

# BUSINESS BANKRUPTCY ALERT

AKIN  
GUMP  
STRAUSS  
HAUER &  
FELD, L.L.P.



A GLOBAL LAW FIRM FOR THE 21st CENTURY

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## DIRECTORS AND OFFICERS LIABILITY COVERAGE IS NOT PROPERTY OF THE BANKRUPTCY ESTATE

Most corporations provide liability coverage insurance for their directors and officers. This insurance coverage typically indemnifies the directors and officers for errors and omissions that may occur in the performance of their duties. Insurance coverage for the corporation itself may be part of the same policy. As can be expected, in many cases where a corporation is forced to file for relief under the Bankruptcy Code, plaintiffs will seek to recover from the non-debtor directors and officers. Frequently, the directors and officers insurance coverage is the only source of recovery to satisfy judgments for securities fraud and other claims that may be brought against a corporation's insiders.

A securities plaintiff may only recover from the directors and officers insurance if the policy is not property of the debtor's bankruptcy estate. If the policy's proceeds become part of the debtor's bankruptcy estate, it will significantly reduce a plaintiff's recovery.

Insurance policies themselves are property of the bankruptcy estate. However, several courts have made a distinction between insurance *policies* owned by a debtor and the *proceeds* payable under such policies. Specifically, where the debtor owns a policy but has no interest in its proceeds, the proceeds are not property of the bankruptcy estate. *In re*

*Edgeworth*, 993 F.2d 51 (5th Cir. 1993). Where the debtor does not have an interest in the proceeds, the courts are in general agreement that policy proceeds are not property of the bankruptcy estate and are available for the payment of successful plaintiffs bringing suit against the former directors and officers of the bankrupt corporation.

Where a Chapter 11 debtor is an insured with its directors and officers under a single policy, the analysis of whether the policy's proceeds are property of the bankruptcy estate is more complicated. To the extent the policy's proceeds are available to indemnify the debtor, the proceeds do qualify as property of the bankruptcy estate and are available for the debtor's creditors. However, in one recent case, the U.S. Bankruptcy Court for the Southern District of Florida held that where a settlement with the former directors and officers will have no effect on the debtor's coverage, the proceeds are not property of the estate and the court has sufficient cause to grant relief from stay to allow payment of the plaintiffs' claims. *In re CHS Electronics*, 2001 WL 435693 (Bankr. S.D. Fla. April 9, 2001). In *In re CHS*, the debtor's exposure under a \$20 million policy was only \$258,000. A settlement of \$11,250,000 in a class action lawsuit against the former directors and officers was proposed. The court held that the entity coverage would not be necessary to satisfy claims against the debtor. Therefore, the policy's proceeds could be made available to indemnify the directors and officers.

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Although the opinion in *In re CHS* is unhelpful to general unsecured creditors, it serves as reassurance to qualified individuals seeking to serve as directors and officers of troubled companies. The fact that insurance proceeds will

be made available to indemnify directors and officers increases the likelihood that qualified individuals will work for troubled companies.

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KEITH MILES AURZADA  
PHONE: (214) 969-2792  
E-MAIL: KAURZADA@AKINGUMP.COM

**AKIN, GUMP, STRAUSS, HAUER & FELD, L.L.P.**  
ATTORNEYS AT LAW  
1700 PACIFIC AVENUE, SUITE 4100  
DALLAS, TEXAS 75201  
PHONE: (214) 969-2800  
FAX: (214) 969-4343

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