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Update on Directors' and Officers' Insurance in Bankruptcy

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Editor's Note: The following post comes to us from Douglas K. Mayer, Of Counsel in the Restructuring and Finance Department at Wachtell, Lipton, Rosen & Katz, and is based on a Wachtell Lipton memorandum by Mr. Mayer, Martin J.E. Arms, and Emil A. Kleinhaus.

Directors' and officers' ("D&O") insurance coverage continues to represent a key element of corporate risk management. *See* memo of July 28 2009. A decision in the bankruptcy of commodities brokerage MF Global, *In re MF Global Holdings Ltd., No. 11-15059 (S.D.N.Y. Sept. 4, 2014)*, provides a recent illustration of how D&O insurance may be treated upon the bankruptcy of the insured company, depending on the specific structure and terms of the insurance at issue.

D&O insurance policies typically provide three basic protections, known as A, B and C coverage, which respectively pay (A) individual directors and officers for defense costs and losses that the company cannot itself pay the individual due to, *e.g.*, governing corporate law or company insolvency; (B) reimbursement to the insured company for indemnification for costs and liabilities the company pays (or pays on behalf of) an individual; and (C) the company directly for losses and costs relating to securities law claims against the company. It is now standard for D&O policies to state plainly that individuals seeking insurance payments for A coverage have priority over B- or C-coverage payments to the company.

Since the 2011 bankruptcy of MF Global, which maintained standard D&O insurance, former MF Global directors and officers sued by shareholders and brokerage customers have repeatedly sought access to their A coverage to fund their defense costs, but have been opposed by representatives of the bankrupt entities, as well as customer plaintiffs, asserting that the D&O insurance is an estate asset subject to the automatic bankruptcy stay due to its B and C coverages. After a series of interim decisions permitting the provision of limited insurance payments to the individuals, the bankruptcy court ruled that in the circumstances presented—where the potential claims against the bankrupt company that could have triggered its B and C coverages had not been asserted and were time-barred—the policy proceeds belong to the insured individuals given their direct A coverage and the policy's priority-of-payment provision. (The court did impose a limited hold-back to cover reimbursement of the company for potential company payments on account of certain contingent indemnity claims.)

The *MF Global* decision highlights the insurance-related risk presented to directors and officers of companies that enter bankruptcy. In *MF Global*, although the court ultimately enforced policy language entitling individual insureds to payment priority, the litigation over coverage was protracted and the outcome turned (at least in part) on a fortuitous lack of claims triggering B and C coverage. To mitigate the risk of this uncertain process, companies should not only work with insurance brokers and counsel to seek the best practicable priority of payment and other protective policy language when negotiating coverage, but should also consider purchasing excess A-only coverage (triggered after underlying A, B, C coverage is exhausted) or Difference-in-Conditions excess coverage with broad coverage terms, as further protection from the possibility that directors and officers will be impeded from accessing A coverage following a bankruptcy.