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U.S. BKCY. APP. PANEL  
OF THE NINTH CIRCUIT

**UNITED STATES BANKRUPTCY APPELLATE PANEL  
OF THE NINTH CIRCUIT**

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In re:	)	BAP No. WW-09-1142-MoPaH
	)	
MILA, INC.,	)	Bk. No. 07-13059-SJS
	)	
Debtor.	)	
<hr/>		
GEOFFREY GROSHONG, Chapter 11	)	
Trustee,	)	
	)	
Appellant,	)	
	)	
v.	)	<b>O P I N I O N</b>
	)	
LAYNE E. SAPP,	)	
	)	
Appellee.	)	
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Argued and Submitted on October 23, 2009  
at Pasadena, California

Filed - January 5, 2010  
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Appeal from the United States Bankruptcy Court  
Western District of Washington

Honorable Samuel J. Steiner, Bankruptcy Judge, Presiding

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Before: MONTALI, PAPPAS and HOLLOWELL, Bankruptcy Judges.

1 MONTALI, Bankruptcy Judge:

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3 Appellant, chapter 11<sup>1</sup> trustee Geoffrey Groshong ("Trustee"),  
4 appeals a bankruptcy court order granting Appellee, Layne E. Sapp  
5 ("Sapp"), relief from the automatic stay allowing the Federal  
6 Insurance Company ("Insurer") to advance payments to Sapp for his  
7 legal defense costs under a directors and officers insurance  
8 policy ("D&O policy") held by corporate debtor MILA, Inc.  
9 ("MILA"). Because the bankruptcy court did not abuse its  
10 discretion in granting Sapp relief from the automatic stay, we  
11 AFFIRM.

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## I. FACTS

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### A. Background Facts.

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<sup>1</sup> Unless otherwise indicated, all chapter, section and rule references are to the Bankruptcy Code, 11 U.S.C. §§ 101-1532, and to the Federal Rules of Bankruptcy Procedure, Rules 1001-9037.

1 INSURED PERSONS DURING THE POLICY PERIOD." "Insured Person(s)" is  
2 defined to include only the directors and officers of MILA. Thus,  
3 MILA's directors and officers are the named insureds.

4 The "liability" part of the Policy, often referred to as  
5 "A-side" coverage, provides direct coverage to MILA's sole  
6 director Sapp and other MILA officers for losses they incur due to  
7 their wrongful acts including damages, judgments, settlements, and  
8 the like, which are not indemnified by MILA, and further includes  
9 payments for their legal defense costs. The "indemnification"  
10 part of the Policy, or "B-side" coverage, reimburses MILA to the  
11 extent that it has indemnified Sapp or other officers for their  
12 own losses.<sup>2</sup>

13 The Policy has a maximum payout of \$1 million for covered  
14 losses under both the A-side and B-side coverage, including  
15 directors' and officers' defense costs. These features are what  
16 make the Policy a "wasting" policy in that any payments for Sapp's  
17 (or other officers') defense costs or any liability payments made  
18 on their behalf under the A-side coverage reduce the amount  
19 available for B-side coverage to MILA and vice versa. The Policy  
20 is also a "claims made" policy, which requires that claims against  
21 Sapp or other officers be made during the policy period in order  
22 to trigger potential coverage.<sup>3</sup>

23 \_\_\_\_\_  
24 <sup>2</sup> Some D&O policies also include liability coverage to the  
25 entity for its own direct losses from a claim brought against it.  
26 This is known as "C-side" coverage. The Policy does not provide  
C-side coverage to MILA.

27 <sup>3</sup> This is distinguished from an "occurrence" policy, whereby  
28 the coverage only extends to losses occurring within the policy  
period though the claim may still be made after the policy

(continued...)

1 MILA's bylaws provide that corporate directors and officers,  
2 past or present, "shall be indemnified by the corporation . . .  
3 against all costs, expenses, judgments and liabilities, including  
4 attorney's fees . . . in connection with or resulting from any  
5 claim, action, suit or proceedings" stemming from his or her  
6 conduct while acting as a director or officer of MILA. Therefore,  
7 MILA is legally obligated to indemnify Sapp and subordinate  
8 officers for the type of losses Sapp has incurred.

9 In December 2007, the Trustee paid approximately \$21,000 in  
10 estate funds to purchase an extension of the Policy's coverage for  
11 an additional year, to include claims made against MILA's  
12 directors or officers through October 22, 2008.

13 **B. Procedural History.**

14 On August 28, 2008, Trustee filed an adversary proceeding  
15 against Sapp alleging a number of claims. Several of these claims  
16 have been disposed of on motions to dismiss. In defending himself  
17 against Trustee's action, Sapp has incurred and will continue to  
18 incur legal fees and expenses.<sup>4</sup> Upon Sapp's request, Insurer  
19 agreed to advance his defense costs from the A-side coverage but  
20 only if Sapp obtained a comfort order stating that Insurer was not  
21 violating the automatic stay by making those payments.

22 On March 13, 2009, Sapp filed a motion for relief from the  
23 automatic stay as to the proceeds of the Policy's A-side coverage.

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24  
25 <sup>3</sup>(...continued)  
26 expires. Helfand v. Nat'l Union Fire Ins. Co., 10 Cal. App. 4th  
869, 885 n.8 (Cal. Ct. App. 1992).

27 <sup>4</sup> Counsel for Sapp stated at an April 17, 2009 hearing that  
28 he was unsure about the amount of legal fees Sapp has incurred to  
date. However, Trustee's counsel stated that he believes the  
figure is around \$300,000.

1 Sapp contended that the Policy's proceeds were not estate property  
2 and thus the automatic stay should not prevent him from using the  
3 proceeds to fund his defense costs. Alternatively, if the  
4 bankruptcy court considered the proceeds property of the estate,  
5 Sapp contended that his direct, immediate, and real defense costs  
6 greatly outweighed any conceivable benefit to MILA, and thus he  
7 was entitled to modification of the stay to receive the insurance  
8 payments.

9 Trustee opposed Sapp's motion, contending that MILA had a  
10 direct interest in the Policy's B-side coverage because it  
11 protects MILA from Sapp's indemnification claims or the estate  
12 from having to make the obliged indemnification payments from its  
13 own assets should Sapp exhaust the Policy's limits. Therefore, he  
14 argued, since MILA's direct interest in the proceeds renders the  
15 estate worth more with them than without them, Ninth Circuit law<sup>5</sup>  
16 dictates that the proceeds are estate property protected by the  
17 automatic stay, and Sapp had failed to provide cause to modify the  
18 stay to permit him access to the proceeds.

19 A hearing on Sapp's motion was held on April 17, 2009. After  
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21 <sup>5</sup> The Minoco Group of Cos., Ltd. v. First State Underwriters  
22 Agency of New Eng. Reins. Corp. (In re The Minoco Group of Cos.  
Ltd.), 799 F.2d 517, 519 (9th Cir. 1986) ("Minoco").

23 In Minoco, the insurer tried to cancel Minoco's D&O policies  
24 after it filed bankruptcy. The subject policies offered A-side  
25 and B-side coverage. The creditors' committee sought declaratory  
26 relief that cancellation of the policies was automatically stayed  
27 by section 362(a), and it also sought an injunction prohibiting  
28 the insurer from canceling the policies. Id. at 518. The Ninth  
Circuit held that since the D&O policies protected against the  
diminution of the value of Minoco's estate because they insured it  
against director and officer indemnity claims, these policies made  
Minoco's estate worth more with them than without them; thus, such  
policies are property of the estate protected by the automatic  
stay. Id. at 519.

1 listening to argument from both parties and making several  
2 inquiries to get a better understanding of the Policy's nuances  
3 and the present circumstances, the bankruptcy court made an oral  
4 ruling, concluding that: the Policy was property of the estate;  
5 MILA was not a named insured and that its recovery right was  
6 purely derivative; there were no other potential indemnification  
7 claims against the estate; Sapp's harm was clear, immediate, and  
8 ongoing; and because it was unlikely that Sapp's defense costs  
9 would leave insufficient proceeds for MILA to pay indemnification  
10 claims, Sapp was entitled to relief from stay.

11 The court entered a final order granting Sapp's motion on  
12 April 17, 2009. This appeal timely followed.

## 13 **II. JURISDICTION**

14 The bankruptcy court had jurisdiction under 28 U.S.C.  
15 §§ 157(b) (2) (G) and 1334. "Orders granting or denying relief from  
16 the automatic stay are deemed to be final orders." Nat'l Envtl.  
17 Waste Corp. v. City of Riverside (In re Nat'l Envtl. Waste Corp.),  
18 129 F.3d 1052, 1054 (9th Cir. 1997). Therefore, we have  
19 jurisdiction under 28 U.S.C. § 158.

## 20 **III. ISSUE**

21 Did the bankruptcy court abuse its discretion when it  
22 determined that Sapp had shown cause to modify the automatic stay?

## 23 **IV. STANDARD OF REVIEW**

24 Whether a particular asset is estate property and whether the  
25 automatic stay is applicable to a particular situation are  
26 conclusions of law reviewed de novo. Monumental Life Ins. Co. v.  
27 Bibo, Inc. (In re Bibo, Inc.), 200 B.R. 348, 350 (9th Cir. BAP  
28 1996), vacated as moot, 139 F.3d 659 (9th Cir. 1998).

1 The decision of a bankruptcy court to grant relief from the  
2 automatic stay under section 362(d) is reviewed for an abuse of  
3 discretion. Kronemyer v. Am. Contractors Indem. Co.  
4 (In re Kronemyer), 405 B.R. 915, 919 (9th Cir. BAP 2009). We  
5 follow a two-part test to determine objectively whether the  
6 bankruptcy court abused its discretion. U.S. v. Hinkson, 585 F.3d  
7 1247, 1261-63 (9th Cir. 2009). First, we determine de novo  
8 whether the bankruptcy court identified the correct legal rule to  
9 apply to the relief requested. Id. If it did, we next determine  
10 whether the bankruptcy court's application of the correct legal  
11 standard to the evidence presented was "(1) 'illogical,'  
12 (2) 'implausible,' or (3) without 'support in inferences that may  
13 be drawn from the facts in the record.'" Id. at 1262 (citation  
14 omitted). If any of these three apply, we may conclude that the  
15 court abused its discretion by making a clearly erroneous finding  
16 of fact. Id.

## 17 V. DISCUSSION

### 18 A. Section 362.

19 Under section 362(a)(3), an automatic stay is imposed as of  
20 the petition date and stays "any act to obtain possession of  
21 property of the estate or of property from the estate or to  
22 exercise control over property of the estate . . . ."  
23 Section 541(a)(1) defines property of the estate as "all legal or  
24 equitable interests of the debtor in property as of the  
25 commencement of the case." Property of the estate is to be  
26 construed broadly (U.S. v. Whiting Pools, Inc., 462 U.S. 198, 204-  
27 05 (1983)), and the Ninth Circuit has determined that a debtor's  
28 insurance policies are property of the estate. Minoco, 799 F.2d

1 at 519.

2 The Bankruptcy Code also recognizes that certain  
3 circumstances require the court to respond to other interests and  
4 permits a flexible approach to the stay as the circumstances may  
5 require. Section 362(d)(1) authorizes the bankruptcy court broad  
6 discretion to grant relief from the automatic stay imposed under  
7 section 362(a) for "cause." Such relief may include "terminating,  
8 annulling, modifying, or conditioning such stay." Mataya v.  
9 Kissinger (In re Kissinger), 72 F.3d 107, 108-09 (9th Cir. 1995).

10 **B. Trustee's Contentions And Minoco.**

11 The Trustee contends that the bankruptcy court erroneously  
12 held that the proceeds were not property of the estate. However,  
13 he also concedes that the court "did not explicitly hold whether  
14 the policy proceeds are estate property." See Trustee's Op. Br.  
15 at 10:11-12. Despite this seemingly contradictory position, he  
16 argues that the bankruptcy court abused its discretion in holding  
17 that cause existed to modify the stay because it erroneously  
18 concluded that the estate had no interest in the Policy's proceeds  
19 in contradiction to Minoco, that its B-side indemnification right  
20 is purely derivative, and, consequently, that the proceeds are not  
21 protected by the stay.

22 At oral argument, the Trustee conceded that the issue before  
23 the Minoco court was only whether the policies were property of  
24 the estate subject to the automatic stay, not the policies'  
25 proceeds. The Minoco court stated as much. 799 F.2d at 519-20.  
26 Further, the Minoco court speculated that perhaps if or when  
27 Minoco received money from the insurer to satisfy indemnification  
28 claims, such proceeds might fall under section 541(b) - property

1 held in trust by debtor solely for another - and thus would not  
2 constitute property of the estate. Id.

3 Moreover, a Washington bankruptcy court has stated that  
4 whether D&O policy proceeds are an estate asset has not been  
5 decided in the Ninth Circuit. See Metro. Mortg. & Sec. Co., Inc.  
6 v. Cauvel (In re Metro. Mortg. & Sec. Co., Inc.), 325 B.R. 851,  
7 855 (Bankr. E.D. Wash. 2005) ("The applicability of § 541 to  
8 proceeds of insurance policies is not yet a settled question in  
9 the Ninth Circuit."). See also Imperial Corp. of Am. v. Milberg  
10 (In re Imperial Corp. of Am.), 144 B.R. 115, 118-19 (Bankr. S.D.  
11 Cal. 1992) (expressly stating that Minoco does not control when  
12 the question presented is whether or not policy proceeds are  
13 estate property); In re Daisy Sys. Sec. Litig., 132 B.R. 752, 755  
14 (N.D. Cal. 1991) (same).

15 Therefore, it does not appear that Minoco compels the outcome  
16 Trustee suggests: that a D&O policy's proceeds, at least policies  
17 offering only A-side and B-side coverage, are property of the  
18 policy owner's bankruptcy estate.

19 **C. The Bankruptcy Court Did Not Decide Whether The Proceeds Were**  
20 **Property Of The Estate.**

21 Contrary to Trustee's assertions, the bankruptcy court did  
22 not determine that the proceeds are not estate property; it ruled  
23 that regardless of the proceeds' status Sapp had shown requisite  
24 cause to be granted relief from stay. Recognizing this  
25 alternative ruling, the Trustee has requested that we declare the  
26 proceeds are estate property. We decline the Trustee's invitation  
27 to render an opinion on this issue because it is not essential to  
28 our decision here.

1           Despite the bankruptcy court's silence on the proceeds'  
2 status, it did make certain findings with respect to the proceeds  
3 in order to ultimately decide if Sapp was entitled to relief from  
4 stay. In making these findings, the bankruptcy court followed the  
5 reasoning set forth in cases which have decided the "policy vs.  
6 proceeds" issue and then went on to ultimately conclude whether or  
7 not a party was entitled to relief from stay, or some other  
8 relief. As explained below, even assuming that the proceeds are  
9 property of the estate, it was proper for the bankruptcy court to  
10 consider these factors in its analysis.

11           In cases involving D&O policy proceeds, the bankruptcy court  
12 must balance the harm to the debtor if the stay is modified with  
13 the harm to the directors and officers if they are prevented from  
14 executing their rights to defense costs. See In re Allied Digital  
15 Techs. Corp., 306 B.R. 505, 514 (Bankr. D. Del. 2004); In re  
16 CyberMedica, Inc., 280 B.R. 12, 18 (Bankr. D. Mass. 2002). Even  
17 in cases where the D&O policy proceeds were considered property of  
18 the estate, courts have nonetheless granted relief from stay to  
19 allow the insurer to advance defense costs payments when the harms  
20 weigh more heavily against the directors or officers than the  
21 debtor. See In re CyberMedica, Inc., 280 B.R. at 18.

22           One factor courts consider, especially in cases of a  
23 "wasting" policy, is whether defense costs payments made to  
24 directors and officers under the A-side coverage might exhaust B-  
25 side policy limits and potentially expose the estate to liability  
26 for obliged indemnification claims. See In re Metro. Mortg. &  
27 Sec. Co., Inc., 325 B.R. at 855-57; In re Leslie Fay Cos., Inc.,  
28 207 B.R. 764, 785 (Bankr. S.D.N.Y. 1997).

1 Here, the bankruptcy court rejected Trustee's concern about  
2 Sapp's defense costs payments exhausting the \$1 million proceeds  
3 and thereby jeopardizing the estate's ability to be indemnified.  
4 It found that because Sapp is likely the only director or officer  
5 to receive payments, "the likelihood of . . . leav[ing]  
6 insufficient proceeds . . . to pay claims for which the estate  
7 might seek B coverage appears to be remote." Although this may be  
8 somewhat speculative, it is not clearly erroneous based on the  
9 facts before the court. Generally, exhausting policy limits is  
10 only a concern when multiple parties are trying to access the  
11 proceeds, not just one officer and one trustee.<sup>6</sup> See Circle K  
12 Corp. v. Marks (In re Circle K Corp.), 121 B.R. 257, 260-62  
13 (Bankr. D. Ariz. 1990) (three civil actions pending in district  
14 court against both the debtor and its directors and officers;  
15 indemnification claims from the directors and officers pending  
16 with additional claims to come, further exposing debtor to  
17 liability should the policy limits be exhausted).

18 Most importantly, courts consider whether a debtor's  
19 indemnification claims under the B-side coverage are real and  
20 actual, or whether the likelihood of any such claims are  
21 hypothetical or speculative. See In re Allied Digital Techs.  
22 Corp., 306 B.R. at 512-14; In re World Health Alternatives, Inc.,

23 \_\_\_\_\_  
24 <sup>6</sup> At least two bankruptcy courts have chastised trustees for  
25 attempting to use their "super powers" to prevent directors or  
26 officers from getting their bargained-for right to receive defense  
27 costs. They recognize that the trustee's real concern is that  
28 defense costs payments may affect the trustee's right as plaintiff  
seeking to recover from the D&O policy rather than, as what  
trustees often claim, a potential defendant seeking protection.  
See In re Allied Digital Techs. Corp., 306 B.R. at 512-13, and  
Miller v. McDonald (In re World Health Alternatives, Inc.), 369  
B.R. 805, 811 (Bankr. D. Del. 2007).

1 369 B.R. at 810-11; La. World Exposition, Inc. v. Fed. Ins. Co.  
2 (In re La. World Exposition, Inc.), 832 F.2d 1391, 1394-95  
3 (5th Cir. 1987); Aetna Cas. & Sur. Co. v. Jasmine, Ltd.  
4 (In re Jasmine, Ltd.), 258 B.R. 119, 128 (D.N.J. 2000); Adelphia  
5 Commc'ns Corp. v. Associated Elec. & Gas Ins. Servs., Ltd.  
6 (In re Adelphia Commc'ns Corp.), 302 B.R. 439, 448 (Bankr.  
7 S.D.N.Y. 2003); Youngstown Osteopathic Hosp. Ass'n v. Ventresco  
8 (In re Youngstown Osteopathic Hosp. Ass'n), 271 B.R. 544, 550-51  
9 (Bankr. N.D. Ohio 2002); In re Circle K Corp., 121 B.R. at 260.

10 As to indemnification, the bankruptcy court found that Sapp  
11 has incurred legal fees and other expenses in his defense, that  
12 Sapp has not asked MILA for payments, and that MILA has not made  
13 (nor will it likely ever make) any indemnification payments to  
14 Sapp for which it is seeking reimbursement. Although Trustee  
15 asserted that other officers may be out there with potential  
16 indemnification claims, the court did not find this argument  
17 persuasive; Trustee could not point to anywhere in the record as  
18 to who these other officers might be, or what potential claims  
19 might be out there against them or the estate, and reasoned that  
20 any such claims would have been brought by now. We note that  
21 since the Policy is a claims made policy, any claims against other  
22 MILA officers must have been filed by no later than October 22,  
23 2008, over one year ago.<sup>7</sup>

24 \_\_\_\_\_  
25 <sup>7</sup> The bankruptcy court also found that MILA was not the named  
26 insured and therefore its right to recover is purely derivative.  
27 Trustee contends this is incorrect. In reviewing the Policy, we  
28 also conclude that MILA's directors and officers are the named  
insureds, not MILA. Further, Trustee conceded at oral argument  
that MILA has no interest in the Policy's B-side coverage unless  
and until it pays something out on behalf of Sapp or any other

(continued...)

1 **D. Regardless Of Whether The Policy's Proceeds Are Property Of**  
2 **The Estate The Bankruptcy Court Did Not Abuse Its Discretion**  
3 **When It Granted Sapp Relief From Stay.**

4 The bankruptcy court properly weighed the parties' respective  
5 harms and determined that Sapp had shown requisite cause for  
6 relief under section 362(d)(1), entitling him to receive payments  
7 from the Insurer. Sapp's defense losses were clear, immediate,  
8 and ongoing, while Trustee could only show hypothetical or  
9 speculative indemnification claims against MILA since neither it  
10 nor the estate has paid anything to Sapp and no other actions have  
11 been filed against other MILA officers. In addition, the  
12 likelihood that Sapp would exhaust the \$1 million policy with his  
13 defense costs appeared to be remote.

14 We note a case with strikingly similar facts that provides  
15 guidance on this issue. The D&O policy in In re CyberMedica had a  
16 limit of \$2 million and provided C-side coverage to the debtor.  
17 280 B.R. at 14. The bankruptcy court ultimately concluded that  
18 the proceeds were property of the estate. Id. at 17.  
19 Nonetheless, it granted two directors' motions for relief from  
20 stay to obtain advances from the insurer for defense costs they  
21 incurred in defending against the trustee's action. Pertinent to  
22 its decision was the fact that the directors faced immediate and  
23 irreparable harm if they were deprived of their contractual right  
24 to payments, while any prejudice to the debtor was merely  
25 speculative because it had made no claims for indemnification or  
26 entity coverage. Id. at 18. Moreover, the court rejected the

27 <sup>7</sup>(...continued)  
28 officer, which renders its interest as purely derivative. In any  
event, this factor has no bearing on whether Sapp was entitled to  
relief from stay.

1 trustee's argument that indemnification claims might arise in the  
2 future, reasoning that defense costs advanced by the insurer would  
3 correspond to the claims for which the directors would seek  
4 indemnification from the debtor. Id. Hence, the insurer's  
5 advancement of defense costs - costs for which the debtor was  
6 ultimately obligated to pay - actually minimized the potential  
7 exposure of the debtor. This is the same reasoning the Fifth  
8 Circuit applied in In re La. World Exposition, 832 F.2d at 1400.  
9 See also In re Allied Digital Techs. Corp., 306 B.R. at 513-14  
10 (proceeds not property of the estate, but even if they were the  
11 automatic stay should be lifted when directors or officers face  
12 immediate harm yet there is no evidence that coverage for the  
13 debtor will be necessary).

14 Accordingly, the bankruptcy court performed the proper  
15 analysis under section 362(d)(1) by weighing the parties'  
16 respective harms and concluding that Sapp showed requisite cause  
17 to modify the stay. Therefore, we conclude that the bankruptcy  
18 court did not abuse its discretion.

19 **VI. CONCLUSION**

20 Based on the foregoing reasons, we AFFIRM.  
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