured were property of the estate).

6. *See In re Downey Fin. Corp.*, 428 B.R. 595, 603 (Bankr. D. Del. 2010) (finding that proceeds of a liability insurance policy "will be property of the estate if depletion of the proceeds would have an adverse effect on the estate to the extent the policy actually protects the estate's other assets from diminution") (citing *In re Allied Digital*, 306 B.R. at 512).

7. *See, e.g.*, *La. World Exposition*, *supra* n.4 at 1401 (holding that proceeds benefitting directors and officers were not part of the estate); *Ochs v. Lipson* (*In re First Cent. Fin. Corp.*), 238 B.R. 9, 32–33 (Bankr. S.D.N.Y. 1999) (allowing payments out of D&O policy to directors because the essence of the D&O policy was to protect directors and officers, not the company).

8. *See, e.g.*, *Aetna Cas. & Sur. Co. v. Jasmine, Ltd.* (*In re Jasmine, Ltd.*), 258 B.R. 119, 128 (D.N.J. 1999) (holding that the company's interest in indemnification proceeds of a D&O policy was enough to make the entire policy part of the bankruptcy estate, including the conventional D&O portion). *But cf. In re Mila, Inc.*, 423 B.R. 537, 545 (B.A.P. 9th Cir. 2010) (allowing officer to use proceeds despite debtor's interest in indemnification proceeds, because debtor could not identify any other directors or officers it might need to indemnify).

9. *See, e.g.*, *SN Liquidation, Inc. v. Icon Int'l, Inc.* (*In re SN Liquidation, Inc.*), 388 B.R. 579, 584 (Bankr. D. Del. 2008) (holding that a policy covering both the debtor and directors and officers was property of the estate); *In re Cybermedica, Inc*., 280 B.R. at 15–16 (holding that policy and proceeds were part of the bankruptcy estate when the policy included entity coverage as well as direct coverage for directors and officers).

10. In *In re CHS Electronics*, 261 B.R. at 542–43, the court held that, when all potential triggers for entity coverage have been extinguished, the existence of entity coverage is not a basis for treating D&O Insurance proceeds as property of the estate. Furthermore, when $8,750,000 was still available under the policy and potential debtor indemnification claims were only $258,000, the automatic stay would only apply to the $258,000.

11. *See In re Downey Fin. Corp.*, 428 B.R. 595, 605 (Bankr. D. Del. 2010).

12. For example, in the *MF Global* case, the court initially declined to determine whether proceeds were property of the estate, but lifted the automatic stay to permit the individual insureds to access $30 million in defense costs. *In re MF Global Holdings,* 469 B.R. at 194. Later, however, the court expanded the cap and ultimately determined that nearly all of the insurance proceeds lay outside the estate. *See In re MF Global Holdings Ltd.*, 515 B.R. 193, 196, 204 (Bankr. S.D.N.Y. 2014). *See also In re Enron Corp.*, No. 01-16034 (AJG), 2002 WL 1008240, 2002 Bankr. LEXIS 544 (Bankr. S.D.N.Y. May 17, 2002) (lifting a part of the automatic stay to permit directors and officers to access D&O liability insurance without addressing whether the policy or its proceeds were property of the estate).

13. *See Citigroup Inc. v. Fed. Ins. Co.*, 649 F.3d 367, 373 (5th Cir. 2011); *Qualcomm, Inc. v. Certain Underwriters at Lloyd's, London*, 161 Cal. App. 4th 184, 193–203, 73 Cal. Rptr. 3d 770, 777–85 (2008). In each case, the courts held that the excess policy unambiguously required the primary insurance to be exhausted or depleted first, and both parties had settled with their primary insurer for an amount less than the policy limit before seeking excess coverage for expenses. In contrast, some courts have found that excess policies may be triggered when exhaustion requirements are ambiguous. *See, e.g.*, *Lexington Ins. Co. v. Tokio Marine & Nichido Fire Ins. Co. Ltd.*, No. 11 Civ. 391(DAB), 2012 WL 1278005, at *4, 2012 U.S. Dist. LEXIS 59635, at *10 (S.D.N.Y. Mar. 28, 2012).

14. Courts have enforced priority of payment provisions in determining whether to allow insured individuals to reach the proceeds of an insurance policy. *See In re MF Global Holdings Ltd.*, 469 B.R. 177, 193 (Bankr. S.D.N.Y. 2012); *In re Downey Fin. Corp.*, 428 B.R. 595, 607 (Bankr. D. Del. 2010) (enforcing the "clear chain of priority among the three types of [D&O Insurance] coverages" set forth in the insurance policy).

15. The presence of a priority of payments provision does not guarantee that a bankruptcy court will modify the automatic stay to allow directors or officers to access Side A coverage, particularly if the debtor seeks to invoke Side B or Side C coverage. In *Miller v. McDonald* (*In re World Health Alternatives, Inc.*), 369 B.R. 805, 811 (Bankr. D. Del. 2007), all three types of coverage were included in the insurance policy, but only Side A coverage was invoked. In ruling that the proceeds lay outside the bankruptcy estate, the court recognized that the priority of payments provision stood as an impediment to the trustee's recoveries, but did not use the priority of payments provision as a determining factor. It is unclear whether the court would have permitted the individual beneficiaries to reach the Side A coverage if the other two types of coverage had been implicated as well. *See id.*

16. As a further procedural point, some policies require the company to give written notice to the insurer before the insurer must make payments on a claim. Because the company may be adverse to the directors and officers, we recommend clarifying that insurance payments should be made in all instances to the directors and officers, even without specific notice from the company or, alternatively, that any

insured or indemnitee may provide notice directly to the insurer.

17. *Compare Fid. & Guar. Ins. Co. v. Emps. Ins. of Wausau* (*In re Apache Prods. Co.*), 311 B.R. 288 (Bankr. M.D. Fla. 2004) (relying upon the plain language of the insurance policy requiring exhaustion of the self-insured retention and holding that the failure to pay resulted in no obligation for the insurer), *with Am. Safety Indem. Co. v. Vanderveer Estates Holding, LLC* (*In re Vanderveer Estates Holding, LLC*), 328 B.R. 18 (Bankr. E.D.N.Y. 2005) ("[C]ase law interpreting § 365 of the Bankruptcy Code makes it clear that … the failure of a bankrupt insured to fund a self-insured retention does not relieve the insurer of the obligation to pay claims under the policy. This is so because where an insured debtor has paid the policy premium in full, the insurance policy is not an executory contract for purposes of § 365 of the Bankruptcy Code, even where the debtor has continuing obligations, such as the payment of a self-insured retention, a deductible, or a premium."), *and Home Ins. Co. v. Hooper*, 294 Ill. App. 3d 626, 632, 691 N.E.2d 65, 69–70 (1998) (holding that requiring actual payment of the self-insured retention as a condition precedent to triggering the insurer's obligation when the insured was bankrupt violated both Illinois public policy as well as the policy provision stating that the bankruptcy or insolvency of the insured will not alter the insurer's obligations under the policy). Even in the case of explicit retention language, there may be confusion when the policy is silent on the apportionment of the cost of retention among the various directors and officers. When the insurance policy is silent, some authors argue that the insurer's obligations arise once directors and officers have incurred indemnifiable defense costs in the amount of retention, regardless of the company's bankruptcy. *See* W. Muzette Hill & James B. Green, *Problems Arising out of the Insured's/Insurer's Bankruptcy*, 539 PLI/Lit 533, 549–57 (1995); Don A. Lesser & Howard M. Garfield, *Impact of the Corporation's Bankruptcy on the Defense of D&O Claims*, 692 PLI/Comm 277, 285–88 (1994).

18. *Republic Techs. Int'l, LLC v. Maley* (*In re Republic Techs. Int'l, LLC*), 275 B.R. 508, 516–17 (Bankr. N.D. Ohio 2002).

19. 90 F. Supp. 2d 932, 939 (N.D. Ill. 2000).

20. An example is an exclusion of coverage for losses "in connection with any claim or claims made against the Directors or Officers … that are brought by any Insured or the company, except for independent shareholder derivative actions." Similar language excludes from coverage any claim "by or on behalf of any person or entity included within the definition of Insured against any other person or entity included within the definition of Insured."

21. In two leading cases from the 1980s, insurers argued unsuccessfully that claims by insured companies against former directors and officers were not covered. *See Nat'l Union Fire Ins. Co. of Pittsburgh, Pa. v. Cont'l Ill. Corp.*, 666 F. Supp. 1180 (N.D. Ill. 1987); *Nat'l Union Fire Ins. Co. of Pittsburgh, Pa. v. Seafirst Corp.*, No. C85-396R, 1986 WL 1174695, 1986 U.S. Dist. LEXIS 28065 (W.D. Wash. Mar. 18, 1986); *see generally* David J. Marchitelli, Annotation, *Construction and Application of Insured vs. Insured Exclusion of Directors and Officers Insurance Policy*, 14 A.L.R.6th 687 (2012). Following these two cases, insurers became careful to exclude claims brought on behalf of the insured company from D&O Insurance. *See Sphinx Int'l, Inc. v. Nat'l Union Fire Ins. Co. of Pittsburgh, Pa.*, 412 F.3d 1224, 1229–31 (11th Cir. 2005) (discussing the policies behind the "insured vs. insured" exclusion).

22. *See generally St. Paul Mercury Ins. Co. v. FDIC*, 774 F.3d 702 (11th Cir. 2014) (finding an "insured vs. insured" exclusion to be ambiguous whether an action brought by the FDIC as receiver of a distressed bank is excluded from coverage).

23. Some policies provide that coverage is only available if the claim is brought without the "assistance, participation or intervention" of an insured or the company. Without a materiality qualifier, insurers could argue that responding to a subpoena or appearing at a deposition is excluded from coverage. Qualifiers such as "voluntary and material assistance or participation" or "active assistance" better protect directors and officers.

24. *See Fed. Ins. Co. v. Surujon*, No. 07-22819 CIV, 2008 WL 2949438, at *6 n.5, 2008 U.S. Dist. LEXIS 57800, at *19–31 n.5 (S.D. Fla. July 29, 2008) (acknowledging that case law is unsettled).

25. *Compare Alstrin v. St. Paul Mercury Ins. Co.*, 179 F. Supp. 2d 376, 405 (D. Del. 2002) (granting the D&O plaintiffs' motion for partial summary judgment on certain policy-related defenses raised by the insurer because claims by the debtor's estate against the D&O plaintiffs did not fall within the insured vs. insured exclusion), *with FDIC v. BancInsure, Inc.*, No. 14-56132 (9th Cir. Jan. 10, 2017) (mem.) (reversing district court and holding that insurer had no obligation to cover claims brought by bank receiver despite receiver's dual role as shareholder).

26. 148 B.R. 575, 583 (E.D. Mo. 1992), *aff'd in part*, 5 F.3d 532 (8th Cir. 1993) (unpublished).

27. *Id.*

28. *Id.* at 580. Upon reviewing the contractual provisions that dealt with bankruptcy, the court concluded that both parties had made reasonable arguments and ultimately construed the contract against the insurer as drafter of the policy. *See Id.* at 579, 580.

29. *Cohen v. Nat'l Union Fire Ins. Co. of Pittsburgh, Pa.* (*In re County Seat Stores, Inc.*), 280 B.R. 319, 328 (Bankr. S.D.N.Y. 2002).

30. *See, e.g.*, *Biltmore Assocs., LLC v. Twin City Fire Ins. Co.*, 572 F.3d 663, 670 n.15 (9th Cir. 2009) (listing numerous cases holding "a post-bankruptcy entity as different from the debtor before it went into chapter 11 for purposes of the insured versus insured exclusion"). The Second

Circuit has not addressed the insured vs. insured exclusion directly but has acknowledged that, "if the policy language is ambiguous, particularly the language of an exclusion provision, the ambiguity must be interpreted in favor of the insured." *Goldberger v. Paul Revere Life Ins. Co.*, 165 F.3d 180, 182 (2d Cir. 1999).

31. *See Indian Harbor Ins. v. Zucker*, 553 B.R. 633, 642–44 (W.D. Mich. 2016) (holding that insured vs. insured exclusion applied when debtor had assigned its claims to a Liquidating Trustee subject to a provision that officers and directors would only be required to pay amounts recovered from insurance), *appeal argued* (6th Cir. Mar. 8, 2017).

32. *See, e.g.*, *XL Specialty Ins. Co. v. Agoglia*, Nos. 08 Civ. 3821, 4196, 5252, 2009 WL 1227485, at *9–11, *32 (S.D.N.Y. Apr. 30, 2009) (denying coverage to all directors and officers based on CEO's knowledge of fraudulent activity).

33. *Id.* (relying on excess policy's language to impute knowledge).

34. *See* 11 U.S.C. § 1123(b)(6) (2012) (providing bankruptcy courts with considerable discretion in approving plans of reorganization). However, some courts have held that even with broad discretion, they do not have authority to release non-debtor parties in the plan of reorganization. *See, e.g.*, *In re Lowenschuss*, 67 F.3d 1394, 1401 (9th Cir. 1995); *Landsing Diversified Props.-II v. First Nat'l Bank & Trust Co. of Tulsa* (*In re W. Real Estate Fund, Inc.*), 922 F.2d 592, 600–02 (1990), *modified sub nom. Abel v. West*, 932 F.2d 898 (10th Cir. 1991); *Owaski v. Jet Fla. Sys., Inc.* (*In re Jet Fla. Sys., Inc.*), 883 F.2d 970, 972–73 (11th Cir. 1989); *see also In re Metromedia Fiber Network, Inc.*, 416 F.3d 136, 142 (2d Cir. 2005) ("No case has tolerated non-debtor releases absent the finding of circumstances that may be characterized as unique.").