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NCAA licensing agent's suit against insurers will stay in Georgia

Insurers for a collegiate licensing agency that allegedly violated student-athletes' publicity rights must continue to defend against the policyholder's declaratory judgment action in Georgia federal court, the 11th U.S. Court of Appeals has affirmed.

Collegiate Licensing Co. v. American Casualty Co. et al. , No. 12-10673, 2013 WL 1149936 (11th Cir. Mar. 21, 2013).

Collegiate Licensing Co. sued American Casualty Co. and three other insurers in Georgia federal court before the four defendants asked to intervene as plaintiffs in a California coverage action that another carrier filed against the licensing company, the appellate panel said.

The Georgia and California actions both seek to determine whether insurers owe coverage for underlying suits accusing CLC and video game developer Electronic Arts Inc. of violating college athletes' rights to publicity, but they involve different carriers, brokers and policies, the appeals court said.

REUTERS/Jonathan Bachman

The underlying lawsuits allege Collegiate Licensing Co. and others wrongfully profited from the unauthorized use of college athletes' names and likeness in video games and advertising.

Therefore, U.S. District Judge Thomas W. Thrash of the Northern District of Georgia correctly ruled

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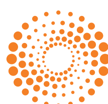

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D&O coverage in Delaware bankruptcies: Not all policies are created equal

By John B. Garver III, Esq.
Robinson Bradshaw & Hinson

Imagine that one of your clients calls. She tells you that, after several years of service on the board of a Delaware company that she does not run and does not invest in, she senses that the company is sliding inexorably into bankruptcy. She assures you that she is certain she has personally done all she could to make the right decisions and fulfill her director obligations in good faith. But, there is talk about the possibility of lawsuits from investors, disappointed partners and even a government agency that provided some seed capital.

All of a sudden, the directors and officers insurance policy she knows exists, but has never actually laid eyes on, has become a document of great interest to her — and to you, her longtime personal lawyer who regrets not having insisted on reviewing the policy when she originally joined the board. She is especially concerned because one of her husband's friends volunteered that he thought he had heard that a bankruptcy trustee could "grab" the insurance proceeds and leave the directors to fend for themselves. What can you tell your anxious client to calm her nerves?

Your first and most important step is of course to *get a copy of the current policy and read it*! There is no substitute, and that includes getting a full copy with the declarations and the endorsements. Hopefully, the policy is in good shape and contains adequate protections to ensure that the onset of bankruptcy will not change the rights of directors to receive the benefits of a policy originally purchased with their protection in mind. Examples of these protections, as discussed below, would include provisions stating clearly that the bankruptcy does not relieve the insurer of any obligations, and a clear outline of the chain of priority for payments (with the directors first).

Quick Takeaways

- Do not wait until the eve of bankruptcy to read the policy. You should do that when your client joins the board.
- Negotiate for a "priority of payments" clause.
- Look for director-favorable language such as "the bankruptcy or insolvency of any organization or any insured person shall not relieve the insurer of any of its obligations, including its obligation to prioritize payments."
- If you can on the front end, insist upon a separate policy for directors only (not the company with no or a minimal retention).
- None of this will increase premiums, so just ensure it is done properly at the outset.

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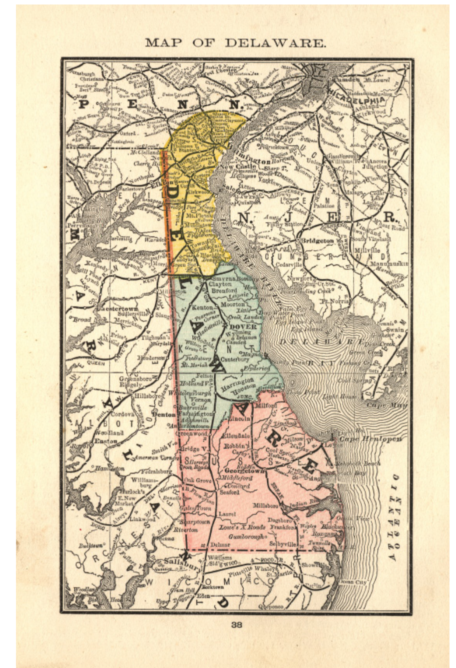
The next step is to consider how the Delaware courts see the issue. Under Delaware law, whether the proceeds of a D&O liability insurance policy will be considered part of a bankruptcy estate depends on the "language and scope of the policy at issue."[1]



Under Delaware law, whether the proceeds of a D&O liability insurance policy will be considered part of a bankruptcy estate depends on the "language and scope of the policy at issue."

This matters a great deal to the directors because, if the proceeds are "part of the estate" of the company, now (or soon to be) a corporate debtor in bankruptcy, then the directors may not access the proceeds to pay ongoing defense costs without an order from the bankruptcy court lifting the automatic stay to allow it.

If a trustee is suing the directors in a derivative action, the trustee and the directors both seek to be paid from the same pot of money. Many or most D&O policies are "wasting policies," that is, each dollar of defense costs paid reduces the amount available under the policy to pay damages. Therefore, trustees frequently assert that insurance proceeds are part of the estate in order to safeguard their source of recovery from depletion to pay attorneys engaged to defend against the trustee's lawsuit.

Here is how Delaware's courts have analyzed this issue: If a policy provides coverage only to the company (debtor), "courts will

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generally rule that the proceeds are property of the estate."[2] Almost all policies currently used will not solely cover the company, so this test usually will not be an issue.

If a policy covers only the directors and officers, "courts will generally rule that the proceeds are not property of the estate."[3] There are policies available that cover only directors and officers. They often are referred to as "Side A only" policies. Such policies are frequently seen in more elaborate or layered protection schemes, and directors and officers should ask for them.

The analysis is more complicated when a policy covers the debtor company *and* its directors and officers (a "mixed coverage" policy). Usually such policies denominate the directors and officers coverage as "Side A," the company's coverage to pay its indemnification obligations to directors and officers as "Side B," and coverage of the company in its own right against securities claims as "Side C."

In Delaware, proceeds of such a mixed-coverage policy become 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."[4] On its face, that language seems an apparent impediment to securing coverage for directors and officers, but in practice the Delaware courts have consistently held that proceeds of mixed-coverage policies are not part of a debtor's estate. For example, in three frequently cited Delaware cases — *In re World Health Alternatives, In re Allied Digital Technologies Corp.* and *In re Downey Financial Corp.*[5] — the trustee could not reach the proceeds of a mixed-coverage policy. As one court explained, and all three courts appear to understand, "the directors and officers bargained for this coverage" and therefore should receive the proceeds.[6]

Directors and officers particularly benefit if a policy outlines a priority scheme that first pays Side A coverage. For example, the *World Health* court noted: "The trustee faces many other impediments to recovering from the policy. These include … the 'priority of payments' [provision] … which requires that payments first be made to Coverage A insureds."[7]

It also is helpful if the policy specifically states that notwithstanding a bankruptcy of the company insured, the priority order that pays Side A coverage first remains inviolate. For example, in *Downey* the policy provided, "The bankruptcy or insolvency of any organization or any insured person shall not relieve the insurer of any of its obligations to prioritize payment of covered loss under this policy." Reviewing this language, the *Downey* court explained that if the "policy proceeds are property of the estate … the trustee would have greater rights in the policy proceeds than the debtor had before bankruptcy."[8] The court therefore held that the proceeds were beyond the trustee's reach.

If the policy provides indemnification coverage to the debtor "but indemnification either has not occurred, is hypothetical, or speculative, the proceeds are not property of the bankruptcy estate."[9] Using this reasoning, the *World Health* court held that when there were no indemnification claims against the debtor, a trustee could not recover the proceeds of a mixed-coverage policy.[10] Remember that the company's Side B coverage is provided to reimburse the company for indemnification paid to directors. Typically, in the case of a bankruptcy of a corporate insured, there will have been no indemnity paid to directors. In fact, in the *Allied Digital* case, the bankruptcy trustee was himself suing the directors over a failed transaction and so there was no possibility that indemnification would be paid (Side B). Because there was no separate securities claim against the company (Side C), the only applicable portion of the policy was the directors' Side A coverage.

Outside Delaware, the rules will vary. Generally, the rules are similar to those of Delaware, but in the case of mixed-coverage policies, there are more problems that can arise for directors. In some jurisdictions, trustees have successfully reached the proceeds of a mixed-coverage policy. For example, in one Pennsylvania bankruptcy case, the court stated: "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."[11]

On the other hand, an Ohio bankruptcy court held that even though a policy provided indemnification coverage to the debtor, the proceeds were not property of the estate.[12] The court explained: "D&O policies are obtained for the protection of individual directors and officers. Indemnification coverage does not change this fundamental purpose. … In essence and at its core, a D&O policy remains a safeguard of officer and director interests and not a vehicle for corporate protection."[13]

Irrespective of the above analysis, it appears clear that in the case of a "mixed coverage" situation, even if proceeds are considered property of the bankruptcy estate, Delaware courts will lift the automatic bankruptcy stay to allow payments of defense or settlement costs to directors and officers. For example, both the *Allied Digital*[14] and *Downey Financial*[15] courts added this clarification *after* finding that proceeds of a mixed-coverage policy were not property of the estate. And, to be clear, the defense and settlement costs are not limited to lawsuits involving the bankruptcy, but as typically worded, the policy will "pay the loss of any insured person arising from a claim made against such insured person for any wrongful act of such insured person, except when and to the extent that an organization has indemnified such insured person."[16]

Thus, when all is said and done, you will probably be able to talk your client back off the ledge. When armed with helpful policy language, the Delaware courts are likely to find that the proceeds of her D&O policy are not part of the bankruptcy estate. Or, if the mixed-coverage policy's proceeds are part of the estate, the Delaware courts will likely protect the directors and officers by lifting the automatic stay. But, the best approach will be to have checked all these points at the inception of the policy, and not just after the friendly process server departs from her office.

NOTES

[1] *In re Allied Digital Techs. Corp.*, 306 B.R. 505 (Bankr. D. Del. 2004).

[2] *In re World Health Alternatives*, 369 B.R. 805, 810 (Bankr. D. Del. 2007).

[3] *Id.*

[4] *In re Allied Digital*, 306 B.R. at 512.

[5] *In re Downey Fin. Corp.,* 428 B.R. 595 (Bankr. D. Del. 2010).

[6] *In re Allied Digital,* 306 B.R. at 514.

[7] *In re World Health,* 369 B.R. at 811.

[8] *In re Downey Fin.*, 428 B.R. at 608.

[9] *In re Allied Digital*, 306 B.R. at 512.

[10] *In re World Health*, 369 B.R. at 811.

[11] *In re Sacred Heart Hosp. of Norristown*, 182 B.R. 413, 420 (Bankr. E.D. Pa. 1995).

[12] *In re Youngstown Osteopathic Hosp. Ass'n*, 271 B.R. 544 (Bankr. N.D. Ohio 2002).

[13] *Id.* at 550 (quoting *In re First Cent. Fin. Corp.*, 238 B.R. 9, 13 (Bankr. E.D.N.Y. 1999)).

[14] *In re Allied Digital*, 306 B.R. at 513.

[15] *In re Downey Fin.*, 428 B.R. at 608.

[16] *Id.* at 599.

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