

Intersections of Bankruptcy Law and Insurance Coverage Litigation

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Bankruptcy and insurance law frequently intersect and sometimes conflict. This article addresses the most important of these intersections, including the ability of a debtor to satisfy insured claims by the assignment of coverage proceeds in bankruptcy, the treatment of D&O insurance in bankruptcy, a debtor's non-payment of a deductible or self-insured retention ("SIR") as a defense to coverage, "buy back" agreements and coverage-in-place settlements in bankruptcy, the ability of insurers and/or debtor-affiliates to obtain third-party releases, insurer insolvency and potential gaps in coverage, and paid-loss retrospective policies and a bankruptcy estate's bad faith claims. As discussed throughout, this is an area of law that is quickly developing and where several issues remain unsettled.

I. Bankruptcy Claims and the Assignment of Coverage

A. Property of the Bankruptcy Estate

The bankruptcy estate is broadly defined as including "all legal or equitable interests of the debtor in property as of the commencement of the case."¹ Accordingly, upon the filing of a petition, the debtor's insurance policies automatically become property of the estate.² An insurance contract may contain a provision that purports to terminate the policy if the insured becomes subject to a reorganization proceeding. These provisions are void under the Bankruptcy Code.³

While the Bankruptcy Code defines the scope of the bankruptcy estate, property entering the estate remains subject to the limitations imposed by applicable state and non-bankruptcy federal law, unless the

Bankruptcy Code preempts or overrides such law.⁴ As such, the right of the debtor to assign its insurance coverage proceeds in satisfaction of a claim will generally be determined by applicable state insurance law, unless there has been federal preemption.⁵

An insured's right to *ongoing coverage* is generally not assignable.⁶ On the other hand, state law generally does permit the insured to assign its right to insurance *proceeds* after a "loss" has occurred.⁷ Bankruptcy courts have recognized that a policyholder may assign its rights to insurance proceeds either pursuant to the policy itself, or in a settlement with an insurer resolving a coverage dispute. Accordingly, the prevailing trend in the case law is that:

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 has no legally cognizable claim to the insurance proceeds, those proceeds are not property of the estate.⁸

Stated another way, "[w]hether the proceeds of an insurance policy are property of a debtor's estate depends upon the nature of the policy and the specific provisions governing the parties' interests in the payment of policy proceeds."⁹

The determination of estate property "must be analyzed in light of the facts of each case."¹⁰ However, as a general rule:

Examples of insurance policies whose proceeds are property of the estate include *casualty, collision, life, and fire* insurance policies in which the debtor is a beneficiary. Proceeds of such insurance policies, if made payable to the debtor rather than a third party such as a creditor, are property of the estate and may inure to all bankruptcy creditors. But under the typical *liability policy*, the debtor will not have a cognizable interest in the proceeds of the policy. Those proceeds will normally be payable only for the benefit of those harmed by the debtor under the terms of the insurance contract.¹¹

In the liability insurance context, courts have recognized that the debtor may have "no cognizable claim to the proceeds paid by an insurer on account of a covered claim" due to the fact that the proceeds are paid directly "to the victim of the insured's wrongful act."¹² Other decisions have held that liability policies that are payable to the debtor are prop-

erty of the estate.¹³ Certain courts have similarly appeared to distinguish indemnity insurance from general liability insurance on the grounds that indemnity insurance is paid directly to the debtor.¹⁴ However, as discussed below, in the D&O insurance context, courts are divided as to whether indemnification proceeds should be considered property of the estate. Specifically, certain courts have found that when coverage limits are depleted by requested indemnification, which could render the policyholder without coverage for future indemnification demands, the indemnification proceeds should be considered estate property.¹⁵

In addition, some courts have recognized that a “secondary impact” on the estate may render insurance proceeds property of the estate. For example, if there was a risk that policy limits were not sufficient to fund payment to claimants, a bankruptcy court may find, on that basis, that the policy proceeds were property of the estate to ensure an equitable distribution to all parties with covered claims.¹⁶ In addition, the Second Circuit has noted that:

In the mass tort context, the decisions by several courts to include the proceeds as property of the estate appear to be motivated by a concern that the court would not otherwise be able to prevent a free-for-all against the insurer outside the bankruptcy proceeding.... There was also a threat that unless the policy proceeds, were marshalled in the bankruptcy proceeding, they would not cover plaintiffs’ claims and would expose the debtor’s estate. These concerns are answered once the court finds that the policy itself is property of the estate....¹⁷

Other courts, however, have rejected this analysis as “utterly backwards” on the grounds that proceeds cannot become property of the estate “merely because such property has the effect of reducing the estate’s liability, or because of some other beneficial effect such property has on the estate.”¹⁸

Presuming that the debtor has a valid claim to the insurance proceeds, if the proceeds are deemed to be property of the debtor’s estate, they will be protected from claimant diminution by the automatic stay.¹⁹ However, just because proceeds are considered property of the estate does not mean that such proceeds will necessarily be distributed to all unsecured creditors on a pro rata basis. Courts have recognized that “[p]roperty of the estate comes into the estate subject to all restrictions applicable to that property under state law, unless the restriction is undone by the Bankruptcy Code.”²⁰ As a result, “insurance proceeds, *if* they were considered property of the estate, necessarily would be distributed only to those to whom the state insurance law, or the policies themselves, gave a right to distribution.”²¹ On the other hand, if the proceeds are not estate property,

the automatic stay will not apply and claimants will be permitted to pursue the funds.²² However, in order to prevent certain injured third parties from obtaining an advantage over others, a court may enjoin such suits under its equitable powers granted by § 105 of the Bankruptcy Code.²³

B. Avoidance of a Pre-Petition Insurance Settlement

Pre-petition insurance settlements can be collaterally attacked by creditors in a subsequent chapter 11 case. Specifically, creditors can seek to avoid a settlement as a constructive²⁴ or actual²⁵ fraudulent conveyance, or seek to avoid a settlement as a preferential transfer.²⁶

In practice, after a debtor files for chapter 11 protection, a bankruptcy court generally will be required to appoint an official committee of unsecured creditors to protect the interests of creditors throughout the case.²⁷ The creditors' committee may allege that a pre-petition insurance settlement unfairly assigned valuable insurance proceeds to a creditor either (i) in exchange for less than reasonably equivalent value,²⁸ or (ii) in a manner that improperly preferred those creditors to other creditors that should have shared the proceeds on a pro rata basis.²⁹ As with the question whether the proceeds were estate property, the determination of these causes of action will depend on the particular facts of each case.

In addition, if the pre-petition settlement was for the assignment of future insurance proceeds and purported to grant the claimant a security interest in such proceeds, the grant of such security interest may be avoided in bankruptcy. Article 9 of the UCC expressly does not apply to "a transfer of an interest in or an assignment of a claim under a policy of insurance, other than an assignment by or to a health-care provider of a healthcare-insurance receivable and any subsequent assignment of the right to payment, but §§ 9-315 and 9-322 apply with respect to proceeds and priorities in proceeds."³⁰ Neither §§ 9-315 nor 9-322 alter the inapplicability of Article 9 to future insurance proceeds.³¹ Upon the insured's bankruptcy filing, the purported grant of the security interest is subject to avoidance by operation of Bankruptcy Code § 544, which (as of the petition date) grants the debtor a hypothetical perfected security interest or lien in all assets of the debtor's estate.³² As a hypothetical lien creditor of all estate property, the debtor can avoid any unperfected security interests as of the petition date. As a result, courts may avoid the liens purportedly granted in future insurance proceeds in bankruptcy.³³

C. Post-Petition Insurance Settlements and Chapter 11 Plans of Reorganization

Coverage disputes may be resolved during the course of a bankruptcy case. Settlements can take the form of policy buy backs, coverage-in-place

agreements or other similar structures.³⁴ Settlements and compromises are “a normal part” of the bankruptcy process.³⁵ Indeed, compromises are “favored in bankruptcy” as a means to “minimize litigation and expedite the administration of a bankruptcy estate.”³⁶ A bankruptcy court may approve a settlement under Bankruptcy Rule 9019 when “it is supported by adequate consideration, is fair and equitable, and is in the best interests of the estate.”³⁷ A bankruptcy court need not decide the numerous issues of law and fact addressed by the settlement, but should instead “canvass the issues and see whether the settlement falls below the lowest point in the range of reasonableness.”³⁸ In doing so, a court considers: (1) the probability of success in the litigation; (2) the likely difficulties of collection; (3) the complexity of the litigation involved; and (4) the paramount interest of the creditors.³⁹

In addition to an individual bankruptcy settlement, a debtor may resolve liability against the estate globally through a plan of reorganization.⁴⁰ The objective of a chapter 11 case is to confirm a financial restructuring plan. A plan can, among other things, convert debt to equity, issue new securities to creditors and sometimes to shareholders, sell assets, reject executory agreements, and settle litigation. Plans allow for significant flexibility and creativity in rehabilitating a business. With respect to insured claims, a plan of reorganization can be structured to resolve numerous claims fairly and on a global basis through, for example, creation of a trust—funded in part by the debtor’s insurance—that will assume liability for all covered claims.

The Bankruptcy Code provides certain procedural and substantive requirements and protections for plan confirmation. For example, plan voting can only occur after solicitation with a court-approved disclosure statement containing “adequate information” sufficient to advise a hypothetical investor.⁴¹ A plan must be approved by at least one impaired, non-insider class of creditors.⁴² A plan must be proposed in good faith⁴³ and be feasible in that it is not likely to lead to a future reorganization or liquidation of the debtor.⁴⁴

With regard to distributions, a plan cannot classify substantially dissimilar creditors in the same class⁴⁵ and must treat all creditors in a particular class the same.⁴⁶ Moreover, unless the plan is consensual, distributions must be in accordance with the Bankruptcy Code’s waterfall payment structure (the “absolute priority rule”)—namely, secured creditors are to be paid before unsecured creditors, and unsecured creditors are to be paid before shareholders.⁴⁷ In other words, a subordinate class cannot receive a distribution from the estate on account of its claim or interest unless the senior class either assents to the plan or is satisfied in full by the plan.⁴⁸

Assignment of insurance proceeds cannot be used to prefer certain creditors unfairly and can prompt other challenges to plan confirmation. However, properly structured, assignments of coverage proceeds can be used to create and help fund a confirmable chapter 11 plan.⁴⁹

II. D&O Insurance in Bankruptcy

A corporation's policies for coverage of its directors and officers ("D&O Insurance") present special issues in bankruptcy.⁵⁰ D&O Insurance protects directors and/or the corporation against securities claims, fiduciary breach claims and other similar claims that can be brought derivatively on behalf of the corporation (to redress damage to the enterprise as a whole) or by a shareholder directly (to redress an individualized injury).⁵¹ Bankruptcy law concerning D&O Insurance is still evolving. How a particular policy will be treated in bankruptcy depends on, among other things, the type of policy at issue, the jurisdiction in which the case is filed, and the claim profile of the debtor.

A. Types of D&O Insurance

There are three main types of D&O Insurance—A-Side, B-Side and C-Side (or entity coverage). A-Side policies provide coverage directly to directors and officers when they are personally liable and when indemnification from the company either is not provided for by contract, not permitted by law, or not available due to insolvency. B-Side policies, on the other hand, are indemnification policies. These policies provide reimbursement to the company after the company indemnifies a director or officer. C-Side policies provide coverage directly to the company for its liability for securities claims. A-Side, B-Side and/or C-Side policies may be combined together in different policy amalgamations. In addition, a single policy can include a priority waterfall in which the insurer will fund different policy components in a pre-established order.⁵²

B. Access to Coverage

The issue that arises in bankruptcy concerns which parties have access to D&O Insurance proceeds and under what conditions. For example, general unsecured creditors may argue that coverage proceeds should be treated as general property of the bankruptcy estate and be available for distribution to all creditors in accordance with the Bankruptcy Code's distribution priorities.⁵³ On the other hand, shareholders bringing securities claims against the estate (and/or directors and officers personally) may argue that the D&O Insurance was intended to apply only to their claims. The Bankruptcy Code subordinates all claims related to the purchase or sale of a security to general unsecured claims

against the estate.⁵⁴ As a result, if coverage proceeds are not exclusively available for distribution on account of shareholders' claims, shareholders may likely receive no recovery from the estate.

If proceeds from D&O Insurance are considered property of the estate, the Bankruptcy Code's automatic stay will prevent a director or officer from accessing coverage or receiving indemnification outside of the general bankruptcy claims allowance process.⁵⁵ The court, however, can dissolve the stay or modify it in specialized fashion "for cause."⁵⁶ Cause is demonstrated under multi-factor tests that balance the interests and harms involved.⁵⁷ In the event that D&O Insurance proceeds are held to be property of the estate, cause has been found to lift the stay to allow directors and officers access to funds when they face "real and identifiable harm" in having to defend ongoing litigation and such harm far outweighs the potential injury to the estate, especially because the directors and officers would have a corresponding indemnification claim against the estate in the amount of the coverage denied.⁵⁸ The automatic stay does not apply to insurance proceeds that are not considered property of the estate.⁵⁹

Cases determining whether insurance proceeds constitute estate property turn on the language and scope of the specific policies at issue, as well as the particular facts of each case.⁶⁰ Several courts have found that because the debtor did not have a "direct interest" in A-Side or B-Side coverage proceeds, those proceeds *were not* property of the estate.⁶¹ On the other hand, other courts have found that a debtor did have a direct interest in B-Side proceeds because the coverage limits could be depleted by requested indemnification, which could render the company without coverage for future indemnification demands. On this basis, these courts have found that the B-Side coverage proceeds *were* property of the estate.⁶² In other words, if the covered indemnification "has not occurred, is hypothetical, or speculative" (*e.g.*, if indemnification has not yet been requested or requested only in an amount far below the SIR⁶³), courts may find that the policy proceeds are not property of the estate.⁶⁴

Bankruptcy courts have similarly diverged in their analysis of C-Side policies. Some courts have found that policy proceeds from entity coverage are property of the estate.⁶⁵ This is not surprising because the debtor can easily be said to have an "interest" in proceeds from coverage under which it is an insured, especially if such policy employs an aggregate limit of coverage for its A-Side, B-Side and C-Side components.⁶⁶ However, when the character of the D&O Insurance at issue is effectively protection for officers and directors alone, courts have generally found that the proceeds are not estate property.⁶⁷

C. Downey Financial

The recent decision in *Downey Financial* from the Bankruptcy Court for the District of Delaware provides a useful example of how courts will assess a D&O policy in light of the particular claim profile of a debtor.⁶⁸ In that case, two proceedings were initiated against the debtor prior to its bankruptcy. The first case was a consolidated securities class action filed against the debtor and certain directors and officers. The second case was a consolidated shareholder derivative action filed against the directors and officers (with the debtor as a nominal defendant). Because of the overlap between the two actions, parties agreed to stay the derivative action until motions to dismiss in the securities action could be decided. The debtor filed for chapter 7 protection on November 25, 2008. Due to the bankruptcy filing, a chapter 7 trustee was substituted for the debtor in the derivative action.

Eleven former officers and directors of the debtor sought permission from the bankruptcy court to access proceeds from the debtor's D&O Insurance policy (the "Policy") to fund their defense of both the securities action and the derivative action (the "Proceeds Motion"). In August 2009, before the Proceeds Motion was decided, the securities action was dismissed with prejudice. After such ruling, the derivative action could proceed. In May 2010, the bankruptcy court entered its decision on the Proceeds Motion in favor of the directors and officers, holding that the proceeds of the Policy were not property of the estate, were not subject to the automatic stay and thus, were available to the directors and officers.

In its opinion, the bankruptcy court reviewed the Policy in detail. The court noted that the Policy had A-Side, B-Side and C-Side components. The court further noted that in the event of a loss, available limits would first fund the A-Side component, second the B-Side component, and lastly the C-Side component. The overall limit for all loss under the Policy was \$10 million. Prior to bankruptcy, the debtor had indemnified the officers and directors for \$588,000 of the \$1 million SIR. The debtor ceased indemnifying the officers and directors upon filing for bankruptcy.⁶⁹

The court began its analysis by noting that the Policy proceeds would be property of the estate if, under the particular circumstances at issue, "depletion of the proceeds would have an adverse effect on the estate."⁷⁰ As a result, the court noted that proceeds of the C-Side and B-Side components would be property of the estate "only to the extent that the Policy's indemnification coverage or entity coverage actually protects the estate's other assets from diminution."⁷¹ Assessing the C-Side (entity coverage) component of the Policy, the court noted that because the securities action had been dismissed, and because the debtor was

only a nominal defendant in the derivative action, the debtor's entity coverage was effectively "no longer protecting the estate's other assets from diminution."⁷² Analyzing the B-Side component of the Policy, the court commented that before the petition date, the debtor had indemnified the officers and directors in the amount of \$588,000. Such amount was within the SIR and therefore did not constitute indemnification "for which the Debtor would be entitled to coverage under the Policy."⁷³ Moreover, since the officers and directors had not sought indemnification post-petition, and it was unlikely that the trustee would agree to indemnify the directors and officers for an amount that would exhaust the SIR, the court found that it was "extremely unlikely" that indemnification would impair estate assets. As a result, the court found that "indemnification in this case is hypothetical or speculative" and that "the Policy's indemnification coverage, like its entity coverage, is no longer protecting the estate's other assets from diminution."⁷⁴

The *Downey* court concluded that "the Policy proceeds are not property of the estate."⁷⁵ Central to its analysis was the fact that there was no likelihood that there would be covered losses under the B-Side or C-Side components of the Policy. The court also commented that the Policy's priority waterfall allowed access to the A-Side coverage proceeds *prior* to proceeds from the B-Side and C-Side components, and that the Policy expressly stated that this priority scheme would not be altered by a bankruptcy filing. The court noted that, if proceeds from the B-Side or C-Side components were found to be property of the estate, such a determination would grant the bankruptcy estate expanded rights in the proceeds that it did not have prior to the bankruptcy filing. This would violate the general bankruptcy rule that the estate does not receive greater rights in property because of the bankruptcy filing.⁷⁶ Notably, the court also determined that even if the Policy proceeds were property of the estate, cause existed to lift the automatic stay to provide access to the officers and directors because the potential harm to such insureds was real and identifiable.

The *Downey* court considered the specific language of the Policy, the anticipated coverage profile of the debtor, how its determination regarding the status of the proceeds would impact the bankruptcy estate, and the potential harm to the officers and directors. Interested parties in a policy should anticipate that each case will be determined by an individualized analysis of the particular circumstances at issue.

III. Non-Payment of Deductible or SIR as Defense to Coverage

Assignment of insurance proceeds is of little use if the carrier can escape its coverage obligations on account of the insured's failure to satisfy

the policy's deductible or SIR. A deductible and SIR are similar in that each sets forth an amount of liability for acts that trigger the policy but that are payable by the insured. They differ in that a deductible is subtracted from the policy's limits while an SIR is structured so that the insurer's coverage obligations do not commence until the SIR is satisfied.⁷⁷

The majority rule is that irrespective of state law, the Bankruptcy Code requires an insurer to provide coverage for liability in excess of the deductible or SIR and up to the coverage limits regardless of whether an insolvent insured satisfies amounts owing under the deductible or SIR.⁷⁸ Indeed, some states have even enacted statutes providing that failure of an insured to pay amounts owed does not relieve the insurer from its coverage obligations.⁷⁹ At least one court has gone so far as to lift the Bankruptcy Code's automatic stay to permit a claimant to pursue the debtor's insurer directly for the policy limits in excess of SIR.⁸⁰

Other courts have required payment of the SIR as an enforceable condition to coverage distinguishing other decisions as merely applying alternative state law.⁸¹ Moreover, when the policy at issue is ambiguous as to the form of payment required, courts have permitted the debtor to satisfy the SIR in various manners (including by a non-dischargeable note and by treatment in the plan of reorganization).⁸² However, when the policy at issue expressly requires payment in a particular form, other courts have enforced these payment provisions literally, effectively requiring satisfaction in cash where the insurance policy expressly required it.⁸³

IV. "Buy Back" and "Coverage-In-Place" Settlements

In a "buy back" agreement, the insurer pays a lump sum to the policyholder to resolve a coverage dispute—*i.e.*, the insurer buys back the policy from the insured and the policy is then canceled. Alternatively, an insured may enter into coverage-in-place settlement with its insurer. In a coverage-in-place settlement, the company and the policy carrier typically agree on a lump sum payment for past amounts owed and establish a formula for payment indemnification and/or defense costs moving forward. Buy back agreements and coverage-in-place settlements both are subject to court approval pursuant to Bankruptcy Rule 9019. Buy back agreements are also subject to Bankruptcy Code § 363, which, as discussed below, offers unique advantages under the right circumstances.

Bankruptcy Rule 9019 and the governing case law provide that a settlement may be approved so long as it "falls below the lowest point in the range of reasonableness."⁸⁴ Coverage litigation, which is often uncertain, complex and expensive, is particularly suitable for settlement in bankruptcy. Moreover, when insurance assets constitute a critical element of the debtor's estate, a settlement with insurers may be especially

appropriate as it will permit the insured to reorganize, regain access to the credit markets, and refocus on its business operations—all of which creates value and facilitates the bankruptcy process.

A buy back settlement must satisfy Bankruptcy Code § 363(b) (sale of estate asset) in addition to Bankruptcy Rule 9019. Bankruptcy Code § 363(b) provides, among other things, that after notice and a hearing, a debtor may sell estate property out of the ordinary course of business.⁸⁵ A bankruptcy court will require that a debtor demonstrate “sound business justifications” for a proposed § 363(b) transaction.⁸⁶ While a court usually will not disturb the estate’s normal exercise of its business judgment, for major transactions that are central to the debtor’s chapter 11 case, a more intensive multi-factored test can be applied.⁸⁷ In general, the court will likely approve a settlement negotiated in good faith that can be shown to be in the reasonable best interests of the debtor’s estate.

Bankruptcy Code § 363(f) provides that a bankruptcy court may approve a sale “free and clear of any interest in such property” so long as:

- (1) applicable nonbankruptcy law permits sale of such property free and clear of such interest;
- (2) such entity consents;
- (3) such interest is a lien and the price at which such property is to be sold is greater than the aggregate value of all liens on such property;
- (4) such interest is in a bona fide dispute; or
- (5) such entity could be compelled, in a legal or equitable proceeding, to accept a money satisfaction of such interest.⁸⁸

Section 363(f) will be satisfied if any one of the conditions enumerated therein is met. While certain other subsections may also apply to a particular buy back settlement, § 363(f)(5) can nearly always be met, as a claimant unquestionably could be forced to accept “money satisfaction” in exchange for its interest in the debtor’s insurance.

Utilizing § 363(f), a buy back settlement may be structured as a sale free and clear of any liability on account of any future claims related to the policy. In other words, after the sale is consummated, future claimants against the company cannot also pursue the insurer as assignee of the policy. The policy is effectively canceled and the insurer’s obligations under it are discharged.

Bankruptcy Code § 363(e) further conditions a free and clear sale by requiring that each holder of an interest in the property being sold receive adequate protection. With respect to buy back agreements,

claimants receive their adequate protection from (1) the settlement amount paid by the insurer, and (2) continued recourse to the debtor's profits from ongoing operations, which operations can be expected to benefit from a successful reorganization.

As added protection for the settling insurer, Bankruptcy Code § 363(m) provides that a properly conducted free and clear sale cannot later be disturbed as to a good faith purchaser.⁸⁹ As a result, barring improper collusion during settlement negotiations,⁹⁰ a court-approved buy back settlement will offer insurers protection from future actions to set aside the settlement—*e.g.*, as a fraudulent conveyance. This § 363(m) protection is not available outside of bankruptcy.

V. Third-Party Releases in Bankruptcy

To supplement a coverage settlement's other bankruptcy protections, the insured and its insurer may seek court approval of a third-party release or injunction expressly barring future liability. The insured's officers and directors and/or its corporate parents and affiliates may also seek this protection although their releases may be opposed. Third-party releases and injunctions are premised on the court's equitable powers set forth in Bankruptcy Code § 105(a).⁹¹ However, a court's ability to grant such releases and injunctions is unsettled and controversial.⁹² In general, the Bankruptcy Code contemplates that only a debtor will receive a discharge of its liabilities, and only after the procedural and substantive protections commensurate with plan confirmation.⁹³ The only express statutory exception to this general rule is for certain defined third parties (including insurers) who make a "substantial contribution" to the reorganization of an asbestos debtor pursuant to Bankruptcy Code § 524(g).⁹⁴ This exception, however, is strictly limited to reorganizing asbestos debtors who satisfy all the requirements of § 524(g).⁹⁵

There is, however, another form of relief under Bankruptcy Code § 105 that does not rise to the level of an outright discharge of indebtedness. An anti-suit injunction can be sought to prevent third party suits against a settling insurer that has paid policy limits or otherwise made full payment under a court-approved settlement.⁹⁶

Whether or not a third party release or a supplemental § 105 anti-suit injunction should be sought as part of a bankruptcy settlement is dependent on the specific case. In addition, unless a particular release or injunction was specifically challenged in the first instance, a court may not uphold that provision in a subsequent challenge. If a release or anti-suit injunction is critically important, the best approach is to incorporate the provision as part of a plan of reorganization where certain courts—including in the Second and Third Circuits—have approved third-party

releases and anti-suit injunctions if there are unusual circumstances that made such release both fair and necessary for a successful reorganization.⁹⁷ Instances where third party injunctions have been approved include mass tort reorganizations involving: (1) asbestos (prior to enactment of § 524(g));⁹⁸ (2) Dalkon Shield intra-uterine devices;⁹⁹ (3) silicone implants;¹⁰⁰ and (4) environmental contamination.¹⁰¹ Note, however, that attempts to extend the anti-suit injunction “a bridge too far” can lead to failure: a bankruptcy court in the Southern District of New York recently denied confirmation of an asbestos debtor’s plan of reorganization on the facts of that case, holding that a proposed plan of reorganization constituted a bad faith attempt to secure a third-party injunction for the debtor’s corporate parent.¹⁰²

Section 105 injunctions are most appropriate for mass tort debtors where future liability is difficult to calculate. In these cases, a common strategy is for the debtor to structure a plan that assigns its insurance coverage for future liability to a trust that will administer a court-approved claims resolution process. While such a trust is expressly authorized by § 524(g) of the Bankruptcy Code in the asbestos context, reorganizing debtors have used a trust device for other injuries—*e.g.*, silicone-related diseases.¹⁰³ Assignment in this context is akin to the permitted assignment of proceeds. Here, the coverage period has already expired and the insurer is not being forced to accept the risk profile of a different entity. Moreover, in the asbestos context, case law almost unanimously holds that § 524(g) of the Bankruptcy Code, as a federal statute with supremacy over state law, will trump contractual anti-assignment provisions.¹⁰⁴ These courts have rejected the insurers’ arguments that their policies are not assignable because they contain affirmative covenants for the policyholder to cooperate with the insurer to defend against liability to claimants and that the claims resolution process violates this duty of cooperation. It is unclear, however, under what circumstances a court might extend these decisions beyond the asbestos, mass or toxic tort contexts.

VI. Insurer Insolvency and Potential Gaps in Coverage

Layering coverage from multiple carriers is an effective way to spread risk and increase coverage. The insured has some protection in the event that one of the carriers becomes insolvent. A single carrier is also protected against having to fund the policyholder’s entire insurable risk. Excess coverage over an insured’s primary policy is typically either: (1) a “follow form” policy containing the same terms as the underlying coverage; or (2) an “umbrella” policy that may be broader than the underlying coverage.

Layering coverage with several “follow form” policies may be a cost-effective approach to structure a company’s risk protection. This structure, however, presents certain problems in the event that a low-level excess insurer becomes insolvent and the higher-level insurers use the failure of that insurer to fund its policy limits as a defense to coverage. For example, if an insured has \$10 million in primary coverage limits, \$5 million in first-level excess coverage and \$5 million in second-level excess coverage, and if the first-level excess insurer becomes insolvent, the second-level excess insurer may assert that it has no coverage obligations until the policyholder itself satisfies the “gap” in the first-level excess coverage by paying the limits of the first level excess policy.

Insolvent insurers are not eligible for relief under the Bankruptcy Code and instead are subject to state receivership or insolvency proceedings.¹⁰⁵ The insured would have a claim for coverage in these proceedings, which—similar to chapter 11 proceedings—may result in a cents-on-the-dollar recovery. The insured would argue that its claim against the insurer in any such proceeding satisfies the first-level excess insurer’s funding obligations triggering the second-level excess coverage. The second-level carrier would argue that enforceable conditions precedent in its policy have not been satisfied and that it should not be forced to “drop down” to provide coverage. The dispute will primarily revolve around contract interpretation.

Nevertheless, and especially in bankruptcy, equitable arguments could also come into play. For example, the market in excess coverage is not designed for higher-level providers to assess the solvency of the lower-level insurers. In other words, a second-level provider sells coverage to the insured on the insured’s risk profile, not the risk profile of the first-level insurer. As a result, the second-level provider’s coverage obligations should arguably be wholly independent of the first-level insurer’s ability to pay. On the other hand, the second-level excess insurer would argue that it expressly did not contract for coverage obligations below a certain threshold.

The bankruptcy of the insured will affect this dispute. The insurer will argue that the bankruptcy court should not re-write the policy. The debtor-insured will argue that the court should reject the inequitable denial of coverage, especially if total liability exceeds all policy limits. Specifically, the debtor will argue that the excess insurer is not harmed by being forced to drop down and that it would be an inequitable use of estate property to fill the gap in coverage when insurance proceeds were otherwise available.

Courts have varied in their response to these insurance “gap” issues and resolution of a particular case will likely depend on the specific contract

language at issue.¹⁰⁶ If an excess policy is drafted with common “amounts recoverable” language (*i.e.*, coverage is available for liability “in excess of the amount recoverable under the underlying insurance”), courts have found that the excess coverage does drop down.¹⁰⁷ On the other hand, other courts have enforced policy language requiring the exhaustion of lower level policies. For example, the Seventh Circuit—focusing on the term “exhausted”—ruled that a policy did not drop down when it provided coverage “only in excess of and after all [underlying coverage] has been exhausted.”¹⁰⁸ Unfortunately, courts may interpret similar clauses differently, meaning that outcomes are difficult to predict.¹⁰⁹

Bankruptcy courts, as courts of equity, may be more sympathetic to the debtor-policyholder in a close case. However, insurance law is a matter of state law and the Supreme Court has recently suggested that bankruptcy courts, as non-Article III court, may lack the constitutional authority to adjudicate issues that primarily concern state law.¹¹⁰

VII. Paid-Loss Retrospective Policies in Bankruptcy

Paid-loss retrospective policies, which generally include workers’ compensation policies, require an insured to fund a reserve balance to pay claims resolved by its carrier up to a certain threshold. Above that threshold, the carrier is obligated to provide coverage up to the policy limits. The size of the reserve—which may be secured by a letter of credit or other collateral—and the amount of additional premiums payable by the insured are calculated in accordance with the policyholder’s evolving risk profile, which is usually re-set after the conclusion of each policy year. Policies also include “add-ons” pursuant to which the insurer, after it resolves a claim against the insured, will be eligible for compensation from the insured in excess of the claim amount to account for administrative and other costs. Liability on a single claim, therefore, can harm an insured in several ways: (1) loss of reserve amount; (2) payment of add-ons; (3) potential for the insurer to raise the reserve requirements; and (4) potential for the insurer to increase other premiums payable by the insured. This cascading liability may leave the insured financially vulnerable, especially if a demanded reserve increase triggers a default in the insured’s credit facilities.

Under retrospective policies, the carrier (or a third party adjuster approved by the carrier) resolves claims against the insured (effectively with the insured’s money), while at the same time potentially profiting on account of the policyholder’s increased liability (in the form of additional premiums and other charges). This practice has led some courts to recognize that an inherent conflict of interest exists and to scrutinize carrier-driven settlements to ensure that they are entered into in

the best interests of the insured.¹¹¹ Specifically, in some states, insureds may bring breach of contract actions against their insurers forcing the insurers to demonstrate that their resolution of claims was based on due investigation, was reasonable and was undertaken in good faith.¹¹² Other jurisdictions, however, have rejected this cause of action leaving the insured with little recourse for the insurer's actions.¹¹³

VIII. Conclusion

Insurance is often a critical asset of a company in financial distress. As set forth above, how a bankruptcy court will treat a debtor's insurance proceeds depends on the terms of the policy, the jurisdiction in which the case is filed, and the circumstances surrounding the filing. While bankruptcy law is still developing in this area, bankruptcy courts have already demonstrated that there is some degree of flexibility in employing the Bankruptcy Code to recognize the unique aspects of insurance coverage.

Notes

1. 11 U.S.C. § 541(a).
2. See *MacArthur Co. v. Johns-Manville Corp.*, 837 F.2d 89, 92 (2d Cir. 1988) ("Numerous courts have determined that a debtor's insurance policies are property of the estate, subject to the bankruptcy court's jurisdiction."), *cert. denied*, 488 U.S. 868 (1988). See also *First Fidelity Bank v. McAteer*, 985 F.2d 114, 116 (3d Cir. 1993); *Louisiana World Exposition, Inc. v. Federal Ins. Co.*, 832 F.2d 1391, 1399 (5th Cir. 1987); *Minoco Group of Cos. v. First State Underwriters Agency*, 799 F.2d 517, 519 (9th Cir. 1986); *A.H. Robins Co. v. Piccinin*, 788 F.2d 994, 1001 (4th Cir. 1986); *Beloit Liquidating Trust v. United Ins. Co.*, 287 B.R. 904, 905-06 (N.D. Ill. 2002); *In re Ames Dep't Stores Inc.*, 1995 WL 311764, at *3 (S.D.N.Y. 1995) (citing *In re Sudbury, Inc.*, 153 B.R. 776, 778-80 (Bankr. N.D. Ohio 1993); *In re Firearms Imp. and Exp. Corp.*, 131 B.R. 1009, 1013-14 (Bankr. S.D. Fla. 1991); *In re Federal Press Co.*, 104 B.R. 56 (Bankr. N.D. Ind. 1989)).
3. See 11 U.S.C. § 541(c)(1)(B). See also *In re Probulk Inc.*, 407 B.R. 56 (Bankr. S.D.N.Y. 2009) (granting motion by chapter 7 trustee to prevent insurers from terminating policies due to debtor's resolution for a "voluntary winding up," noting a termination of coverage would violate the automatic stay).
4. See *In re Supreme Beef Processors, Inc.*, 468 F.3d 248, 255 (5th Cir. 2006).
5. See, e.g., *In re Baird*, 567 F.3d 1207, 1213 (10th Cir. 2009) ("The question of the assignability of the liability policy is a question of state law."); *Maertin v. Armstrong World Ind., Inc.*, 241 F. Supp. 2d 434, 446 n.6 (D.N.J. 2002) (noting that insurance proceeds will not be property of the debtor's estate if, prior to bankruptcy, the debtor makes an absolute assignment of its interest in the proceeds) (citing *Excelsior Ins. Co. v. Pennsbury Pain Ctr.*, 975 F. Supp. 342, 346, 353 (D.N.J. 1996)). See *infra* note 104 and accompanying text discussing preemption under § 524(g) of the Bankruptcy Code.
6. As a general matter, insurance policies contain strict anti-assignment provisions that prohibit an insured from assigning its ongoing coverage. The policy behind this rule protects the insurer who contracted with the insured based on its specific risk profile; such insurer generally will not be forced to maintain coverage for a different entity with a different risk profile. Applying state law, bankruptcy courts will uphold these anti-assignment provisions. As noted,

however, the Bankruptcy Code specifically prohibits an insurer from terminating coverage due to an insured's insolvency. See 11 U.S.C. § 541(c)(1)(B); see also 11 U.S.C. § 365(b)(1).

7. See, e.g., 44 Am. Jur. 2d Insurance § 786 (“After a loss has been incurred, the claim to recover insurance proceeds may be effectively assigned by the insured.”). See also *Baird*, 567 F.3d at 1213 (“The parties agree that under Utah law, the assignability question depends on whether a loss has occurred in this case, because if a loss has occurred, then restrictions on assignability no longer have force.”).

8. *In re Edgeworth*, 993 F.2d 51, 55-56 (5th Cir. 1993) (citing *First Fidelity Bank v. McAteer*, 985 F.2d 114, 117 (3d Cir. 1993) (“[I]f the owner of a life insurance policy did not have an interest in its proceeds, the filing of the petition in bankruptcy cannot create one.”); *In re Gagnon*, 26 B.R. 926, 928 (Bankr. N.D. Pa. 1983) (“[T]he estate’s legal and equitable interests in property rise no higher than those of the debtor.”)). See also *In re Nutraquest, Inc.*, 434 F.3d 639, 647 n.4 (3d Cir. 2006) (noting that an “exception” to the “general rule” exists when the debtor “does not own the insurance proceeds”); *In re Endoscopy Center of S. Nevada, LLC*, 451 B.R. 527, 546-47 (Bankr. D. Nev. 2011) (assessing existing case law).

9. *In re Gladwell*, No. 06–82063, 2009 WL 140098, at *2 (Bankr. C.D. Ill. Jan. 21, 2009) (citing *In re Feher*, 202 B.R. 966, 969 (Bankr. S.D. Ill. 1996); *In re Hill*, 174 B.R. 949, 952 (Bankr. S.D. Ohio 1994)). See also *In re Allied Digital Techs., Corp.*, 306 B.R. 505, 509 (Bankr. D. Del. 2004) (noting that “cases are controlled by the language and scope of the policy at issue not by broad, general statements”).

10. *Gladwell*, 2009 WL 140098, at *2 (citing *In re CHS Electronics, Inc.*, 261 B.R. 538, 542 (Bankr. S.D. Fla. 2001); *In re First Cent. Fin. Corp.*, 238 B.R. 9, 16 (Bankr.E.D.N.Y.1999)).

11. *Edgeworth*, 993 F.2d at 56 (emphasis added) (citing *McAteer*, 985 F.2d at 117; *Holland Am. Ins. Co. v. Succession of Roy*, 777 F.2d 992, 996 (5th Cir. 1985); *Bradt v. Woodlawn Auto Workers*, 757 F.2d 512, 515 (2d Cir. 1985)). See also *In re 15375 Memorial Corp.*, 382 B.R. 652, 688 (Bankr. D. Del. 2008), rev’d on other grounds 400 B.R. 420 (D. Del. 2009) (“Neither the Third Circuit nor this Court appears to have squarely addressed the question of whether a debtor ordinarily has a property interest in the proceeds of liability insurance that constitutes property of the estate under section 541(a) of the Bankruptcy Code protected by the automatic stay, but the limited body of case law in this Circuit addressing analogous issues suggests that the Third Circuit will follow the reasoning of *Edgeworth* and its progeny.”).

12. *Landry v. Exxon Pipeline Co.*, 260 B.R. 769, 786 (Bankr. D. La. 2001) (“The insured debtor cannot ask the insurance company to pay him, or determine on its own how the proceeds of the policy should be distributed, nor can any creditor of the insured seize the proceeds in satisfaction of a claim not falling within the terms of the insurance contract.”).

13. See, e.g., *In re W.R. Grace & Co.*, — B.R. —, No. 11-199, 2012 WL 310815, at *15-19 (D. Del. Jan. 30, 2012) (distinguishing the reasoning of *Edgeworth* on account of the fact that “the proceeds of the Grace-CNA insurance policies [were] payable to Grace, not the Libby Claimants,” and holding that liability insurance proceeds were property of the debtor’s estate).

14. See *Endoscopy Center*, 451 B.R. at 543 (“Liability Versus Indemnity Insurance”); *Landry*, 260 B.R. at 797 (noting that “the proceeds of general liability insurance (as opposed to indemnification of liability insurance) are (to a point) analogous to a third-party guarantor’s funds used to pay a loan upon the default of a primary obligor”).

15. See *infra* notes 60-64 and accompanying text.

16. See *Edgeworth*, 993 F.2d at 56.

17. *Id.* at 56 n.21 (citing *First Fidelity Bank v. McAteer*, 985 F.2d 114 (3d Cir.1993); *McArthur Co. v. Johns-Manville Corp.*, 837 F.2d 89 (2d Cir.), cert. denied, 488 U.S. 868 (1988); *In re Louisiana World Exposition, Inc.*, 832 F.2d 1391 (5th Cir. 1987); *Tringali v. Hathaway Mach. Co.*, 796 F.2d 553 (1st Cir. 1986); *A.H. Robins Co. v. Piccinin*, 788 F.2d 994 (4th Cir. 1985), cert. denied, 479 U.S. 876 (1986); *In re Davis*, 730 F.2d 176 (5th Cir. 1984); *Wedgeworth v. Fibreboard Corp.*, 706 F.2d 541 (5th Cir. 1983)).

18. *Landry*, 260 B.R. at 790. See also *Endoscopy Center*, 451 B.R. at 546-47.

19. See 11 U.S.C. § 362(a).

20. Landry, 260 B.R. at 787 n.62 (citing *Board of Trade v. Johnson*, 264 U.S. 1 (1924); *Butner v. United States*, 440 U.S. 48 (1979)).

21. *Id.*

22. See *Edgeworth*, 993 F.2d at 56 n.21; Landry, 260 B.R. at 787 n.63.

23. See *In re Adelpia Commc'ns Corp.*, 298 B.R. 49, 54 (S.D.N.Y. 2003) (noting bankruptcy court's authority to expand the automatic stay to prevent "an immediate adverse economic consequence for the debtor's estate") (quoting *Queenie, Ltd. v. Nygard Int'l*, 321 F.3d 282, 287 (2d Cir. 2003)).

24. The elements of a constructive fraudulent conveyance claim are: (1) that there be a "transfer"; (2) of "an interest of the debtor in property"; (3) while the transferor is insolvent; and (4) that is in exchange for less than reasonably equivalent value. See 11 U.S.C. § 548(a)(1) (B). See also UFTA § 4(a)(2).

25. The elements of an actual fraudulent conveyance claim are: (1) that there be a "transfer"; (2) of "an interest of the debtor in property"; and (3) that the transferor had actual intent to hinder, defraud or delay its creditors. See 11 U.S.C. § 548(a)(1)(A). See also UFTA § 4(a)(2).

26. Under the Bankruptcy Code, a transfer may be avoided as a preference if there is: (1) a transfer; (2) that was made to or for the benefit of a creditor; (3) on account of an antecedent debt; (4) while the debtor was insolvent; (4) on or within 90 days before the commencement of the bankruptcy case (or one-year if to an insider); (5) that enables the transferor to receive more than in the event of the debtor's liquidation. See 11 U.S.C. § 547(b).

27. See 11 U.S.C. § 1102. A creditors' committee may acquire standing to pursue an estate cause of action if: (1) the debtor consents; or (2) the court finds that the contemplated action is in the best interests of the estate, and is necessary and beneficial to the fair and efficient resolution of the bankruptcy proceedings. See *In re Commodore Int'l, Ltd.*, 262 F.3d 96, 100 (2d Cir. 2001). The creditors' committee's activities are funded by the estate, not the individual members of the committee. See 11 U.S.C. § 503(b). Compensation is subject to court approval pursuant to a reasonableness standard. See 11 U.S.C. § 330(a).

28. See generally *Lac d'Amiante du Québec Ltée, et al. v. Allstate Ins. Co. et al.* (In re ASARCO), Adv. No. 07-02025 (Bankr. S.D. Tex.). To be subject to avoidance under the Bankruptcy Code, the settlement must have been made within two years of the petition date. *Id.* In addition, under Bankruptcy Code § 544, a debtor's estate may bring state law causes of action. See 11 U.S.C. § 544. Typically, a statute of limitations of six years applies to state law fraud actions.

29. As noted above, preference claims can only avoid transfers made on or within 90 days of the petition date (or one year if to an insider). See 11 U.S.C. § 547(b).

30. UCC § 9-109(d)(8).

31. UCC § 9-315(c) provides that "a security interest in proceeds is a perfected security interest if the security interest in the original collateral was perfected." This section is inapplicable because no perfected security interest could be granted in the insurance policies under § 9-109(d)(8). UCC § 9-322(b)(1) provides that a security interest in proceeds is perfected if "the time of filing or perfection as to a security interest in collateral is also the time of filing or perfection as to a security interest in proceeds." This section is likewise inapplicable because by definition, the perfection of a security interest in future proceeds cannot occur simultaneously with the perfection of a security interest in the underlying policy if no perfected security interest could be granted in the underlying policies under § 9-109(d)(8).

32. See 11 U.S.C. § 544(a)(1). Operation of § 544 is commonly referred to as the estate's status as a "hypothetical lien creditor."

33. See *In re Congoleum*, No. 05-06245 (Bankr. D.N.J. July 27, 2007) (Dkt. No. 147).

34. See *infra* Part IV.

35. *Protective Comm. for Indep. Stockholders of TMT Trailer Ferry, Inc. v. Anderson*, 390 U.S. 414, 424 (1968) (quoting *Case v. Los Angeles Lumber Prods. Co.*, 308 U.S. 106, 130 (1939)). See also Fed. R. Bankr. P. 9019(a).

36. In re Martin, 91 F.3d 389, 393 (3rd Cir. 1996) (quoting Collier on Bankruptcy ¶ 9019.03[1] (15th rev. ed. 1993)).

37. In re Ionosphere Clubs, Inc., 156 B.R. 414, 426 (S.D.N.Y. 1993), aff'd, 17 F.3d 600 (2d Cir. 1994) (quoting TMT Trailer Ferry, Inc., 390 U.S. at 424).

38. In re Jasmine, Ltd., 258 B.R. 119, 123 (D.N.J. 2000) (quoting In re Neshaminy Office Bldg. Assocs., 62 B.R. 798, 803 (E.D. Pa.1986)).

39. See In re Martin, 91 F.3d at 393.

40. The Bankruptcy Code specifically contemplates debtors and creditors pre-negotiating plans of reorganization prior to the petition date. See 11 U.S.C. § 1125(g).

41. See 11 U.S.C. § 1125.

42. See 11 U.S.C. § 1129(a)(10) (provided, of course, that the plan impairs at least one non-insider class). A creditor class assents to a plan if accepted by at least two-third in amount and more than one-half in number, counting only those creditors that vote. See 11 U.S.C. § 1126(c). Non-impaired classes are deemed to accept the plan. See 11 U.S.C. § 1129(f).

43. See 11 U.S.C. § 1129(a)(3).

44. See 11 U.S.C. § 1129(a)(11).

45. See 11 U.S.C. § 1122(a).

46. See 11 U.S.C. § 1123(a)(4).

47. See 11 U.S.C. § 1129(b)(1) (requiring that a non-consensual plan provide “fair and equal” treatment and not “discriminate unfairly”).

48. See 11 U.S.C. § 1129(b)(2) (providing that such treatment would not be “fair and equitable” to the dissenting class).

49. See, e.g., In re Johns-Manville Corp., No. 82-11656 (Bankr. S.D.N.Y. Dec. 22, 1986) (confirmation order).

50. See generally Kimberly M. Melvin, D&O Policy Proceeds as Bankruptcy Estate Assets: The Elusive Quest for Clarity, Coverage (ABA Section of Litigation), Vol. 16, No. 3 (2006).

51. Derivative claims can be brought by shareholders. Derivate standing may also be available to creditors of an insolvent corporation, including insolvent Delaware corporations. See Catholic Educ. Programming Found. Inc. v. Gheewalla, 930 A.2d 92 (Del. 2007). Derivative standing is not available to creditors of certain entities with other kinds of businesses, including most notably Delaware limited liability companies. See CML V LLC v. Bax, 28 A.3d 1037 (Del. 2011) (citing § 18-1002 of the Delaware LLC Act).

52. See Melvin, D&O Policy Proceeds (citing In re Enron Corp., No. 01-16034, 2002 Bankr. LEXIS 544 (Bankr. S.D.N.Y. May 17, 2002) (order lifting automatic stay with respect to D&O Insurance)). Another approach is for the policyholder to agree to waive application of the automatic stay pre-petition, although some courts have refused to enforce these waivers. See In re DB Capital Holdings, LLC, 454 B.R. 804 (Bankr. D. Colo. 2011) (collecting cases).

53. See 11 U.S.C. § 541(a) (property of the estate includes “all legal or equitable interests of the debtor in property as of the commencement of the case”).

54. See 11 U.S.C. § 510(b).

55. See 11 U.S.C. § 362(a).

56. 11 U.S.C. § 362(d) (“On request of a party in interest and after notice and a hearing, the court shall grant relief from the stay provided under subsection (a) of this section, such as by terminating, annulling, modifying, or conditioning such stay—(1) for cause, including the lack of adequate protection of an interest in property of such party in interest; [or] (2) with respect to a stay of an act against property under subsection (a) of this section, if—(A) the debtor does not have an equity in such property; and (B) such property is not necessary to an effective reorganization....”).

57. See In re Downey Fin. Corp., 428 B.R. 595, 609 (Bankr. D. Del. 2010) (“This court has adopted a three-prong to determine whether to grant relief from the stay: (1) whether any great prejudice to either the bankrupt estate or the debtor will result from a lifting of the stay; (2) whether the hardship to the non-bankrupt party by maintenance of the stay considerably

outweighs the hardship to the debtor; and (3) the probability of the creditor prevailing on the merits.”) (citing *In re W.R. Grace & Co.*, 2007 WL 1129170, at *2 (Bankr. D. Del. 2007); *In re Continental Airlines*, 152 B.R. 420, 424 (Bankr. D. Del. 1993); *In re Rexene Products Co.*, 141 B.R. 574, 576 (Bankr. D. Del. 1992)). See also *In re Sonnax Indus., Inc.*, 907 F.2d 1280, 1286 (2d Cir. 1990).

58. See generally *Downey Fin.*, 428 B.R. at 610 (citing *In re Allied Digital Techs. Corp.*, 306 B.R. 505, 514 (Bankr. D. Del. 2004)).

59. See cases cited *supra* note 22.

60. See *In re Medex Reg'l Labs., LLC*, 314 B.R. 716, 720 (Bankr. E.D. Tenn. 2004) (“In making its determination, the court must analyze the facts of each particular case, focusing primarily upon the terms of the actual policy itself.”); *In re CyberMedica, Inc.*, 280 B.R. 12, 16 (Bankr. D. Mass. 2002) (“Whether the proceeds of a D & O liability insurance policy is property of the estate must be analyzed in light of the facts of each case.”). See generally *Downey Fin.*, 428 B.R. at 603 n.31.

61. See *In re Youngstown Osteopathic Hosp. Ass'n*, 271 B.R. 544, 548-550 (Bankr. N.D. Ohio 2002) (“Courts have held... that if a debtor does not have a direct interest in the proceeds of the insurance policy, the insurance proceeds are no longer property of the debtor’s estate.”; “D & O policies are obtained for the protection of individual directors and officers. Indemnification coverage does not change this fundamental purpose.”) (quotations omitted). See also *In re La. World Exposition, Inc.*, 832 F.2d 1391 (5th Cir. 1987); *In re Imperial Corp. of Am.*, 144 B.R. 115 (Bankr. S.D. Cal. 1992); *In re Daisy Sys. Secs. Litig.*, 132 B.R. 752 (N.D. Cal. 1991); *In re Zenith Lab. Inc.*, 104 B.R. 659 (Bankr. D.N.J. 1989).

62. See *In re Leslie Fay Cos., Inc.*, 207 B.R. 764, 785 (Bankr. S.D.N.Y. 1997) (“Here, the debtors have an interest in those proceeds because of the possibility that the class action might deplete the policy and theoretically force claims for indemnification to fall upon the estate.”). See also *In re Circle K Corp.*, 121 B.R. 257 (Bankr. D. Ariz. 1990).

63. As discussed *infra* note 77 and accompanying text, a SIR is similar to a deductible in that each sets forth an amount of liability payable by the policyholder before policy proceeds can be accessed.

64. *Allied Digital*, 306 B.R. at 512. See also *Adelphia*, 298 B.R. at 53 (“Adelphia does not have a property interest in the proceeds of the [B-Side D&O Insurance] policies yet.... Claiming the debtors now have a property interest in those proceeds makes no sense at this juncture. Such argument would be akin to a car owner with collision coverage claiming he has the right to proceeds from his policy simply because there is a prospective possibility that his car will collide with another tomorrow....”); *Youngstown*, 271 B.R. at 550.

65. See *In re Sacred Heart Hosp. of Norristown*, 182 B.R. 413, 420 (Bankr. E.D. Pa. 1995) (“Proceeds available for the Debtor’s liability exposure are not segregated from the proceeds available to the directors and officers. Thus, the Debtor is indeed an insured and has a sufficient interest in the Proceeds as a whole to bring them into the estate.”). See also *In re Vitek, Inc.*, 51 F.3d 530 (5th Cir. 1995); *In re Metropolitan Mortgage & Secs. Co.*, 325 B.R. 851 (Bankr. E.D. Wash. 2005); *In re Eastwind Group, Inc.*, 303 B.R. 743 (Bankr. E.D. Pa. 2004); *In re Boston Reg'l Med. Ctr., Inc.*, 285 B.R. 87 (Bankr. D. Mass. 2002); *CyberMedica*, 280 B.R. 12.

66. See 11 U.S.C. § 541 (providing that the debtor’s estate includes “all legal or equitable interests of the debtor in property as of the commencement of the case”).

67. See *In re World Health Alternatives, Inc.*, 369 B.R. 805 (Bankr. D. Del. 2007); *In re Medex Reg'l Labs., LLC*, 314 B.R. 716 (Bankr. E.D. Tenn. 2004); *In re Adelphia Commc'ns Corp.*, 298 B.R. 49 (S.D.N.Y. 2003); *In re marchFIRST, Inc.*, 288 B.R. 526 (Bankr. N.D. Ill. 2002); *In re CHS Elecs., Inc.*, 261 B.R. 538 (Bankr. S.D. Fla. 2001); *In re First Cent. Fin. Corp.*, 238 B.R. 9 (Bankr. E.D.N.Y. 1999).

68. 428 B.R. 595 (Bankr. D. Del. 2010).

69. Pursuant to the terms of the Policy, the SIR no longer applied once the debtor filed for bankruptcy. The Policy provided that the debtor need not indemnify any “Loss for which an Organization has neither indemnified nor is permitted to indemnify an Insured Person pursuant

to law or contract.” The court found that the Bankruptcy Code’s automatic stay was applicable “law” that prohibited further indemnification during the pendency of the debtor’s bankruptcy case. *Id.* at 601 n.16.

70. *Id.* at 604.

71. *Id.*

72. *Id.* at 604-05 (citing *Allied Digital*, 306 B.R. at 512-13).

73. *Id.* at 606.

74. *Id.* at 606-07.

75. *Id.* at 608.

76. *Id.*

77. In addition, certain policies expressly obligate third parties to pay the deductible and/or SIR. These provisions have been found to be enforceable even if such third party has no liability for the event triggering coverage. See, e.g., *Northbrook Ins. Co. v. Kuljian Corp.*, 690 F.2d 368, 373 (3d Cir. 1982).

78. See *In re Vanderveer Estates Holdings, LLC*, 328 B.R. 18, 25 (Bankr. E.D.N.Y. 2005) (“[W]here (as in this case) 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. Failure of the debtor to perform these continuing obligations does not excuse the insurer from performance under the contract, but gives rise to an unsecured claim by the insurer for any damages incurred by reason of the debtor’s breach of the policy.”) (citing *Home Ins. Co. of Illinois v. Hooper*, 691 N.E.2d 65 (Ill. App. 1998); *In re Ames Dep’t Stores, Inc.*, No. 93-4014, 1995 WL 311764 (S.D.N.Y. 1995)). See also *Albany Ins. Co. v. Bengal Marine, Inc.*, 857 F.2d 250 (5th Cir. 1988); *Columbia Casualty Co. v. Federal Press Co.*, 104 B.R. 56 (Bankr. N.D. Ind. 1989). See generally *Patricia A. Bronte, ‘Pay First’ Provisions and the Insolvent Policyholder*, *The Insurance Coverage Law Bulletin*, Vol. 3, No. 5 (2004); *Patricia A Bronte et al., Coverage Issues for the Insolvent Policyholder*, *Coverage (ABA Section of Litigation)*, Vol. 14, No. 2 (2004).

79. See *Bronte, ‘Pay First’* at 1 (noting such states include Arkansas, Florida, Louisiana, Maryland, Minnesota, New York, Oregon, and Virginia).

80. See *In re OES Environmental, Inc.*, 319 B.R. 266, 269 (Bankr. M.D. Fla. 2004) (in a state with no direct action statute that would otherwise permit a claimant’s suit against the insurer without first obtaining judgment against the defendant, lifting the automatic stay to allow claimant of debtor to pursue insurer for coverage in excess of SIR when claimant waived any recovery from the estate) (citing *In re Amatex Corp.*, 107 B.R. 856, 871-72 (E.D. Pa. 1989)).

81. See *In re Kismet Products, Inc.*, No. 04-25167, 2007 WL 6872750 (Bankr. N.D. Ohio Aug. 28, 2007) (applying Ohio law). See also *Pak-Mor Manuf. Co. v. Royal Surplus Lines Ins. Co.*, No. 05-135, 2005 WL 3487723 (W.D. Tex. Nov. 3, 2005) (applying Texas law); *In re Apache Prods.*, 311 B.R. 288 (Bankr. M.D. Fla. 2004) (applying Alabama law).

82. See *Pak-Mor Manuf. Co.*, 2005 WL 3487723, at *6-7; *In re Keck, Mahin & Cate*, 241 B.R. 583, 596 (Bankr. N.D. Ill. 1999).

83. See *Kismet Products*, 2007 WL 6872750, at *9 (enforcing precondition to coverage that debtor-insured pay SIR by “check or draft” with “adequate funds on deposit at time of presentation for payment”) (citing).

84. See *supra* note 38 and accompanying text. See also *In re Jasmine, Ltd.*, 258 B.R. 119, 123 (D.N.J. 2000) (quoting *In re Neshaminy Office Bldg. Assocs.*, 62 B.R. 798, 803 (E.D. Pa.1986)).

85. 11 U.S.C. § 363(b)(1).

86. *In re Lionel*, 722 F.2d 1063, 1071 (2d Cir. 1983).

87. Factors applied include: (1) the proportionate value of the asset to the estate as a whole; (2) the amount of elapsed time since the filing; (3) the likelihood that a plan of reorganization will be proposed and confirmed in the near future; (4) the effect of the proposed disposition on

future plans of reorganization; (5) the proceeds to be obtained from the disposition vis-à-vis any appraisals of the property; (6) which of the alternatives of use, sale or lease the proposal envisions; and (7) most importantly perhaps, whether the asset is increasing or decreasing in value. *Lionel*, 722 F.2d at 1071. The bankruptcy court in *In re General Motors Corp.*, No. 09-50026 (Bankr. S.D.N.Y. July 5, 2009) (the “GM Sale Order”) recently added the following: (8) Does the estate have the liquidity to survive until confirmation of a plan?; (9) Will the sale opportunity still exist as of the time of plan confirmation?; (10) If not, how likely is it that there will be a satisfactory alternative sale opportunity, or a stand-alone plan alternative that is equally desirable (or better) for creditors?; and (11) Is there a material risk that by deferring the sale, the patient will die on the operating table? GM Sale Order at 33-34. See also *In re Chrysler LLC*, 405 B.R. 84 (Bankr. S.D.N.Y. 2009).

88. 11 U.S.C. § 363(f).

89. See 11 U.S.C. § 363(m). See also *In re Mark Bell Furniture Warehouse, Inc.*, 992 F.2d 7, 8 (1st Cir. 1993); *In re Willemain v. Kivitz*, 764 F.2d 1019, 1023 (4th Cir. 1985); *In re Vanguard Oil & Serv. Co.*, 88 B.R. 576, 580 (E.D.N.Y. 1988).

90. See 11 U.S.C. § 363(n).

91. 11 U.S.C. § 105(a) (authorizing a bankruptcy court to “issue any order, process, or judgment that is necessary or appropriate to carry out the provisions of this title”).

92. Appellate courts have reversed bankruptcy decisions for attempting to use § 105 equitable powers to create new substantive rights not otherwise contemplated by the Bankruptcy Code. See, e.g., *In re Dairy Mart Convenience Stores, Inc.*, 351 F.3d 86, 92 (2d Cir. 2003) (noting that § 105 does not allow the bankruptcy court “to create substantive rights that are otherwise unavailable under applicable law”). See generally Deryck A. Palmer et al., *Third Party Releases Survive Supreme Court’s Decision in Travelers Indemnity Co. v. Bailey*, *Pratt’s J. of Bankr. Law* (2009) at 554 (noting that courts in the Fifth, Ninth and Tenth Circuits prohibit non-debtor injunctions/releases, but that courts in the Second, Third, Fourth, Sixth and Seventh Circuits have adopted more flexible approaches).

93. See 11 U.S.C. §§ 524(e), 1129 & 1141.

94. See 11 U.S.C. §§ 524(g)(4)(B)(ii); 524(g)(4)(A)(ii)(III). See also *In re Congoleum Corp.*, 362 B.R. 167, 179-80 (Bankr. D.N.J. 2007) (citing *In re Western Asbestos Co.*, 313 B.R. 832 (Bankr. N.D. Cal. 2003); *In re Kaiser Aluminum Corp.*, 2006 WL 616243 (Bankr. D. Del. Feb. 6, 2006); *In re J T Thorpe Co.*, 308 B.R. 782 (Bankr. S.D. Tex. 2003)).

95. See 11 U.S.C. § 524(g)(1)(A).

96. See, e.g., *In re Congoleum*, No. 09-4371 (D.N.J. June 7, 2010) (Dkt. No. 664); *In re Owens Corning*, No. 00-3837 (Bankr. D. Del. Sept. 26, 2006) (Dkt. No. 19366); *In re Kaiser Aluminum Corp.*, No. 02-10429 (Bankr. D. Del. Feb. 6, 2006) (Dkt. No. 8225).

97. See *In re Metromedia Fiber Network, Inc.*, 416 F.3d 136, 143 (2d Cir. 2005); *In re United Artists Theatre Co.*, 315 F.3d 217 (3rd Cir. 2003). See also *Behrmann v. National Heritage Found.*, 663 F.3d 704 (4th Cir. 2011); *In re Ingersoll, Inc.*, 562 F.3d 856 (7th Cir. 2009); *In re Dow Corning Corp.*, 280 F.3d 648 (6th Cir. 2001).

98. See *In re Johns-Manville Corp.*, No. 82-11656 (Bankr. S.D.N.Y. Dec. 22, 1986) (confirmation order).

99. See *In re A.H. Robins, Inc.*, 880 F.2d 694 (4th Cir. 1989).

100. See *In re Dow Corning Corp.*, 280 F.3d 648 (6th Cir. 2002).

101. See *In re Met-Coil Sys. Corp.*, No. 03-12676 (Bankr. D. Del. Aug. 17, 2004) (confirmation order).

102. *In re Quigley Co.*, 437 B.R. 102 (Bankr. S.D.N.Y. 2010). In that case, Pfizer, Inc. acquired Quigley Co., a manufacturer of certain products containing asbestos, as a subsidiary in 1968. Addressing Quigley’s proposed plan of reorganization, the bankruptcy court concluded, among other things, that the plan did satisfy the Bankruptcy Code’s “good faith” requirement because it was improperly designed to secure a third party injunction in favor of Pfizer. Specifically, the court found that the debtor achieved acceptance of the proposed plan through a “tainted vote” in which claimants were provided improper financial incentives in separate

settlements with Pfizer in exchange for the claimants' vote in favor of the plan. *Id.* at 132. After the court's decision, the debtor amended its plan. Confirmation of a plan remains forthcoming in that case.

103. See *In re Dow Corning Corp.*, 280 F.3d 648 (6th Cir. 2002).

104. See, e.g., *In re Federal-Mogul Global*, 402 B.R. 625 (D. Del. 2009); *In re Congoleum Corp.*, No. 03-51524, 2008 WL 4186899 (Bankr. D.N.J. Sept. 2, 2008) (citing *In re Combustion Engineering, Inc.*, 391 F.3d 190 (3d Cir. 2004)); *In re Kaiser Aluminum Corp.*, 343 B.R. 88 (Bankr. D. Del. 2006).

105. See 11 U.S.C. § 109.

106. See *Premcor USA, Inc. v. Am. Home Assurance Co.*, 2004 WL 1152847, at *6 (N.D. Ill. May 21, 2004) (citing *Zurich Ins. Co. v. Heil Co.*, 815 F.2d 1122, 1125 (7th Cir. 1987)). See generally Patrick J. Boley, Penny Wise and Pound Foolish? Issues for Excess Insurers in the Wake of Comerica and Qualcomm, Covered Events (2009).

107. See *Premcor USA, Inc.*, 2004 WL 1152847, at *6 (citing *Donald B. MacNeal, Inc. v. Interstate Fire & Cas. Co.*, 477 N.E.2d 1322 (Ill. App. 1985); *Reserve Ins. Co. v. Pisciotta*, 640 P.2d 764 (Cal. 1982)).

108. *New Process Baking Co. v. Federal Ins. Co.*, 923 F.2d 62, 63 (7th Cir. 1991) (asserting "[e]xhaustion" does not occur until the underlying insurance limits have been met through payment") (citing *Zurich Ins. Co.*, 815 F.2d at 1126).

109. See *Premcor USA, Inc.*, 2004 WL 1152847, at *8 (noting contrary Second Circuit precedent holding that "exhaustion" of the primary policies' payments "does not require collection of the primary policies as a condition precedent to the right to recover excess insurance") (citing *Zeig v. Massachusetts Bonding & Ins. Co.*, 23 F.2d 665 (2d Cir. 1928)). See also *Hudson Ins. Co. v. Gelman Sciences, Inc.*, 921 F.2d 92, 94-95 (7th Cir. 1990) (condition to coverage upheld when additional clause provided that "in the event of such failure [to maintain underlying coverage] Hudson shall be liable hereunder only to the extent that it would have been liable had the Insured complied therewith"); *Premcor USA, Inc.*, 2004 WL 1152847, at *7 (noting conflicting provisions but upholding condition to coverage on account of "Endorsement # 10," which provided that "the liability of the Company shall not be increased by the refusal or inability of the Insured to pay its Self-Insured Retention (or retained limit) or by the refusal or inability of any underlying insurer to pay, whether by Reasons of Insolvency, Bankruptcy or otherwise").

110. *Stern v. Marshall*, 131 S. Ct. 63 (2011) (holding that a bankruptcy court's final adjudication of a compulsory counterclaim, although permitted by 28 U.S.C. § 157, was unconstitutional).

111. See *Corrado Bros. v. Twin City Fire Ins. Co.*, 562 A.2d 1188 (Del. 1989). See generally John N. Ellison & Jeannine W. Chanes, Leaving the Fox in Charge of the Chicken Coop How the Administration of Retrospective Insurance Premiums Can Go Awry, N.J.L.J., Vol. 156, No. 33 (1999); Eugene R. Anderson & Glenn F. Fields, Retrospective Premiums: The Law Favors the Policyholder, Policyholder Advisor, Vol. 3, No. 9 (1994).

112. See also *Stan Koch & Sons Trucking, Inc. v. Great West Cas. Co.*, 517 F.3d 1032, 1043-44 (8th Cir. 2008) (noting that retrospective premiums are analogous to SIR and trigger the same inherent conflict of interest) (citing *Transp. Indem. Co. v. Dahlen Transp., Inc.*, 161 N.W.2d 546 (Minn. 1968)). An example of the inherent duty of good faith outside of the retrospective policy context is instructive. In one case, the insured—Anne Dunlap—suffered severe injuries when a Delaware Transit Corporation (DART) bus struck Mark Cardillo's car in which she was a passenger. See *Dunlap v. State Farm Fire and Cas. Co.*, 878 A.2d 434 (Del. 2005). Dunlap's policy with State Farm Fire and Casualty Co. (State Farm) provided for \$1 million in coverage, but required that Dunlap first exhaust "all bodily injury bonds and insurance policies available." Dunlap received full policy limits from Cardillo's insurance (\$500,000). DART denied any culpability and while DART had a policy limit of \$300,000, its final settlement offer was for only \$175,000. State Farm refused to consent to Dunlap's settlement with DART reserving its right to assert that such settlement did not satisfy Dunlap's conditions precedent to coverage. Dunlap was forced to take DART to trial, where she lost. Thereafter, Dunlap sued State Farm for a bad faith breach of its policy in refusing to allow Dunlap to accept the \$175,000 settlement, which resulted in the loss of that amount and other trial-related expenses. The trial court granted

State Farm's motion to dismiss Dunlap's claim. Ultimately, the Delaware Supreme Court reversed, holding that State Farm's implied duty of good faith could have been breached when State Farm refused to consent to the DART settlement. The court held that State Farm had no good faith reason not to consent to the settlement because, given the sheer size of the total damages, it would have suffered "no realistic prejudice" even if the full \$300,000 DART limits were available but had not been funded.

113. See *Insurance Co. of Greater New York v. Glen Haven Residential Health Care Facility Inc.*, 253 A.D.2d 378, 378 (N.Y. 1st Dep't 1998) ("New York has never recognized a cause of action or defense for breach of an insurer's implied covenant of good faith and fair dealing where, as here, it is alleged that an insurer's failure to reasonably investigate claims made against the insured results in an increased retrospective premium."). See also *Liberty Mut. Ins. Co. v. Precision Valve Corp.*, 402 F. Supp. 2d 481, 487-88 (S.D.N.Y. 2005).