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The D&O Diary

A Periodic Journal Containing Items of Interest From the World of Directors & Officers Liability, With Occasional Commentary

4th Circ.: Bankruptcy Trustees Lack Standing to Sue D&O Insurer

By Kevin LaCroix on March 2, 2025

A D&O insurance policy provides its most important protection in the bankruptcy context, when the company is unable to indemnify its executives for claims arising out of their service as directors or officers. But because of the competing interests in bankruptcy – including the interests of the bankruptcy estate itself – bankruptcy can also be a complicated insurance coverage context. A Fourth Circuit decision, in which it held that two bankruptcy trustees lacked standing to sue a bankrupt company's D&O insurer in a declaratory judgment action, highlights important principles governing D&O insurance in the bankruptcy context.

A copy of the Fourth Circuit's February 26, 2025, opinion can be found **here**. A February 28, 2025 *LinkedIn* post by Geoffrey Fehling of the Hunton Andrews Kurth law firm about the 4th Circuit's decision can be found **here**.

Background

As the Fourth Circuit put it in its opinion, this case is "a tale of two bankruptcies and two adversary actions."

David Levine was the CEO of Geostellar. Geosteller filed for bankruptcy. The Geosteller bankruptcy trustee brought an adversary action (the Geosteller Adversary Action) against Levine, accusing him of defrauding and bankrupting the company. Levine sought insurance from Geosteller's D&O insurer, which provided Levine with a defense in the Geosteller Adversary Action.

Levine and his wife then filed for personal bankruptcy. The Levines bankruptcy filing stayed the Geosteller Adversary Action. The Geosteller Bankruptcy trustee filed a motion in the Levines' bankruptcy to lift the stay. In his motion to lift the stay, the Geosteller Trustee admitted that because Geostellar had not objected to Levine's discharge, Levine's debt to Geostellar was uncollectable, and therefore Levine himself had no interest in the Geostellar Adversary Action beyond any available insurance coverage. The bankruptcy court in the Levine bankruptcy lifted the stay to enable the Geostellar trustee's adversary claim against Levine to proceed to the extent of insurance only.

The Geostellar Adversary Action proceed to mediation. At the mediation, the insurer contended that under the policy, Levine's consent to settlement was needed. The Geostellar trustee disagreed, contending that the only Levine bankruptcy trustee's consent was required, not Levine's.

To sort out these issues, the two trustees (that is, the trustee in the Geostellar bankruptcy and the trustee in the Levine bankruptcy) filed an action seeking a judicial declaration that because the D&O Insurance policy is an asset of the Levines' bankruptcy estate, of which the Levine bankruptcy trustee was the sole representative, only the Levine bankruptcy trustee's consent to settlement was required.

The insurer filed a motion to dismiss on the grounds that the bankruptcy trustees lacked standing to sue. The district court granted the insurer's motion and the trustees appealed.

The February 26, 2025, Opinion

In a concise February 26, 2025, opinion written for a unanimous three-judge panel by Judge **DeAndrea Gist Benjamin**, the Fourth Circuit affirmed the district court, holding that the district court had correctly determined that the trustees lacked standing to pursue their declaratory judgment action against the insurer.

In affirming the district court, the appellate court considered the purported standing of each of the two trustees separately.

The Geostellar bankruptcy trustee had tried to argue that because Geostellar bought the D&O Insurance policy, he (that is, the trustee), as Geostellar's estate's representative, had first-party status under the policy. However, the appellate court said that under West Virginia law an injured party (such as Geostellar) only can bring a direct action against a liability insurer if there is a verdict against an insured or if the insurer has denied coverage. Because the Geostellar Adversary Action is ongoing and Geostellar's insurer is providing Levine with a defense, West Virginia law does not permit the Geostellar trustee to sue an insurer for a judicial declaration.

The policy, the court said, is activated only because Geostellar sued Levine, and under the operation of the D&O insurance policy, only Levine is an insured, not Geostellar. The Geostellar trustees "real concern" is that the insurer's payment of Levine's defense costs are eroding the policy's limits of liability. This "fear," the court said, "does not establish standing."

The appellate court also agreed with the district court that the Levine bankruptcy trustee also lacked standing. The court noted that the bankruptcy court in the Levine bankruptcy had lifted the stay only to the extent of the insurance policy's coverage limits. The court said that because any judgment in the Geostellar Adversary Action cannot exceed the "extent of the insurance" and because Levine's debt to Geostellar is otherwise discharged and uncollectable, a judgement in the Geostellar Adversary Action poses no threat to the Levine Bankruptcy Estate." Put simply, the court said, the Geostellar Adversary Action "will not impact the Levine Bankruptcy Estate in anyway." Accordingly, the court said, "the Levine Trustee has failed to establish an injury in fact" sufficient to establish standing, and therefore the Levine Trustee lacks standing to sue.

The Levine Trustee also tried to argue that he had standing to sue because the policy is an asset of the bankruptcy estate. The court said that while the policy may be an asset of the estate, the proceeds of the policy are not. The appellate said that interpreting policies identical to the one at issue in this case, "courts routinely find that when the liability policy only provides the direct coverage to the directors and officers, the proceeds are not the property of the [debtor company's] estate." Levine, the court said, and not the Trustees, has an interest in the policy's proceeds.

The appellate court went on to say that

> The nature of the policy's coverage is to protect Levine and similarly-situated employees from incurring liability as directors and officers of Geostellar and to ensure that potential losses incurred as the result of their service in such capacities remain separate from their personal finances. For these reasons … courts regularly recognize that the benefits

> provided to directors and offices by directors and officers liability insurance coverage cannot be stripped from them by a bankruptcy trustee.

Neither trustee, the court concluded has standing to sue the insurer. The policy, the court said, covers Levine and the right to consent to settlement is neither the Geostellar Trustee nor the Levine Trustee's property.

Discussion

The appellate court's decision here is narrow, as it is focused on the jurisdictional issue of whether the trustees had sufficient standing to sue the insurer seeking a judicial declaration. But while narrow, the court's opinion also underscores some key points about the nature of the D&O insurance policy itself.

First, the court said that neither the fact that the company bought the policy nor the fact that the fact that the payment of defense costs was eroding the remaining policy limits were sufficient to give the trustees standing to sue the insurer. The fear that the insurer's payment of defense costs could reduce the amount from which the Geostellar trustee ultimately might recover is not sufficient to establish standing.

Second, the court found that while the policy itself may be an asset of the estate, courts "routinely" find that when a D&O insurance policy only provides direct coverage to the directors and offices (as was the case here, since Levine was the only one who was sued), the policy proceeds are not property to the debtor company's estate. In highlighting this point, the court emphasized that courts "regularly" recognize that the benefits provided to directors and officers a D&O insurance policy "cannot be stripped from them by a bankruptcy trustee."

These key principles are critically important in the bankruptcy context. As I noted at the outset, the protection afforded by a D&O insurance policy is at its greatest importance in bankruptcy. The policy proceeds are there to protect the individual insureds, not defray the debts of the bankrupt company. It is particularly helpful that the appellate court recognized that courts "routinely" and "regularly" uphold these important principles.

PLUS D&O Symposium: On Tuesday, March 4, 2025, and Wednesday March 5, 2025, I will be in New York for the annual PLUS D&O Symposium. If you are a D&O Diary reader and you are going to be at the D&O Symposium, I hope you will say hello if you see me there, particularly if we have not met before. I always enjoy a chance to talk to The D&O Diary's readers.