

**Insurance and Bankruptcy:
It's All Clear As Mud
A Basic Primer**

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**INSURANCE AND BANKRUPTCY:
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A BASIC PRIMER**

Ownership of the Policy

1. Property of the estate is defined in §541(a) of the Bankruptcy Code.¹ The Fifth Circuit has held that an insurance policy is generally property of the estate. *Houston v. Edgeworth (In re Edgeworth)*, 993 F.2d 51, 55 (5th Cir. 1993) (based on broad definition of property of the estate in §541, courts are generally in agreement that the policy is property of the estate); *In re Louisiana World Exposition, Inc.*, 832 F.2d 1391, 1399 (5th Cir. 1987). Other courts have reached the same conclusion.²

2. Consequently, the automatic stay generally applies to an insurance policy. *In re Davis*, 730 F.2d 176, 184 (5th Cir. 1984); *see, e.g., Pintlar Corp. v. Fidelity & Cas. Co. (In re Pintlar Corp.)*, 175 B.R.

¹Section references are, unless otherwise specified, to the Bankruptcy Code, Title 11 of the United States Code.

²*A.H. Robins Co. v. Piccinin*, 788 F.2d 994, 1001 (4th Cir. 1986), (“[I]nsurance contracts have been said to be embraced in the statutory definition of “property”.... A products liability policy of the debtor is similarly within the principle....”); *MacArthur Co. v. Johns-Manville Corp.*, 837 F.2d 89, 91 (2d Cir. 1988) (Numerous courts have determined that a debtor’s insurance policies are property of the estate.”); *In re Minoco Group of Cos.*, 799 F.2d 517 (9th Cir. 1986) (“Under the weight of authority, insurance contracts have been said to be embraced in this statutory definition of property”); *National Union Fire Ins. Co. v. Titan Energy, Inc. (In re Titan Energy, Inc.)*, 837 F.2d 325, 329 (8th Cir. 1988) (“[W]e hold that the policies are property of Titan’s estate...”); *In re St. Clare’s Hosp. & Health Center*, 934 F.2d 15, 18 (2d Cir. 1991) (“[T]he debtors’ rights under its insurance policies are property of a debtor’s estate under §541(a) of the Code.”).

379, 382-83 (Bankr. D. Idaho 1994), *rev’d on other grounds*, 124 F.3d 1310 (9th Cir. 1997); *Forty-Eight Insulations, Inc. v. Lipke (In re Forty-Eight Insulations, Inc.)*, 54 B.R. 905 (Bankr. N.D. Ill. 1985); *In re Johns-Manville Corp.*, 40 B.R. 219 (S.D.N.Y. 1984); *Holland Am. Ins. Co. v. Sportservice, Inc. (In re Cahokia Downs, Inc.)*, 5 B.R. 529 (Bankr. S.D. Ill. 1980).

Ownership of the Policy Proceeds

3. Section 541(a)(6) includes proceeds of or from property of the estate as a part of the bankruptcy estate. This definition “is ‘intended to be a broad term to encompass all proceeds of property of the estate.’” *Bradt v. Woodlawn Auto Workers, F.C.U.*, 757 F.2d 512, 515 (2d Cir. 1985). From this, the conclusion might be drawn that if the policy is a part of the estate, then policy proceeds must also be property of the estate pursuant to §541(a)(6). This greatly oversimplifies the issue. An insurance policy is a contract between the insurer and the owner of the policy. It may involve an agreement to indemnify the insured against certain liabilities. It may involve a contract to make the insured whole after a casualty loss. Or it may provide for a payment of a death benefit upon the demise of the insured. In each case, the nature of the estate’s interest in the proceeds will depend upon the nature of the insurance contract, and the identity of the beneficiary of the coverage.

**Ownership of Directors’ and
Officers’ Liability Insurance Policy and
Its Proceeds**

4. In numerous cases, Directors’ & Officers’ (“D&O”) liability insurance may be one of the principal assets of a bankrupt company. The three basic types of D&O insurance provide: 1) liability coverage to the individual directors and officers when the corporation does not provide reimbursement, 2) corporate indemnification which reimburses the corporation for losses or expenses incurred by indemnifying its directors and officers from liability for covered wrongful acts, or 3) entity coverage which provides direct liability protection against claims brought against the corporation due to director and officer wrongful acts.³ To initiate recovery from the directors and officers, a claimant must assert a valid, covered liability claim against the directors and officers. The D&O insurer must then confirm the validity of the claim against the directors’ and officers’ liability policy.⁴

5. In a bankruptcy proceeding, a claimant may file an adversary proceeding pursuant to Bankruptcy Rule 7001.⁵ This would arise where a trustee pursues a claim on the debtor’s behalf to recover for D&O

³George Ong, *Directors & Officers Insurance Proceeds in Bankruptcy: The Impact on an Estate and Its Claimants*, 13 BANKR. DEV. J. 239 (1996).

⁴See *id.* at 242.

⁵FED. R. BANKR. P.7001 (proceeding “ to recover money or property”).

misconduct. Alternatively, a claimant may bring an action directly against the D&O outside the bankruptcy and seek a judgment to be satisfied by the insurance carrier.⁶

6. Because of these various scenarios for potential recovery, the issue of whether the insurance policy is property of the estate, and more importantly, whether the proceeds are property of the estate, has become critical to a claimant’s recovery. The key distinction for “property of the estate” purposes appears to be between the D&O policies themselves and the proceeds of the policies.

7. It appears settled that where a debtor is an insured, the policy itself will be property of the debtor’s estate.⁷ As an example, the automatic stay may prevent an insurance company from canceling a policy without first obtaining relief from the bankruptcy court or a debtor may be allowed extra time to pay premiums on a policy.⁸

8. This analysis, however, does not address the separate issue of whether the *proceeds* of the D&O policies are property of the estate. As the United States Court of

⁶*Louisiana World Exposition, Inc. v. Federal Ins. Co.*, 864 F.2d 1147 (5th Cir. 1989).

⁷See, e.g., *Homsy v. Floyd (In re Vitek, Inc.)*, 51 F.3d 530, 533 (5th Cir. 1995) (“The language of §541(a)(1) is unquestionably broad enough to cover a debtor’s interest in liability insurance”).

⁸See, e.g., *In re Minoco Group of Cos.*, 799 F.2d 517, 519 (9th Cir. 1986) (declaring a D&O policy property of the estate thereby disallowing insurance company’s attempts to cancel the policy).

Appeals for the Third Circuit has recognized, an “estate in bankruptcy only includes property to which the debtor would have a right if the debtor were solvent”.⁹ In other words, the fact that the D&O policies are property of the debtor’s estate gives the debtor nothing more than rights of ownership to the policies – and does not address their right to the proceeds. On this key issue - whether proceeds of a policy are property of a debtor’s estate - depends on the language of the particular D&O policy, the parties intention with respect to the policy, and the facts of the particular case.

9. A standard provision in most D&O insurance policies normally states that the proceeds of the policy are paid directly to individual directors and officers as reimbursement for payments actually made by them to third party claimants. They are not payable to the corporation and do not cover any of the corporation’s liability. Because insurance proceeds are not payable to the corporation and cannot be used to pay any of the corporation’s liabilities, the proceeds payable under this provision should not be construed as property of the corporate debtor’s estate.

10. Under another section of a standard D&O policy, the proceeds of the D&O policies are usually paid to the corporate debtor only as reimbursement for payments actually made by the corporation on behalf of the directors and officers to third party claimants. They are never payable to the corporation on account of any other corporate liabilities. If the

⁹*First Fidelity Bank v. McAteer*, 985 F.2d 114, 117 (3d Cir. 1993).

corporation does not reimburse the directors and officers, then this section of the policy is inapplicable. If the corporate debtor’s estate will *never* pay any amounts on behalf of the directors and officers in a D&O action, the carrier will *never* reimburse the corporate debtor’s estate. Because the carrier will never reimburse the corporate debtor’s estate, any proceeds payable under the D&O policies arguably cannot be property of the corporate debtor’s estate.

11. Two circuit courts of appeals, the Fifth and the Ninth, have addressed the issue of whether proceeds of a D&O policy are property of the debtor’s estate.¹⁰ Both of these circuit courts have indicated that the proceeds of a policy are *not* property of a debtor’s estate. The Fifth Circuit has twice ruled that, even though a D&O policy may be property of the estate, the proceeds of that policy are not property of a corporate debtor’s estate.¹¹ In addition,

¹⁰*See In re Louisiana World Exposition, Inc.*, 832 F.2d 1391 (5th Cir. 1987); *Pintlar Corp. v. Fidelity & Cas. Co. (In re Pintlar Corp.)*, 124 F.3d 1310 (9th Cir. 1997). The Third Circuit has not directly addressed this precise issue but has held in *Gillman v. Continental Airlines (In re Continental Airlines)*, 203 F.3d 203, 216 (3d Cir. 2000), that “[o]ne cannot assume too quickly that the proceeds of this [D&O] policy are property of the estate when the non-debtor D&Os, not the [debtor corporation], are the direct beneficiaries of the policy.”

¹¹*See In re Louisiana World Exposition, Inc.*, 832 F.2d 1391, 1394 (5th Cir. 1987) (“On the merits, we hold that it was not error to dismiss the complaint because the proceeds of the liability coverage afforded the LWE directors and officers are not property of the LWE bankruptcy estate.”); *In re Vitek, Inc.*, 51 F.3d at 535 (“when a debtor corporation owns a liability policy that *exclusively* covers its directors and officers...the proceeds of that D&O policy are *not* part of the debtor’s bankruptcy estate.” (emphasis added)); see also *Houston v. Edgeworth (In re Edgeworth)*, 993 F.2d 51, 56 (5th Cir. 1993) (holding that in a dispute over

the Ninth Circuit has reached the same conclusion.¹²

the proceeds of a medical malpractice policy, "[w]hen the debtor has no legally cognizable claim to the insurance proceeds, those proceeds are not property of the estate.").

¹²See *Pintlar Corp. v. Fidelity & Cas. Co.*, (*In re Pintlar Corp.*), 124 F.3d 1310, 1312 (9th Cir. 1997) ("We hold that the appeal is not moot, but that the directors' and officers' liability coverage is not property of the estate.").

Most of the lower courts that have addressed this issue have also held that D&O liability insurance proceeds *not* property of the corporate debtor's estate.¹³

Ownership of D&O Liability Insurance Proceeds: Spotlight on the Fifth Circuit

12. In *Louisiana World Exposition* the Fifth Circuit dealt with D&O policies which indemnified the corporation's officers and directors for liabilities and legal expenses they might incur by virtue of their positions with the company. The policies also provided indemnification for the corporation itself to the extent it might be required to reimburse the officers and directors for legal expenses or liabilities. 832 F.2d at 1394. The creditor's committee brought suit on behalf of the estate against the officers and directors alleging malfeasance and mismanagement. *Id.* at

¹³ See *In re Scott Wetzel Servs. Inc.*, 243 B.R. 802, 805 (Bankr. M.D. Fla. 1999) ("[T]he proceeds of the Liability Insurance Policies are not property of the estate because the Debtor would not have the right to keep the funds."); *Ochs v. Lipson (In re First Cent. Fin. Corp.)*, 238 B.R. 9, 20 (Bankr. E.D.N.Y. 1999) (same); *Imperial Corp of Am. v. Milberg, Weiss, Bershad, Spechtrie & Lerach (In re Imperial Corp. of Am.)*, 144 B.R. 115, 119 (Bankr. S.D. Cal. 1992) (same); *In re Daisy Sys. Sec. Litig.*, 132 B.R. 752, 755 (N.D. Cal. 1991) (holding that proceeds of D&O policies were not assets of the estate because the directors and officers were the primary beneficiaries of the policies); *Duval v. Gleason*, No. C-90-0242-DLJ, 1990 WL 261364, at *5 (N.D. Cal. Oct. 19, 1990) (holding that although a D&O policy was property of the estate, the court was "not persuaded that the insurance policy proceeds...necessarily constitute 'property' of the debtor policy-owner within the meaning of §541(a)(1) such that the present proceedings [against non-debtor co-defendants] must be stayed."); *In re Technical Equities Corp.*, Case No. 3-86-00366, Adv. 3-89-0130 (Bankr. N.D. Cal. Jan. 26, 1989) (proceeds of debtors' D&O policy not property of the estate) (cited in *In re Daisy Sys.*, 132 B.R. at 755, and in *Duval*, 1990 WL 261364, at *5).

1395. The committee then brought suit to enjoin the insurance companies from paying the officer's and director's legal fees on the basis that the policy proceeds were property of the estate.

13. The Fifth Circuit held that, while the policies themselves were property of the estate, the policy proceeds were not. While most courts have recognized that the policies were property of the estate, the court recognized that this did not end the inquiry, stating: "The question is not who owns the policies, but who owns the liability proceeds." *Id.* at 1399. The estate's interest in property could rise no higher than those of the debtor. *Id.* Because the proceeds were payable to the officers and directors to indemnify them against their losses, the officers and not the debtor had the property interests. The court found more persuasive the cases holding that when the owner of a policy assigns the proceeds elsewhere, the assignee or beneficiary owns the proceeds and the estate does not. *Id.* at 1401.¹⁴ Consequently, the proceeds were not property of the estate to the extent they represented payments for expenses incurred by the officers and directors.¹⁵

¹⁴ *In re Moskowitz*, 14 B.R. 677, 680-81 (Bankr. S.D.N.Y. 1981) (insurance proceeds assigned to hospital that treated debtor are not property of the estate); *In re Ivory*, 32 B.R. 788, 793-94 (Bankr. D. Or. 1983) (fire insurance proceeds made payable "to the mortgagees...to the extent of their interest" were not property of the debtor/mortgagors, who had purchased the policy); *In re Family & Indus. Medical Facilities, Inc.*, 25 B.R. 443, 450-51 (Bankr. E.D. Pa. 1982) (debtor's assignment of fire insurance proceeds excluded those proceeds from bankrupt's estate).

¹⁵ *Accord Ochs v. Lipson (In re First Cent. Fin. Corp.)*, 238 B.R. 9, 16-17 (Bankr. E.D.N.Y. 1999); *In re Daisy Sys. Sec. Litig.*, 132 B.R. 752, 755 (N.D. Cal. 1991) (proceeds of D&O policy were

14. *Louisiana World Exposition* noted that the same policy might provide coverage to both the officers and directors and the corporation.¹⁶ In that case, the corporation would still own the proceeds designated to cover corporate losses or liabilities. *Id.* at 1400. This would not extend, however, to proceeds payable to the officers and directors as beneficiaries as reimbursement for their expenses.

15. In *In re Edgeworth*,¹⁷ the Fifth Circuit followed *Louisiana World Exposition* and again distinguished between the ownership of the policy and the proceeds:

The overriding question when determining whether insurance proceeds are property of the estate is whether the debtor would have a right to receive and keep those proceeds when the insurer paid on a claim. When a payment by the insurer cannot inure to the debtor's pecuniary benefit, then that payment should neither enhance nor decrease the bankruptcy estate. In other words, when the debtor

not assets of the estate because officers and directors were principal beneficiaries).

¹⁶The policy at issue also provided for indemnification of the corporation itself to the extent it was required to reimburse the officers and directors.

¹⁷993 F.2d 51 (5th Cir. 1993).

has no legally cognizable claim to the insurance proceeds, those proceeds are not property of the estate....

Under the typical liability policy, the debtor will not have a cognizable interest in the proceeds of the policy. *These proceeds will normally be payable only for the benefit of those harmed by the debtors under the terms of the insurance contracts.*

Id. at 55-56 (emphasis added, [footnote omitted])¹⁸.

16. Two years later, in *Homsy v. Floyd (In re Vitek, Inc.)*, the Fifth Circuit again addressed the issue of whether D&O liability insurance proceeds are property of the estate.¹⁹ In *Vitek*, the debtor (Vitek, Inc.) and the Homsys (as directors and officers) were sued by over 400 plaintiffs who claimed injuries from allegedly defective prostheses manufactured by Vitek. The Chapter 7 trustee settled with the insurance carriers who agreed that the remainder of the limits under the liability policies would be paid into the estate in exchange for an injunction against third party suits. This left the Homsys exposed, resulting in an appeal

¹⁸The above was cited with approval by the Fifth Circuit in the 1995 decision of *Feld v. Zale Corp. (In re Zale Corp.)*, 62 F.3d 746, 758 fn.33 (5th Cir. 1995) (While debtor's rights against the insurer, contractual or otherwise, are a part of the estate, the policy proceeds are not property of the estate if the debtor has no legally cognizable interest in the proceeds).

¹⁹51 F.3d 530 (5th Cir. 1995).

to the district court which reversed, concluding that the Homsys had independent rights in the policy proceeds. The trustee then appealed to the Fifth Circuit.

17. The Fifth Circuit stated the issue as follows: when one of the two or more co-insureds declare bankruptcy, what part of the policy proceeds should enrich the estate of the co-insured debtor? *Id.* at 533. Having so framed the issue, the court avoided answering the question and reversed the district court on the basis that it had misapplied insurance law. The basic thrust of the holding was that, as opposed to asserting ownership interests in the policy proceeds, the Homsys' remedy was to pursue their claims against the insurance companies for breach of duties owed to them as co-insureds. *Id.* at 536-37.

18. The *Vitek* court analyzed the issue of proceeds ownership in terms of policy ownership:

Most courts do not even recognize a technical distinction between ownership of insurance policies and ownership of the proceeds of those policies: *They simply conclude that such policies – and, by implication, the proceeds of such policies – are valuable properties of debtors' bankruptcy estates.*

Id. at 534 (emphasis added). In a footnote, the *Vitek* court acknowledged that the *Edgeworth* "panel did include some general

language that appears to endorse broadly the policy proceeds dichotomy introduced in *World Exposition*," but concludes that the language in *Edgeworth* to the effect that, under the typical liability policy, the debtor will not have a cognizable interest in the proceeds of the policy, was dicta. *Id.* at n. 17. The *Vitek* court reiterated that ownership of the policy proceeds is generally determined based on policy ownership:

As indicated infra the vast majority of courts do not bother to distinguish ownership of insurance policies from ownership of the proceeds of those policies, but treat that the two go hand-in-hand. Thus, the scope of the policy proceeds distinction enshrined in *Louisiana World Exposition* is still in ferment: whether that distinction will be extended more broadly has yet to be determined.

Id. at n.17 (emphasis added).

19. The precedential value of this portion of the *Vitek* opinion has been questioned.²⁰ First, the above quoted

²⁰ *Vitek* leaves unsettled the key question. A liability policy may cover a number of persons or entities. If one beneficiary files for bankruptcy, and joint and several claims are asserted against all of the insureds, how are the proceeds to be allocated? The *Louisiana World Exposition* opinion is clear that the estate owns proceeds designated to cover its losses and liabilities. 832 F.2d at 1400. *Louisiana World Exposition* is also clear, however that the estate's rights in the proceeds rise no higher than those of the debtor. 832 F.2d at 1399; 993 F.2d at 55. That would suggest that, while the estate may have an interest in the proceeds, the other insureds have some form of concurrent interest, and filing for bankruptcy does not give the estate precedence

portions of the opinion appear to be dicta. See *In re Sfuzzi, Inc.*, 191 B.R. 664, 667 n.8 (Bankr. N.D. Tex. 1996) (“This language was, however, dicta, and the ultimate decision was based on a misapplication of insurance law by the District Court”). Another recent case has stated that, “*Vitek* does not abrogate *Edgeworth*, and this court is satisfied that the *Edgeworth* test is appropriate to apply here.” *In re Scott Wetzel Servs., Inc.*, 243 B.R. 802, 804 (Bankr. M.D. Fla. 1999).

20. Second, the above portions of *Vitek* conflict with the *Louisiana World Exposition* and *Edgeworth* opinions, both of which hold that the ownership of the policy is not determinative on the issue of ownership of the proceeds.

21. Third, many courts have accepted the reasoning of *Louisiana World Exposition* and *Edgeworth* regarding ownership of D&O policy proceeds. See, e.g., *In re Sfuzzi, Inc.*, 191 B.R. at 667-68; *In re Scott Wetzel Servs., Inc.*, 243 B.R. at 804.

22. Other cases have also employed the analysis of *Louisiana World Exposition* and *Edgeworth* holding that the ownership of the policy is not determinative of the ownership of the proceeds. This includes the following decisions:

a. *Pine Bush Equip. Co.*

over the other insureds. This problem may provide fertile ground for channeling orders or other injunctive relief. The result in *Vitek* might have been different had the Homsys sought injunctive relief to require the tort claimants to first exhaust their claims against the policy proceeds.

v. Florian (In re Florian), 233 B.R. 25, 27 (Bankr. D. Conn. 1999) (with respect to insurance policy purchased by debtor covering a leased fork lift, policy proceeds belonged to lessor);

b. *In re Reider*, 177 B.R. 412, 416 (Bankr. D. Me. 1994) (citing *Edgeworth* as one of the “general principles” governing the treatment of insurance policies in bankruptcy);

c. *In re Goodenow*, 157 B.R. 724, 725 (Bankr. D. Me. 1993) (Debtor had purchased credit life and disability insurance which named holder of car loan as beneficiary. Policy proceeds were not property of estate);

d. *In re Pelullo*, 1999 U.S. Dist. LEXIS 14920, at *8-12 (E.D. Pa. Sept. 29, 1999). (Proceeds of policy payable for debtor’s defense costs were not property of the estate because proceeds were payable for benefit of those who provided defense);

e. *Johnson v. USAir Fed. Credit Union (In re Johnson)*, 162 B.R. 464, 465-66 (Bankr. M.D.N.C. 1993) (Credit disability insurance policy payable to lender was not property of the estate, following *Edgeworth* and *McAteer*); and

f. *Ochs v. Lipson (In re First Central Financial Corp.)*, 238 B.R. 9, 16-17 (Bankr. E.D.N.Y. 1999) (following *Louisiana World Exposition*, proceeds of D&O policy were not property of the estate).

Ownership of Indemnification Proceeds

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23. In contrast to liability insurance proceeds, it appears that indemnification proceeds may be classified as property of the estate in view of the fact that the policy/proceeds distinction does not apply.²¹ Proceeds from an indemnification policy directly reimburse the debtor for payments the debtor made to the directors and officers, and thus directly benefit the debtor and its estate.²²

24. Nevertheless, other courts have used the reasoning of *Louisiana World Exposition*, even though a liability insurance proceeds case, to justify the exclusion of indemnification insurance proceeds.²³

Ownership of D&O Proceeds in Mass Tort Lawsuits

25. In mass tort cases, some courts have included mass tort and products liability insurance proceeds in the bankruptcy estate. *See, e.g., A.H. Robins*

²¹ *See In re Sacred Heart Hosp.*, 182 B.R. 413, 420 (Bankr. E.D. Pa. 1995) (characterizing the distinction between an insurance policy and its proceeds as “illusory”); *Circle K Corp.*, 121 B.R. 257, 259-60 (Bankr. D. Ariz. 1990) (distinction inapposite because the policy provided indemnification coverage to the debtor).

²² *Feld v. Zale Corp. (In re Zale Corp.)*, 62 F.3d 746, 758 n. 33 (“The overriding question when determining whether insurance proceeds are property of the estate is whether the debtor would have a right to receive and keep those proceeds when the insurer paid on a claim. When a payment by the insurer cannot inure to the debtor’s pecuniary benefit, then that payment should neither enhance nor decrease the bankruptcy estate.[w]hen the debtor has no legally cognizable claim to the insurance proceeds, those proceeds are not property of the estate”).

²³ *In re Imperial Corp. of Am.*, 144 B.R. 115, 118 (Bankr. S.D. Cal. 1992); *In re Titan Energy, Inc.*, 837 F.2d 325, 329 (8th Cir. 1988); *In re Daisy Systems Sec. Litig.*, 132 B.R. at 755.

Co. v. Piccinin, 788 F.2d 994, 1001 (4th Cir.), *cert. denied*, 479 U.S. 876 (1986); *In re Johns-Manville Corp.*, 40 B.R. 219, 230-31 (S.D.N.Y. 1984) (“insurance policies and their proceeds . . . constituted substantial property of the Manville estate which will be diminished if and to the extent that third party direct actions against the insurance carriers result in plaintiffs’ judgments”).

26. The Fifth Circuit’s opinion in *Louisiana World Exposition* sought to distinguish such mass tort cases where the overwhelming number of plaintiffs seeking recovery for personal injury threatens to exhaust liability coverage. The Court explained that the objective of the creditors’ committee in *Louisiana World Exposition* was to gather proceeds to enlarge the estate on behalf of the debtor, while the underlying products liability actions in *A.H. Robins* and *Johns-Manville* against the debtors and their officers and directors were brought by plaintiffs seeking damages for alleged personal injuries suffered. *See Louisiana World Exposition*, 832 F.2d at 1400. The Fifth Circuit noted that the courts in *A.H. Robins* and *Johns-Manville* stayed the plaintiffs’ third-party actions against the officers and directors in part because of the likelihood that the D & O liability coverage would be exhausted. *See id.* At that point, the officers and directors would turn to the bankrupt corporation for indemnification, thus threatening an asset of the estate, indemnification proceeds. *See id.*

27. In contrast, permitting payment of the officers’ and directors’ defense costs in *Louisiana World Exposition* out of liability proceeds would have resulted in a diminution of any potential D & O

indemnification claim and therefore there was no potential for increasing the estate's exposure by payment of liability proceeds due to the officers and directors. *See id.* The Fifth Circuit noted that the *A.H. Robins* court and the *Johns-Manville* court "stayed third-party suits against either the debtor and/or its directors and officers or their liability insurers, they did *not* stay payment of liability proceeds to directors and officers who were so insured under policies carried for that purpose by the bankrupt corporation." *Id.*

28. Although discussing the application of the automatic stay, the *A.H. Robins* court offered another possible justification for treating insurance proceeds as property of the estate: "when there is such identity between the debtor and the third-party defendant that the debtor may be said to be the real party defendant and that a judgment against the third-party defendant will in effect be a judgment or finding against the debtor." *See* 788 F.2d 999. An illustration of such a situation would be a suit against a third-party who is entitled to absolute indemnity by the debtor on account of any judgment that might result against them in the case. *See id.*

Ownership of Policy Proceeds In Other Instances

A. Credit Life Insurance

29. Proceeds of a credit life insurance policy belong to the lender who is the beneficiary of the policy. *First Fidelity Bank v. McAteer*, 985 F.2d at 117 & 119. In

that case, the Third Circuit, much like the *Edgeworth* court, reasoned that the estate's legal and equitable property rights in the policy proceeds rose no higher than the

debtor's. Therefore, the life insurance proceeds payable to the bank were not property of the estate because the deceased debtor had no property rights in the proceeds. *Accord In re Goodenow*, 157 B.R. 724, 725 (Bankr. D. Me. 1993) (debtor had purchased credit life and disability insurance which named holder of car loan as beneficiary. The policy proceeds were not property of the estate). The same result is reached as to credit disability insurance. *Johnson v. USAir Fed. Credit Union (In re Johnson)*, 162 B.R. 464, 465-66 (Bankr. M.D.N.C. 1993) (credit disability insurance payable to lender was not property of the estate).

B. Casualty Insurance

4. Proceeds of casualty insurance are generally property of the estate. *Bradt v. Woodlawn Auto Workers, F.C.U.*, 757 F.2d 512, 516 (2d Cir. 1985).²⁴ However, as discussed below, the existence of a clause designating a mortgagee as a loss payee may limit the estate's rights in the proceeds.

C. Life Insurance

5. Section 541(a)(5)(C) includes death benefits paid to the beneficiary of a life insurance policy, if the debtor becomes entitled to acquire this within 180 days. If the insured dies within 180 days of the petition date, the proceeds flow into the

²⁴*In re Hawkeye Chem. Co.*, 71 B.R. 315 (Bankr. S.D. Iowa 1987); *In re Island Helicopter Corp.*, 63 B.R. 515, 522 (Bankr. E.D.N.Y. 1986); *Fisher v. Ins. Co. of Pennsylvania (In re Pied Piper Casuals)*, 50 B.R. 549, 555 (Bankr. S.D.N.Y. 1985).

estate. *Dollinger v. Bottom (In re Bottom)*, 176 B.R. 950, 952 (Bankr. N.D. Fla. 1994); *In re Pettigrew*, 115 B.R. 214 (Bankr. E.D. Mo. 1990).

Assignment of Policy Proceeds

6. *Louisiana World Exposition* recognizes that a valid assignment of policy proceeds removes the proceeds from the bankruptcy estate. 832 F.2d at 1401.²⁵ This would include an assignment of the proceeds to a hospital for medical services rendered to the debtor. *In re Moskowitz*, 14 B.R. 677, 680-81 (Bankr. S.D.N.Y. 1981).

7. A common form of "assignment" of policy proceeds is a loss payee clause providing that casualty insurance proceeds will be paid to the lender as its interest appears. Generally, this is required by the terms of the mortgage or security agreement requiring the debtor to maintain casualty insurance and designate the lender as an additional loss payee to the extent its interest may appear.²⁶ In addition, many mortgages also contain clauses giving the lender the discretionary right to either apply the proceeds to the debt or to the restoration of the damaged improvements.

8. When the loss occurs post-petition, the proceeds are generally

²⁵*Accord, Gibraltar Resources, Inc. v. Black Max Downhole Tools, Inc., (In re Gibraltar Resources)* 211 B.R. 216, 221 (Bankr. N.D. Tex. 1997).

²⁶"As its interest may appear" means the indebtedness owed to the lender under the note or mortgage. *Nelson v. Consumers County Mut. Ins. Co.*, 326 S.W.2d 535, 538 (Tex.Civ.App.—San Antonio 1959, writ dismissed w.o.j.).

considered a part of the bankruptcy estate. *First State Bank v. Asay (In re Asay)*, 184 B.R. 265, 267-68 (Bankr. N.D. Tex. 1995); *Jones v. GE Capital Mortgage Co. (In re Jones)*, 179 B.R. 450, 454 (Bankr. E.D. Pa. 1995).²⁷ These cases generally reason that the insurance policies come within the broad scope of property of the estate under §541, which supercedes or limits the lender's rights, or that the automatic stay prevents the lender from exercising these collateral rights. *In re Asay*, 184 B.R. at 266-67.

9. When the loss occurs pre-petition, a different result may follow. As a general rule, property interests are defined and governed by state law,²⁸ although the question of whether specific property (as defined by state law) is a part of the estate is a question of federal law.²⁹ Applying state law, the debtor may hold bare legal title to pre-petition casualty insurance proceeds, so that they are not property of the estate. *In re Ivory*, 32 B.R. 788, 794 (Bankr. D. Or. 1983). *In re Family & Indus. Med. Facilities, Inc.*, 25 B.R. 443, 450-2 (Bankr. E.D.Pa. 1982). The *Asay* opinion also recognizes that this is arguably the case, reasoning that the mortgagee's rights in the proceeds may vest pre-petition so that the debtor has no interest as of the

²⁷ *Tringali v. Hathaway Machinery Co.*, 796 F.2d 553, 560-61 (1st Cir. 1986); *Bradt v. Woodlawn Workers F.C.U.*, 757 F.2d 512, 515 (2d Cir. 1985); *In re Reed*, 94 B.R. 48, 52-53 (E.D. Pa. 1988); *Ledford v. Fidelity Fin. Servs. (In re Hill)*, 174 B.R. 949 (Bankr. S.D. Ohio 1994); *Pare v. Natale (In re Natale)*, 174 B.R. 362, 365 (Bankr. D.R.I. 1994).

²⁸

Butner v. U.S., 440 U.S. 48, 54-56 (1979).

²⁹ *In re Ballard*, 238 B.R. 610, 618 (Bankr. M.D. La. 1999).

commencement of the case. 184 B.R. at 269. In that instance, neither §541 nor the automatic stay would prevent the lender's rights in the proceeds from irrevocably vesting. However, other courts have reached the contrary conclusion.³⁰

10. Even if the proceeds are property of the estate, they are still cash collateral subject to §362. *Asay*, 184 B.R. at 269.³¹ The debtor may only use the proceeds upon a showing that the lender is adequately protected.

11. In Texas, however, the argument that state law precludes the proceeds from entering the estate, or at least greatly limits the debtor's rights in them, may have considerable strength. Under Texas law, a mortgagee clause is enforceable in accordance with its terms.³² The effect of such a clause is to make an independent contract between the mortgagee and the insurance company.³³ The Texas Supreme

³⁰ *Hawkeye Chemical Co.*, 71 B.R. 315, 319-321 (Bankr. S.D. Iowa 1987); *Fisher v. Ins. Co. of Pennsylvania (In re Pied Piper Casuals, Inc.)*, 50 B.R. 549, 551 (Bankr. S.D.N.Y. 1985).

³¹ *Accord Bradt v. Woodlawn Auto Workers, F.C.U. (In re Bradt)*, 757 F.2d 512, 516 (2d Cir. 1985) (credit union was entitled adequate protection of its collateral interests, including in insurance proceeds); *In re Island Helicopter Corp.*, 63 B.R. 515, 522 (Bankr. E.D. N.Y. 1986) ("Insurance policies and the derivative proceeds thereon received by the debtor are property of the debtor's estate under 11 U.S.C., §541(a)(6).... A creditor whose security interest extends to insurance proceeds is entitled to adequate protection only, and is not entitled to possession of the collateral nor the insurance proceeds thereof.")

³² *Lexington Ins. Co. v. Gray*, 775 S.W.2d 679, 683 (Tex.App.—Austin 1989, writ denied).

³³ *Id.*; *Citizens State Bank v. American Fire & Cas. Co.*, 198 F.2d 57, 60 (5th Cir. 1952); *Camden Fire Ins. Assn. v. Harold E. Clayton & Co.*,

Court has enforced such a mortgagee provision as giving the lender the right to apply the insurance proceeds to the debt, even if the borrowers want to rebuild.³⁴ Other cases have stated that the policy proceeds become the mortgagee's property to the extent of the amount due on the mortgage, and that the mortgagee's rights became fixed upon the occurrence of the loss.³⁵ Indeed, one Texas Supreme Court case has stated that the effect of a loss payee clause "when attached to a policy, is to make a new and independent contract between the insurer and the mortgagee, and to effect separate insurance on the mortgagee's interest." *Camden Fire Ins. Ass'n v. Harold E. Clayton & Co.*, 6 S.W.2d 1029, 1030 (Tex. 1928).

12. The same result may follow even as to a post-petition loss. Because property rights in a bankruptcy case are created and defined by state law, state law will be so applied absent a countervailing federal interest. *American Bankers Ins. Co. v. Maness.*, 101 F.3d 358, 363 (4th Cir. 1996). In that case, which involved a post-petition loss, the court of appeals concluded that nothing in §541(a)(6) relating to proceeds created a countervailing federal interest requiring that the term "proceeds" be defined differently than under state law. *Id.* at 365. The court questioned those cases, including *In re Asay*, which concluded

6 S.W.2d 1029, 1030 (Tex. 1928).

³⁴ *English v. Fischer*, 660 S.W.2d 521, 523 (Tex. 1983).

³⁵ *Nelson v. Consumers Casualty Mut. Insurance Co.*, 326 S.W.2d 535, 538 (Tex.Civ.App.—San Antonio 1959, writ dismissed w.o.j.).

that §541 supercedes state law regarding ownership of proceeds. *Id.* The court was also influenced by the legislative history of §541 which states that the section "is not intended to expand the debtor's rights against others more than they exist at the commencement of the case". *Id.*

13.. In addition, the debtor may still be bound by the provisions of the mortgage which give the lender the discretionary option of applying the proceeds to the debt or rebuilding the improvements. In both *Louisiana World Exposition*³⁶ and *Edgeworth*,³⁷ the Fifth Circuit reasoned that the estate's property rights in the proceeds could rise no higher than the debtor's. The Third Circuit has employed essentially the same reasoning.³⁸ Applying this reasoning to casualty insurance proceeds, the proceeds may still remain subject to these contractual restrictions, even if property of the estate.

14. This was essentially the conclusion in *In re Jones*, 179 B.R. at 455.

³⁶ 993 F.2d at 56, n. 20, citing *First Fidelity Bank v. McAteer*, 985 F.2d 114, 117 (3d Cir. 1993), stating that "if the owner of the life insurance policy did not have an interest in the proceeds, the filing of the petition in bankruptcy cannot create one", and *In re Gagnon*, 26 B.R. 926, 928 (Bankr. N.D. Pa. 1983), stating that "the estate's legal and equitable interests in property rise no higher than those of the debtor."

³⁷ 832 F.2d at 1399, citing *In re Gagnon*, 26 B.R. at 928, "Nonetheless, 'the estate's legal and equitable interests in property rise no higher than those of the debtor.'"

³⁸ *First Fidelity Bank v. McAteer*, 985 F.2d 114, 117 (3d Cir. 1993) (estate's legal and equitable interests in property could rise no higher than the debtor's).

There, the casualty loss occurred post-petition, and the court considered that the proceeds were property of the estate. The debtor sent the insurance checks, jointly payable to the debtor and mortgagee, to the mortgagee for endorsement. When the mortgagee refused to return them, the debtor filed an adversary against the mortgagee under §542 for the turnover of the proceeds. The mortgagee then returned the checks. The debtor, however, sought damages resulting from the mortgagee's alleged wrongful detention of the policy proceeds. Denying the claim for damages, the court concluded that the mortgagee's rights under the mortgage negated any duty to turnover the proceeds. The court started from the premise that the debtor could not obtain greater rights in the policy proceeds by filing a bankruptcy petition. *Id.* at 455. In addition, the debtor held the proceeds subject to the mortgagee's rights under applicable state law. *Id.* Because the mortgage gave the mortgagee absolute discretion to keep or disburse the insurance proceeds, the debtor had no right to turnover of the funds.³⁹

15. At least two later decisions have followed this reasoning. In *Thomas v. Universal Am. Mortgage*, 1998 U.S. Dist. LEXIS 1392 at *11 & 12 (E.D. Pa. Feb. 6, 1998), the mortgage required the borrower to maintain property insurance. The lender was given the option of applying the proceeds to the debt or the restoration of the

³⁹ Another opinion has found that policy proceeds were not property of the estate because of the lender's contractual rights. *In re Suter*, 181 B.R. 116, 119 (Bankr. N.D. Ala. 1994). The court likewise reasoned that filing a bankruptcy petition did not elevate the debtor's rights.

property. The bankruptcy court had ordered the proceeds turned over to the lender for application to the debt. Citing *In re Jones*, the district court affirmed on the basis that "The owner of an insurance policy cannot obtain greater rights to the proceeds of that policy...by merely filing a bankruptcy petition."

16. The same conclusion was reached in *PNC Bank, N.A. v. Schwab (In re Thomas)*, 1998 Bankr. LEXIS 1669 at *2 (Bankr. M.D. Pa. Sept. 10, 1998). Although the debtor owned the policy, the bankruptcy trustee acquired no greater rights than the debtor. Accordingly, the bankruptcy court ordered turnover of the policy proceeds to the lender.

17. This approach is consistent with the Fifth Circuit's analysis in *Edgeworth*. There the court stated the overriding question was "whether the debtor would have a right to receive and keep the proceeds when the insurer paid on the claim." 993 F.2d at 55-56. In such an instance, the debtor would have no right to both receive and retain the policy proceeds where the mortgage grants the lender the right to apply the proceeds to the debt. Instead, the debtor's only legally cognizable claim under state law would be to require the lender, in accordance with the terms of the mortgage, to use the proceeds either to pay the debt or restore the property.

18. This would also address the common situation where the proceeds are paid jointly to the lender and the debtor. In that instance, the debtor would have no right to both receive and keep the proceeds, even though jointly payable.

19. In Texas, the strength of this argument increases if the proceeds payable to the lender “as its interest appears” are deemed to arise under a separate contract between the lender and the insurer. In that instance, the debtor’s rights in the proceeds are even more attenuated, and there would be no right to receive and keep the proceeds. The debtor’s only legally cognizable right in proceeds arising from a separate contract would likely be to require application of the funds in accordance with the mortgage.

Effects of Discharge on Liability Insurers Pursuing Claims Against Insurance Proceeds

20. Section 524(e) states that the debtor’s discharge does not discharge claims against third parties. Consequently, the debtor’s discharge will not shield the insurer from liability.

21. This was the holding in *Edgeworth*, 993 F.2d 51. In that case, both the bankruptcy and district courts had enjoined the malpractice tort claimants from proceeding with their lawsuit on the basis that the claims were discharged. The Fifth Circuit began its analysis with the premise that a discharge does not extinguish the debt itself, but merely releases the debtor from personal liability. Section 524(e) states that the debt still exists and can be collected from any other responsible entity. *Id.* at 53. However, in the liability insurance context, the tort plaintiff must first establish the debtor’s liability before the insurer becomes contractually obligated. In *Edgeworth*, the issue was whether the discharge barred such suits on liability even if the plaintiff had agreed to look solely to the insurance.

22. Noting that most cases have held that the discharge does not bar such suits,⁴⁰ the court concluded the bankruptcy court’s fresh start policy was not intended to provide a method for an insurer to escape its policy obligations based on the financial misfortunes of the insured debtor. *Id.* at 54. The court dismissed the argument that Dr. Edgeworth would be inequitably burdened by attending depositions or trial. The court concluded that “as long as the costs of defense are borne by the insurer and there is no execution or judgment against the debtor personally, section 524(a) will not bar a suit against the discharged debtor as the nominal defendant.” *Id.*

23. In most cases, the plaintiff obtains relief from the stay based on an agreement to look solely to the insurance to satisfy any resulting judgment. The plaintiff’s lawsuit derives its legitimacy only from the order lifting the stay, and the claim may only be pursued in strict conformity with this order. This was the gist of the Fifth Circuit’s holding in *Casperone v. Landmark Oil & Gas Corp.*, 819 F.2d 112,114 (5th Cir. 1987), regarding a plaintiff’s right to proceed with litigation upon obtaining relief from the stay. The issue before the Fifth Circuit in *Casperone* was whether the district court exceeded the scope of the bankruptcy court’s order modifying the stay. *Id.* at 113. The Fifth Circuit began its analysis with the

⁴⁰*First Fidelity Bank v. McAteer*, 985 F.2d at 117; *Green v. Welsh*, 956 F.2d 30, 35 (2d Cir. 1992); *In re Fernstrom Storage & Van Co.*, 938 F.2d 731, 733-34 (7th Cir. 1991); *In re Jet Florida Sys., Inc.*, 883 F.2d 970, 976 (11th Cir. 1989); *In re Lembke*, 93 B.R. 701, 702-3 (Bankr. D.N.D. 1988).

proposition that the stay acted as an absolute bar to the commencement or continuation of any lawsuit:

The automatic stay under 11 U.S.C. §362(a) serves, until further order of the bankruptcy court, as an absolute bar to the commencement or continuation of any judicial, administrative or other proceeding against the debtor “that was or could have been commenced before the commencement of the [bankruptcy] case....

Id. at 114 (citations omitted).

24. The Fifth Circuit then reasoned that the continuation of any proceeding could “derive legitimacy only from the bankruptcy court order” lifting the stay. In this respect, the court stated as follows:

Because a section 362 stay freezes in place all proceedings against the debtor, and because only an order of the bankruptcy court can authorize any further progress in the stayed proceeding, it follows that the continuation of any proceeding can derive legitimacy only from the bankruptcy court order. The terms of an order modifying the automatic stay must therefore be strictly construed.

Id. at 115.

25. As another Fifth Circuit case observed, once the §362 stay comes into play, absent modification of the stay “a case...must, as a general rule, simply languish on the court’s docket until final disposition of the bankruptcy proceeding.” *Pope v. Manville Forest Prods. Corp.*, 778 F.2d 238, 239 (5th Cir. 1985). The automatic stay deprives the state court of the power to proceed with litigation pending before it except upon modification of the stay by the bankruptcy court. *Gruntz v. County of Los Angeles (In re Gruntz)*, 202 F.3d 1074, 1082 (9th Cir. 2000). “[B]ecause only an order of the bankruptcy court can authorize any further progress in the stayed proceedings, it follows that the continuation of the [stayed] proceeding can derive legitimacy only from the bankruptcy court order”. *Id.* (quoting *Noli v. Commissioner*, 860 F.2d 1521, 1525 (9th Cir. 1988), itself citing *Casperone*, 819 F.2d at 114).

26. This has important ramifications to both the tort plaintiff and the insurer. The tort plaintiff can proceed only in conformity with the order lifting the stay. This limits the tort claimant to a recovery from the policy proceeds. If the occurrence falls outside the policy coverage, or if the coverage has been exhausted or depleted by other claims, the plaintiff’s right to proceed against the insurance may have little or no value.

27. As to the insurer, its duties in defending against the claim may be greatly affected. An insurer owes its insured a duty to act within due care to settle the claim

within the policy limits. *G.A. Stowers Furniture Co. v. American Indem. Co.*, 15 S.W.2d 544 (Tex.Comm'n.App.–1929, holding approved).⁴¹ This duty is often referred to as the Stowers Doctrine. If an insurance company fails to settle within policy limits, and a judgment is entered against the insured in excess of policy limits, the insured may have a cause of action against the insurer. However, if the tort plaintiff has agreed to look solely to the insurance for satisfaction of the claim, an excess judgment would not damage the

⁴¹ A recent Fifth Circuit case explained the Stowers doctrine as follows:

Texas courts have recognized only one tort duty regarding third party insurance cases, that being the duty stated in *Stowers Furniture Co. v. American Indem. Co.*, 15 S.W.2d 544 (Tex.Comm'n.App.–1929, holding approved) [citations omitted]. According to this duty, an insurer may be held liable in damages upon refusing an offer of settlement when it appears that an ordinary prudent person in the insured's situation would have settled. See *Stowers*, 15 S.W.2d at 547. However, a settlement demand triggers the Stowers duty only upon meeting three prerequisites: "(1) the claim against the insured is within the scope of coverage; (2) the demand is within the policy limits; and (3) the terms of the demand are such that an ordinarily prudent insurer would accept it, considering the likelihood and degree of the insured's potential exposure to an excess judgment." *American Physicians Ins. Exch. v. Garcia*, 876 S.W.2d 842, 849 (Tex. 1994).

Ford v. Cimarron Ins. Co., 230 F.3d 828, 831 (5th Cir. 2000). This is the sole tort duty recognized by Texas courts in this context. *Maryland Ins. Co. v. Head Indus. Coatings and Servs., Inc.*, 938 S.W.2d 27, 28 (Tex. 1996).

insurer or give rise to a Stowers claim against the insurer. This gives the insurer much more latitude in litigating the claim, and allows the insurer to take a more aggressive settlement posture because its insured no longer has any personal liability.⁴²

"Insured versus Insured" Exclusions

28. Most D&O insurance policies contain "insured versus insured" exclusions. These exclusions generally eliminate coverage for claims against directors and officers by other insured persons, the corporation and, in some instances, by shareholders of the corporation in participation with other insureds. Thus, the exclusion attempts to eliminate coverage for any claim brought by the company or an affiliate of the company against its directors and officers.

29. Trustees of bankrupt corporations may assert that they are

⁴² Some counsel include language in the order lifting the stay stating that the order does not release the insurer from any type of Stowers duty. The plaintiff's lawsuit, and any future judgment, derive the legitimacy solely from the order lifting the stay. *Casperone v. Landmark Oil & Gas Corp.*, 819 F.2d 112, 114 (5th Cir. 1987). If the order limits the plaintiff to collecting through the insurance, it is difficult to see how the insurer could breach a Stowers duty if the insured has no potential liability for an excess judgment. Stowers liability is predicated on an insurer failing to act within ordinary prudence "considering the likelihood and degree of the insured's potential exposure to an excess judgment." *Ford v. Cimarron Ins. Co.*, 230 F.3d 828, 830 (5th Cir. 2000), citing *American Physicians Ins. Exch. v. Garcia*, 876 S.W.2d 842, 849 (Tex. 1994). This is the sole tort duty recognized by Texas courts in this context. *Maryland Ins. Co. v. Head Indus. Coatings & Servs., Inc.*, 938 S.W.2d 27, 28 (Tex.1996). If the insured has no potential exposure to an excess judgment, it is difficult to envision how a Stowers claim could arise in this context.

entities distinct from the company. Such an argument derives support from cases litigated by the Federal Deposit Insurance Corporation (FDIC) as receiver of insolvent banks. In a number of FDIC cases, the courts have distinguished between the FDIC and the failed bank or thrift. For example, in *Fidelity & Deposit Co. v. Zandstra*⁴³, the court determined that the FDIC did not “step into the shoes” of the failed bank since it could also raise claims on behalf of creditors and shareholders and was subrogated to the rights of depositors in the bank, and the court found that the “insured versus insured” exclusion did not apply to preclude the FDIC’s lawsuit. The court in *FDIC v. Zaborac*⁴⁴, reached the same result. It held that the exclusion did not apply because the FDIC could stand in the shoes of shareholders and, therefore, had independent authority to bring suit.

30. A trustee will assert that he does not merely “stand in the shoes” of the debtor corporation, but is asserting claims on behalf of all of the corporation’s creditors and shareholders. This argument is compelling where the D&O policy in question defines “insured versus insured” claims as those made “by” the corporation rather than defining them more broadly as claims “of” the corporation or “on behalf of” the corporation.

31. In *Reliance Ins. Co. v. Weis*,⁴⁵

⁴³756 F. Supp. 429, 432-33 (N.D. Cal. 1990).

⁴⁴773 F. Supp. 137, 144 (C.D. Ill. 1991).

⁴⁵148 B.R. 575, 583 (E.D. Mo. 1992), *aff’d*, 5 F.3d 532 (8th Cir. 1993), *cert. denied*, 510 U.S. 1117 (1994).

the court prevented the liquidating agent for the debtor corporation from prosecuting suits for breach of fiduciary duty and mismanagement against certain former officers of the corporation by virtue of the “insured versus insured” exclusion contained in the D&O policy. However, the policy’s exclusionary language was broadly drawn as claims made against the directors and officers “by or on behalf of the company” were excluded.

32. The *Weis* court found that the corporation had a right of action against the defendants at the time of the filing of its bankruptcy petition, and that right belonged to the bankruptcy estate.⁴⁶ The court’s review of the plan of liquidation provided for the liquidating agent to pursue the corporation’s right of action in order to recover assets for the bankruptcy estate:

It is clear that the pending state court action was filed on behalf of [the corporation] and its estate, although the benefits sought may eventually inure to the creditors. For purposes of this litigation, there is no significant legal distinction between [the corporation] and its bankruptcy estate.⁴⁷

33. The intent of an “insured versus insured” exclusion is to prevent collusive suits.⁴⁸ It would logically follow

⁴⁶*Id.*

⁴⁷*Id.*

⁴⁸*See Level 3 Communs., Inc. v. Federal*

that the “insured versus insured” exclusion should not prevent an action such as a preference suit against directors and officers by the corporation’s successor in bankruptcy since the cause of action for recovery of a preference does not arise until a bankruptcy case is filed, unlike a claim for breach of fiduciary duty or mismanagement, and a trustee is not “stepping into the shoes” of the corporation, but rather on behalf of the creditors of the estate.

34.. Other courts appear to recognize a distinction between a litigation trustee and the insured company. In *Cigna Insurance Co. v. Gulf United States Corp.*,⁴⁹ the court found that the debtor-in-possession was performing a role similar to the function performed by the FDIC as receiver for a failed bank, and determined that the “insured v. insured” exclusion did not apply to the D&O claims. In a similar ruling, an Ohio bankruptcy court had no trouble distinguishing between the appointed trustee in a Chapter 7 Bankruptcy and a Debtor.⁵⁰ The court found unconvincing the

insurance companies argument that the Trustee “stands in the shoes” of the Debtor, finding that a bankruptcy trustee is a separate legal entity that neither represents the Debtor nor owes the Debtor a fiduciary obligation, and the Trustee’s responsibility is to the bankruptcy estate that he or she represents.⁵¹

Ins. Co., 168 F.3d 956 (7th Cir. 1999).

⁴⁹1997 U.S. Dist. LEXIS 23816 at p. *6 (“Under the Bankruptcy Code and the confirmed Chapter 11 plan, *Gulf* as debtor-in-possession is asserting claims on behalf and for the benefits of *Gulf*’s shareholders and creditors. In this respect, the claims are not made “by” or “on behalf,” or by “successors” to *Gulf*. Instead, the asserted claims are of the same type that could have been made pre-petition by the corporation’s shareholders. The “insured v. insured” exclusions at issue in this appeal explicitly provide for insurance coverage for such claims, *See also Pintlar Corp. v. F & C of N.Y.*, 205 B.R. 945, 948 (Bankr. D. Idaho 1997) (holding that litigation trustees were acting for benefit of the corporations creditors).

⁵⁰*See Buckeye County Mark, Inc. v. Baudendistel*, 251 B.R. 835, 840-41 (Bankr. 2000).

⁵¹*See Id.* at p. 840 (when the plaintiff is not the corporation but a bankruptcy trustee acting as a genuinely adverse party to the defendant officers and directors, there is no threat of collusion).

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