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# WHO OWNS THE PROCEEDS OF A DIRECTORS' AND OFFICERS' INSURANCE POLICY IN CORPORATE BANKRUPTCY?

CHS Electronics, Inc. and certain of its directors and officers were sued in a class action alleging fraud under the federal securities laws. After a mediation, the class action plaintiffs agreed to settle all of their claims for $11.75 million and other consideration.

Before the parties to the class action sought approval of their settlement in the district court, CHS sought bankruptcy relief under Chapter 11. The Bankruptcy Code's automatic stay thus prevented the parties from seeking that approval. In the meantime, the bankruptcy court confirmed CHS's plan of reorganization and appointed a liquidating trustee to administer the debtor's estate. The plan apparently discharged the debtor from any claims that could be asserted against it but did not discharge the debtor's former directors and officers with respect to claims the liquidating trustee apparently intended to assert against them directly.

CHS carried $20 million of D&O liability insurance under two separate policies, each of which included Part A coverage for direct claims against officers and directors, Part B coverage to reimburse the company for indemnification claims of its officers and directors, and Part C entity coverage for claims asserted directly against the company.

The plaintiffs and CHS's directors and officers subsequently sought the bankruptcy court's approval to fund the class action settlement with proceeds of the debtor's D&O policies, subject to the district court's approval of the substantive settlement. The liquidating trustee objected to the motion claiming that the D&O policies and their proceeds were allegedly property of CHS's estate because the Part C "entity coverage" insured the corporation itself. The bankruptcy court denied the trustee's objection, relying on precedents distinguishing who owns an insurance policy from who owns its proceeds and on the fact that the plan of reorganization had discharged the debtor corporation from any claims that might otherwise be covered by the Part C entity coverage.

The Bankruptcy Court, however, left open the possibility that in some circumstances the proceeds of a D&O policy with entity coverage can be property of the estate under section 541 of the Code. If, for example, securities claims against the debtor corporation had survived the plan's confirmation, the court would have likely found that some or all of the policy proceeds consti-

tuted property of the estate. Indeed, the CHS court noted other decisions that have reached that conclusion when presented with those facts. In those situations, policy proceeds were distributed only to those with claims against the debtor covered by the policy and were not ratably distributed among all of the debtor's creditors.

Bankruptcy practitioners should carefully review a debtor's D&O policy to determine whether the policy proceeds might be considered estate property. Moreover, corporate counsel should consider including policy provisions to protect their debtors and officers from being left uninsured or under-insured in the event of a corporate bankruptcy. Likewise, claimants against joint insureds, when one insured is a debtor in bankruptcy, should take care not to violate the Bankruptcy Code's automatic stay provisions when pursuing co-insureds and their coverages.

For a comprehensive discussion of this topic, read the law review article published recently by one of our partners. It can be found at http://www.jwlaw.com/db30/cgi-bin/pubs/bankruptcy.pdf.
***Click here to view the article.***

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*Remember that these legal principles may change and vary widely in their application to specific factual circumstances. You should consult with counsel about your individual circumstances. For further information regarding these issues, contact:*

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