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Creditors at the Gate: How Good Are Your Indemnities and D&O Insurance?

By Carl E. Black, Mark J. Andreini, and Jonathan Noble Edel*

In this article, the authors discuss bankruptcy considerations affecting director and officer insurance policies.

Most states (and many corporations' bylaws) allow, and in certain circumstances require, corporations to indemnify their directors and officers for certain actions taken in their official capacities. In addition, corporations usually purchase director and officer insurance policies ("D&O Policies") as an extension of the indemnification that they provide to their directors and officers. However, when a corporation files for bankruptcy, it may be unable or unwilling to satisfy its indemnification obligations.

To compound this issue, when a company files for bankruptcy, the likelihood that stakeholders will initiate litigation against directors and officers increases substantially. As a result, various issues concerning D&O Policies often arise when a corporation files for bankruptcy.[1] This article provides an overview of those issues with respect to indemnities and D&O Policies.[2]

INDEMNIFICATION

Indemnification Generally

Section 145 of the Delaware General Corporation Law (the "DGCL") sets forth the powers of a corporation to indemnify directors, officers, and other parties.[3] With respect to direct actions (i.e., actions that are not by, or derivatively on behalf of, the corporation), a corporation is authorized to

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[1] *See*, *e.g.*, *CMH Liquidating Trust v. Nat'l Union Fire Ins. Co. of Pittsburgh, PA (In re Cmty. Mem'l Hosp.)*, No. 12-20666 (E.D. Mich. July 23, 2019) (resolving a dispute between a provider of a D&O Policy and a debtor, wherein the provider sought to invoke a "bankruptcy exclusion" provision to deny coverage of certain actions against the directors and officers of the debtor, by determining that such provision was an unenforceable *ipso facto* clause in the D&O Policy).

[2] This article focuses primarily on the law of the State of Delaware and federal law as applied in the U.S. Court of Appeals for the Third Circuit.

[3] *See* 8 Del. Code Ann. § 145.

indemnify a director or an officer for liabilities and expenses (including attorneys' fees) incurred in proceedings brought against him or her "by reason of the fact" that he or she is a director or an officer of the corporation, provided such director or officer "acted in good faith and in a manner the person reasonably believed to be in or not opposed to the best interests of the corporation."[4] With respect to derivative actions (i.e., actions commenced by shareholders or, in some cases, creditors on behalf of the corporation), indemnification is permissible for expenses under an identical standard. However, indemnification by the company (or its bankruptcy estate) is not permitted for liabilities incurred as a result of derivative actions.[5]

In both direct and derivative actions, if directors and officers are "successful on the merits or otherwise," the corporation is required to indemnify the directors and officers for "expenses (including attorneys' fees) actually and reasonably incurred . . . in connection therewith."[6] However, prior to any determination as to whether indemnification is appropriate (i.e., prior to a determination as to whether the directors and officers have been "successful on the merits or otherwise"), expenses incurred by a director or an officer may be advanced, provided that such director or officer first executes an agreement (commonly referred to as an "undertaking") to repay such amount if it is ultimately determined that he or she is not entitled to be indemnified by the corporation.[7]

Although Section 145 of the DGCL permits corporations to indemnify directors and officers, it does not require corporations to advance defense costs. Accordingly, directors and officers should carefully review their corporation's governing documents to determine the scope of their advancement rights.[8]

Impact of Bankruptcy on Indemnification Rights

Prepetition and Postpetition Conduct

When a director or an officer is sued for conduct that occurred prior to the corporation's bankruptcy filing, the corporation will, absent bankruptcy court

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[4] *Id.* § 145(a).

[5] *Id.* § 145(b).

[6] *Id.* § 145(c).

[7] *Id.* § 145(e).

[8] In addition to indemnification and insurance, directors' liability in certain jurisdictions may also be limited by the adoption of provisions in the corporate charter for the exculpation of directors' liability related to claims for breaches of the fiduciary duty of care. *See*, *e.g.*, 8 Del. Code Ann. § 102(b)(7); N.Y. Bus. Corp. Law § 402(b); Cal. Corp. Code § 204(a)(10).

approval or the court-approved assumption of an employment or other agreement providing for such indemnity, be prohibited from honoring its indemnification obligations to such director or officer.[9] In addition, any claims by a director or an officer for indemnification regarding prepetition conduct will likely be classified as general unsecured claims.[10] The foregoing is true regardless of whether the litigation against a director or an officer was commenced before or after the bankruptcy filing. After payment or treatment under a Chapter 11 plan of secured, priority, and administrative claims, holders of timely filed and allowed prepetition general unsecured claims share the unencumbered assets of the debtor corporation's bankruptcy estate *pro rata.* In many cases, holders of such general unsecured claims receive only minimal recoveries in respect of their claims.

By contrast, when a director or an officer is sued for conduct that occurred after the corporation's bankruptcy filing, the corporation, depending on the scope of available indemnities, may be permitted to honor indemnification obligations to such director or officer.[11] Moreover, indemnification claims by a director or an officer regarding postpetition conduct should be entitled to

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[9] *See In re Summit Metals, Inc.*, 379 B.R. 40, 56 (Bankr. D. Del. 2007) (finding that a request for indemnification relating solely to prepetition activities was not entitled to administrative expense priority status, because "it is a form of prepetition compensation for services that is not entitled to administrative expense priority"); *see also* Section V.G of Debtors' Plan of Liquidation Pursuant to Chapter 11 of the Bankruptcy Code, *In re CMTSU Liquidation, Inc.*, No. 17-10772 (Bankr. D. Del. Oct. 2, 2017), ECF Docket No. 671 (seeking authorization to provide directors with general unsecured claims with respect to indemnification obligations relating to prepetition and post-effective date expenses in defending against certain causes of action).

[10] *See In re Mid-Am. Waste Sys., Inc.*, 228 B.R. 816, 821 (Bankr. D. Del. 1999) (reasoning that, because "[a]n indemnification claim by an officer or director based on that officer's or director's prepetition services is not a claim on account of 'services rendered after the commencement of a case' that is entitled to administrative expense priority, . . . the [claimants'] indemnification claims are merely claims for prepetition compensation for services rendered, not unlike salary or other benefits" and, thus, were not entitled to administrative expense status).

[11] *See*, *e.g.*, *In re RNI Wind Down Corp.*, 369 B.R. 174, 181–82 (Bankr. D. Del. 2007) (finding that a corporation was authorized to advance payments for litigation defense costs to an officer defending against various lawsuits for conduct during a bankruptcy case); *In re Adelphia Commc'ns*, 323 B.R. 345, 396 (Bankr. S.D.N.Y. 2005) (concluding that "the Court appropriately can, and will, direct [the debtor] to cause the Managed Entities to make advances (and, for [one defendant], to provide indemnification) where that is a bona fide obligation of the Managed Entities in question" under their corporate organizational documents). *But see In re Baldwin-United Corp.*, 43 B.R. 443, 446 (S.D. Ohio 1984) (concluding that "§ 503(b)(1)(A) does not permit the debtors to advance attorney fees to their former officers and directors in order that they might defend themselves against allegations of misconduct during their tenure on the boards[, because] it seems less likely that such payments would assist in preserving the estate after

administrative priority.[12] With certain exceptions, administrative priority claims must be paid in full ahead of the claims of all other unsecured creditors from any unencumbered assets of the bankruptcy estate. Administrative priority claims include, among other things: (1) the actual and necessary costs and expenses of preserving the debtor's business post-bankruptcy; and (2) the post-bankruptcy wages of the debtor's employees.[13] If, however, the corporation has insufficient resources to satisfy all administrative claims, holders of postpetition indemnification claims would generally share *pro rata* with holders of all other administrative claims. Accordingly, directors and officers should not assume that their indemnification claims relating to post-bankruptcy conduct will always be fully satisfied.

Disallowance of Indemnification Claims

The provisions of the Bankruptcy Code regarding the disallowance of contingent reimbursement claims may impact the allowability of a director or an officer's indemnification claims in certain circumstances. Section 502(e)(1)(B) of the Bankruptcy Code provides that "the court shall disallow any claim for reimbursement or contribution of an entity that is liable with the debtor on or has secured the claim of a creditor, to the extent that . . . (B) such claim for reimbursement or contribution is contingent as of the time of allowance or disallowance of such claim for reimbursement or contribution . . . ."[14] The U.S. Bankruptcy Court for the District of Delaware has held that "[f]or a claim to be disallowed under this section, three requirements must be satisfied: (1) the claim must be one for reimbursement or contribution; (2) the entity asserting the claim for reimbursement or contribution must be liable with the debtor on the claim; and (3) the claim must be contingent at the time of its allowance or disallowance.[15]

According to other Delaware bankruptcy court rulings: (1) "[a] claim is

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the individuals' liability has been determined . . . .") (internal quotation marks and citation omitted).

[12] *See*, *e.g.*, *In re Heck's Props., Inc.*, 151 B.R. 739, 768 (S.D. W. Va. 1992) (finding that indemnification claims of directors and officers qualified as administrative expenses under Section 503(b)(1)(A) of the Bankruptcy Code to the extent the claims "related solely to post-petition conduct and services"); *see also In re Keene Corp.*, 208 B.R. 112, 116 (Bankr. S.D.N.Y. 1997) ("Corporate fiduciaries generally rely on the expectation of indemnification, and may recover their legal fees and expenses on an administrative basis, at least to the extent they arise from defending postpetition conduct as an officer or director.").

[13] *See* 11 U.S.C. § 503(b).

[14] *See* 11 U.S.C. § 502(e)(1)(B).

[15] *In re APCO Liquidating Tr. & APCO Missing Stockholder Tr.*, 370 B.R. 625, 631 (Bankr. D. Del. 2007) (internal quotation marks and citations omitted).

contingent where it has not yet accrued and . . . is dependent upon some future event that may never happen";[16] and (2) claims for indemnity constitute claims for reimbursement.[17] Therefore, if a director or an officer files a proof of claim seeking indemnification for future liability or defense costs stemming from pending or anticipated litigation (i.e., a "contingent" claim), the proof of claim will likely be disallowed unless the director or officer can show that he or she is not liable with the debtor on the claim.[18]

Conversely, if a director or an officer files a proof of claim for incurred defense costs, the claim is not contingent and the claim will not be disallowed under Section 502(e)(1)(B).

D&O POLICIES

D&O Policies Generally

Generally, D&O Policies include one or more of the following:

(1) Coverage for losses sustained or incurred by directors and officers (including defense costs) when the corporation does not or may not indemnify them ("Side A Coverage");

(2) Coverage for indemnification payments that the corporation is permitted or required to make to directors and officers ("Side B Coverage"), usually after the payment of a retention amount (which is akin to a deductible); and

(3) Coverage for losses relating to certain types of claims brought directly against the corporation ("Side C Coverage").

Many corporations purchase D&O Policies that include all three types of coverage ("ABC D&O Policies") bundled into a single policy.

D&O Policies are almost always "claims-made" policies. A "claims-made"

[16] *RNI Wind Down*, 369 B.R. at 182 (internal citations and quotation marks omitted).

[17] *See In re Touch Am. Holdings, Inc.*, 409 B.R. 712, 716 (Bankr. D. Del. 2009).

[18] *See*, *e.g.*, *In re Touch Am. Holdings, Inc.*, 381 B.R. 95, 107 (Bankr. D. Del. 2008) ("A claim is contingent where it has not yet accrued and . . . is dependent upon some future event that may never happen. Indemnification claims are usually contingent until the underlying litigation is resolved.") (internal citations and quotation marks omitted); *see also RNI Wind Down*, 369 B.R. at 187–88 (noting that co-liability is determined by "the substantive law of the underlying cause of action" and holding that co-liability did not exist, because—even if the debtor may have been co-liable on the underlying cause of action—the debtor was not liable for the claimant's costs incurred defending against such cause of action, which formed the basis for his claim).

policy is one that generally covers only claims that are made against an insured during the policy period. As such, if an alleged wrongful act giving rise to a claim occurs during the policy period, but the claim is first made in writing against an insured after the end of the policy period, the claim is unlikely to be covered by the policy in place during the commission of the wrongful act unless: (i) the policyholder provides notice during the policy period of the alleged wrongful act and the reasons that it is likely to give rise to a claim; or (ii) the corporation purchased or otherwise is entitled to "tail coverage." Tail coverage permits an insured, for a fixed period of time (commonly up to six years), to report claims that are made against the insured after the policy period if the alleged wrongdoing that gave rise to the claim took place before the expiration (or cancellation) of the policy.

Common Issues Arising with D&O Policies in Bankruptcy

It is important that all businesses—regardless of their financial condition—engage in periodic reviews of their D&O Policies. Generally, this review should include an analysis of policy limits (to ensure, for example, that the company has not "outgrown" its D&O Policies), prevailing market terms and conditions, and any potential "gaps" in coverage. For businesses nearing insolvency and the threat of bankruptcy, however, directors and officers should be especially wary of the potential issues outlined below.

Property of the Estate and the Automatic Stay

Once a corporation files for bankruptcy, all of its assets become part of its bankruptcy estate, and absent court approval, the automatic stay bars parties from, among other things, taking actions that impact the bankruptcy estate.[19] As such, the actual D&O Policies purchased by the debtor constitute property of its estate, although the policy proceeds thereof may not, depending upon the type of coverage involved.

Because the proceeds from Side A Coverage are paid directly to the directors and officers, a majority of courts addressing the issue have determined that, although a D&O Policy with Side A Coverage is property of a debtor corporation's bankruptcy estate, the proceeds of the policy are not.[20] Thus, the

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[19] *See* 11 U.S.C. § 541(a)(1) ("The commencement of a case under . . . this title creates an estate. Such estate is comprised of all of the following property, wherever located and by whomever held . . . [except as expressly provided otherwise] all legal or equitable interests of the debtor in property as of the commencement of the case.").

[20] *See*, *e.g.*, *In re Downey Fin. Corp.*, 428 B.R. 595, 603 (Bankr. D. Del. 2010) ("[W]hen the liability insurance policy only provides direct coverage to the directors and officers, courts

automatic stay does not generally bar directors and officers from seeking payment of the proceeds of a D&O Policy with Side A Coverage.

Unlike Side A Coverage, however, proceeds recovered under D&O Policies with Side B Coverage are disbursed directly to the debtor corporation as reimbursement for the amounts the debtor has paid as indemnification to its directors and officers. Because of this structure, proceeds of a D&O Policy with Side B Coverage are generally considered property of the estate.[21] If, however, no indemnification payments have actually been made, courts consider such available proceeds too "speculative" to qualify as estate property.[22] Therefore, the proceeds of a Side B Coverage policy will constitute property of the debtor corporation's estate only if a director or an officer has requested indemnification from the debtor (if such indemnification remains available after the commencement of the bankruptcy case), which request for indemnification likely requires relief from the automatic stay under Section 362 of the Bankruptcy Code in order for a director or an officer to pursue the collection thereof.[23]

Finally, Side C Coverage covers the corporation's losses arising from certain claims against the corporation in its own right (usually securities-related claims). Side C Coverage usually excludes claims asserting bodily injury or property damage, and usually (but not always) excludes claims against the corporation for breach of contract. However, because plaintiffs suing a

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generally hold that the proceeds are not property of the estate."); *In re Allied Digital Techs. Corp.*, 306 B.R. 505, 512 (Bankr. D. Del. 2004) (finding that "when the liability insurance policy only provides direct coverage to the directors and officers[,] the proceeds are not property of the estate").

21 *See Aetna Cas. & Sur. Co. v. Jasmine, Ltd. (In re Jasmine, Ltd.)*, 258 B.R. 119, 128 (D.N.J. 1999) ("Since Jasmine's duty of indemnification was established and not merely speculative, it would have been entitled to proceeds under the Policy if there was coverage. Thus, Jasmine had an indemnification interest in the proceeds, and the proceeds are property of the estate and subject to the authority of the trustee under these circumstances.").

22 *See Allied*, 306 B.R. at 512 ("[W]hen the liability policy provides the debtor with indemnification coverage but indemnification either has not occurred, is hypothetical, or speculative, the proceeds are not property of the bankruptcy estate."); *accord In re World Health Alts., Inc. Sec. Litig.*, No. 02: 05cv1194, 2007 U.S. Dist. LEXIS 41971, at *11 (W.D. Pa. June 8, 2007) ("Significantly, the Trustee also does not assert that any indemnification claims have been asserted against World Health. Thus, the Trustee's indemnification obligations appear to be speculative."); *SN Liquidation, Inc. v. Icon Int'l, Inc. (In re SN Liquidation, Inc.)*, 388 B.R. 579, 584 (Bankr. D. Del. 2008) (following *Allied*).

23 *See Allied*, 306 B.R. at 512–13 (noting that "when the liability policy provides the debtor with indemnification coverage but indemnification . . . has not occurred, . . . the proceeds are not property of the bankruptcy estate" while determining whether the court needed to grant relief from stay).

corporation often sue its directors and officers as well, litigation that includes an action that implicates a D&O Policy's Side C Coverage would also likely include an action that implicates the Side A Coverage or the Side B Coverage as well. Accordingly, the general rule is that "the proceeds [of a D&O Policy with Side C Coverage] will be property of the estate if depletion of the proceeds would have an adverse effect on the estate to the extent the policy actually protects the estate's other assets from diminution."[24] Stated another way, to the extent proceeds paid to directors and officers under Side B Coverage reduces the amount of potential recovery to the estate under Side C Coverage (e.g., by reducing the amount available under the policy limit), the payment implicates property of the estate and would constitute a violation of the automatic stay. Nevertheless, if payments under Side B Coverage to directors and officers do not reduce any potential payout to the estate, the proceeds do not constitute estate property. For example, if a plaintiff files a securities related action jointly against Company X and its directors and officers, but the claims against Company X are barred by relevant statutes or otherwise resolved, the proceeds from Company X's D&O Policy with Side C Coverage will not generally be considered property of Company X's bankruptcy estate.[25]

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[24] *Downey*, 428 B.R. at 603 (internal citations and quotation marks omitted); *accord Fed. Ins. Co. v. DBSI, Inc. (In re DBSI, Inc.)*, No. 08-12687(PJW), 2012 Bankr. LEXIS 2937, at *20 (Bankr. D. Del. June 27, 2012) ("Where the policy provides direct coverage to both the debtor and to officers and directors, the proceeds will be property of the estate if depletion of the proceeds would have an adverse effect on the estate to the extent the policy actually protects the estate's other assets from diminution. The debtor must have existing covered claims under the policy, and coverage must be more than merely hypothetical or speculative. In other words, where the debtor is no longer covered by the policy, the policy proceeds no longer constitute property of the bankruptcy estate." (internal citations and quotation marks omitted)); *Miller v. McDonald (In re World Health Alts., Inc.)*, 369 B.R. 805, 810 (Bankr. D. Del. 2007) ("When a policy covers the debtor and its directors and officers, and there is risk that payment of proceeds to the directors and officers will result in insufficient coverage of the debtor, then the proceeds are property of the estate and any attempts to obtain the proceeds are prohibited under the automatic stay.").

[25] *See Allied*, 306 B.R. at 513 (holding that the proceeds from the company's D&O Policy with Side C Coverage were not property of the company's bankruptcy estate because "[t]he Trustee has made no credible showing that the direct coverage of Allied Digital under Clause B(i) for securities claims has any continuing vitality"); *see generally Downey*, 428 B.R. at 604–05 ("Where a liability insurance policy includes entity coverage, but there are no covered Securities Claims outstanding, courts have generally held that the insurance proceeds are not property of the estate . . . . Accordingly, because there are no longer any covered Securities Claims pending against the Debtor, the Debtor no longer enjoys any direct entity coverage. Therefore, the Court finds that the Policy's entity coverage is no longer protecting the estate's other assets from diminution." (internal citations and quotation marks omitted)).

ABC D&O Policy Issues and Best Practices

As noted above, in general, corporations purchase ABC D&O Policies to bundle the entirety of their D&O Policies into a single package. This strategy, however, may have certain downsides, including when the ABC D&O Policy has a "single limit"—i.e., one comprehensive limit for claims regardless of whether (and what mix of) claims arise under the Side A Coverage, the Side B Coverage, or the Side C Coverage.

Importantly, if an ABC D&O Policy does not allocate specific amounts to Side A Coverage, Side B Coverage, and Side C Coverage, all of the proceeds from the ABC D&O Policy could constitute property of the debtor corporation's bankruptcy estate and be unavailable to directors and officers. Some courts have found that, because proceeds paid under such single-limit policies may ultimately inure to the benefit of the estate, any payments thereunder constitute property of the estate. This is so because, even if the relevant claims are made under the Side A Coverage portion of the ABC D&O Policy, such payments would potentially reduce the amount available to the estate under either Side B Coverage or Side C Coverage.[26] There are, however, certain strategies and structures directors and officers can undertake to avoid this problem.

First, the company can obtain standalone Side A Coverage. Although requiring additional policy limits, and thus additional insurance premiums, Side A Coverage is generally not considered property of the bankruptcy estate, as the proceeds thereof are only paid directly to directors and officers.[27] Accordingly, such proceeds are dedicated to satisfying only non-indemnifiable claims made by directors and officers.

Second, if additional coverage is not available or is economically unfeasible, directors and officers can negotiate a "priority of payment" provision in the ABC D&O Policy. A priority of payment provision simply dictates how and in what order policy proceeds will be paid. For example, an ABC D&O Policy might state that if Side A Coverage, Side B Coverage, and Side C Coverage are

[26] *See SN Liquidation*, 388 B.R. at 584 ("The issue of ownership becomes more complicated when the policy at issue provides coverage to both debtor, on the one hand, and its directors and officers on the other. If there is a risk that indemnity payments to directors and officers will result in insufficient coverage available to the debtor, then the proceeds are property of the estate.").

[27] *See*, *e.g.*, *Downey*, 428 B.R. at 603 ("[W]hen the liability insurance policy only provides direct coverage to the directors and officers, courts generally hold that the proceeds are not property of the estate."); *Allied*, 306 B.R. at 512 (concluding that "when the liability insurance policy only provides direct coverage to the directors and officers[,] the proceeds are not property of the estate").

triggered, Side A Coverage must be paid in full before any Side B Coverage and Side C Coverage distributions may be made, and Side B Coverage must be paid in full before any Side C Coverage distributions may be made. To maximize the likelihood of being able to use the policy proceeds to defend and resolve claims, directors and officers should consider negotiating clear, unambiguous priority of payment provisions in D&O Policies. Importantly, however, priority of payment provisions should be drafted in a manner that makes them always applicable (as distinguished from being applicable only after the corporation has become insolvent or has filed for bankruptcy). That is because, even outside of bankruptcy, there may be many different claims made against the various types of coverage simultaneously, which may lead to confusion if the policy is not drafted clearly. With clear, unambiguous language in place, however, insurance carriers and courts will likely honor or enforce the terms of the policy, notwithstanding competing claims for the ABC D&O Policy proceeds.

Insured vs. Insured Exclusion

Most D&O Policies exclude coverage for claims asserted by one insured against another insured (an "Insured vs. Insured Exclusion" or "Entity vs. Insured Exclusion"). The ostensible purpose of the Insured vs. Insured Exclusion is to prevent collusive suits—i.e., to prevent a corporation from asserting claims against its directors and officers and having any settlement or judgment therefrom be covered by its D&O Policy.

Insurers have argued that a claim asserted by a bankruptcy trustee on behalf of the debtor's estate against the debtor's former or current directors and officers constitutes a suit by one insured against another insured, even though the debtor's estate and the debtor are separate legal entities.[28] This argument has met with mixed success. The U.S. District Court for the District of Delaware has concluded that the Insured vs. Insured Exclusion does not apply in the context of bankruptcy unless there is evidence of collusion.[29] Other courts, however, have enforced the Insured vs. Insured Exclusion to deny coverage for claims brought against a debtor corporation by a litigation trustee on behalf of creditors.[30] Much depends on the wording of the Insured vs. Insured Exclusion.

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[28] *See, e.g., Cirka v. Nat'l Union Fire Ins. Co. of Pittsburgh*, No. Civ. A. 20250-NC (Del. Ch. Aug. 6, 2004).

[29] *See Alstrin v. St. Paul Mercury Ins. Co.*, 179 F. Supp. 2d 376, 404 (D. Del. 2002) ("The court agrees with the D&O plaintiffs and the Estate Representative that the 'insured v. insured' exclusion should not apply to claims brought by a bankruptcy Estate Representative against the former directors and officers of the Debtor where the Debtor is the insured entity, because the Debtor's Estate Representative . . . and the Debtor . . . are separate entities.").

[30] *See, e.g., Indian Harbor Ins. Co. v. Zucker*, 860 F.3d 373 (6th Cir. 2017).

As a result, directors and officers should ensure that their policies contain now-standard policy language stating that the Insured vs. Insured Exclusion does not apply to any claim brought or maintained by or on behalf of a debtor-corporation that is in bankruptcy, including any claim asserted by a bankruptcy trustee, an examiner, a liquidator, a receiver, or a rehabilitator on behalf of any insured entity.

Retention Payments

As noted above, when a claim is made against the Side B Coverage of a D&O Policy, generally a "retention" must be paid by the company, which operates as self-insurance or a deductible. Upon a bankruptcy filing by the corporation, however, it is unclear whether a retention payment will—or even may—be made. Specifically, claims against Side B Coverage that arise prepetition may result in the retention being treated as an unsecured claim of the insurer (or in some cases, the indemnified directors or officers) against the estate, with little prospect of any significant recovery.[31] Furthermore, depending on the financial condition of the debtor, the debtor may be unable to pay the retention at all. Nevertheless, careful drafting of the language of the policy may be sufficient to mitigate these risks.[32] For example, the policy may provide specific rights in the event of a bankruptcy filing—including a reduction or waiver of the retention amount, or that the failure to pay the retention in full during the course of a bankruptcy case does not have any impact on coverage for the directors and officers.[33]

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[31] Depending on how the policy language is drafted, the covered directors and officers may be obligated to pay the retention if the debtor is unable to do so. *See*, *e.g.*, *Republic Techs. Int'l, LLC v. Maley (In re Republic Techs. Int'l, LLC)*, 275 B.R. 508, 516–17 (Bankr. N.D. Ohio 2002) (finding that a policy providing that a retention payment was to be made "by the Company or the Insureds" obligated the insured officers and directors to pay such amount after the company filed for bankruptcy and thus was unable to do so).

[32] As noted above, negotiating a D&O Policy that either includes standalone Side A Coverage or provides that Side A Coverage claims take priority over all other claims would obviate the majority of issues addressed in this section.

[33] Unfortunately, it does not appear that many courts have opined on whether a retention must be paid specifically as part of a D&O Policy prior to the insurer having any obligations thereunder. If, however, courts were to apply jurisprudence applicable to general liability and other forms of insurance, a majority of jurisdictions have found that failure to pay a retention due to insolvency does not relieve an insurer of its obligation to provide coverage under a policy. *See*, *e.g.*, *Sturgill v. Beach at Mason Ltd. P'ship*, No. 14cv0784 (WOB) (S.D. Ohio Oct. 20, 2015) ("[T]he great weight of authority from other jurisdictions holds, under policy language similar to that contained in the . . . policy [including a bankruptcy clause], that the insured's failure to pay a [retention] does *not* relieve the insurer of its contractual duties under the policy."); *Am. Safety Indem. Co. v. Vanderveer Estates Holding, LLC (In re Vanderveer Estates Holding, LLC)*, 328 B.R.

Change in Control Provisions

Finally, almost all D&O Policies include "change in control" language providing for a change in, or termination of, coverage upon the occurrence of certain, specified actions or events that constitute a change in control of the corporation's business. Importantly, however, how policies define "change in control" can be flexible, so directors and officers should negotiate for specific and clearly defined language identifying when a change in control has occurred. Although each situation is different and the relevant language should be specifically tailored for the particular industry and business, potential change in control triggers include the replacement of a certain number of members of the board of directors, the breach of maximum or minimum equity ownership thresholds for shareholders, or the sale of a certain percentage or amount of the corporation's assets. Ultimately, however, there is no one size-fits-all approach, so consulting with insurance and/or restructuring experts is of vital importance.

In addition to what particular events trigger a change in control, directors and officers should also consider negotiating what happens under the policy upon the occurrence of such an event to ensure that the policy remains in place for as long as possible. Although certain releases and indemnifications for directors and officers may be negotiated as part of a Chapter 11 plan, it would also be prudent to consider the extent of tail coverage related to the D&O Policies, and whether such a tail policy also includes a change in control trigger. In general, a best practice would be to pre-fund such tail coverage and to ensure that it remains available until the release of any potential claims occurs—whether pursuant to a Chapter 11 plan or the expiration of the statute of limitations.

18, 25 (Bankr. E.D.N.Y. 2005) ("Failure of the debtor to perform these continuing obligations [including payment of a self-insured retention or a deductible] 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."). Nevertheless, a minority of jurisdictions have found that the payment of a retention is a condition precedent to coverage, and the failure to pay relieve an insurer of its obligations under the policy. *See*, *e.g.*, *Pak-Mor Mfg. Co. v. Royal Surplus Lines Ins. Co.*, No. SA-05-CA-135-RF (W.D. Tex. Nov. 3, 2005) ("The unambiguous text of the insurance policy compels the conclusion that [the debtor] must pay the self-insured part of the policy before [the insurer] has any obligation to pay any excess."); *Fid. & Guar. Ins. Co. v. Emp'rs Ins. of Wausau (In re Apache Prods. Co.)*, 311 B.R. 288, 297 (Bankr. M.D. Fla. 2004) (applying Alabama law and holding "the courts in Alabama have not addressed this exact issue on point [regarding the effect of the failure to pay a retention] but it appears in the limited cases regarding this discrete and narrow issue, one cannot escape the plain language of the [insurance] policy").

CONCLUSION

Corporate directors and officers should make sure that they understand the key terms of their companies' D&O Policies as well as the scope and limitations of their corporations' indemnification provisions. This is particularly true for companies facing bankruptcy, as directors and officers may find their access to indemnification and insurance unavailable or severely limited at a time when it is most needed. The issues identified above, although key items for consideration, are not the only issues that can arise in the bankruptcy context. Accordingly, the timely engagement of professionals to review the D&O Policies and to advise directors and officers regarding best practices is critical to avoiding unwelcome surprises.