PUBLICATION

THE SVB BANKRUPTCY DECISION AND ITS LESSONS FOR D&O INSURANCE PROGRAMS

AUGUST 22, 2023

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Directors and Officers (D&O) policies are intended first and foremost to protect a company's individual directors and officers from significant claims which may be asserted against those individuals in their capacities as directors and officers. That protection encourages and supports talented individuals to bring their skills to the company for the benefit of the company and its stakeholders.

D&O policies also are intended to protect a company from various securities actions and similar claims brought against the company. These claims can constitute a material event for a company and significantly impact the company's balance sheet. A robust D&O program can ameliorate that impact.

It is important for a company to secure the protection and benefits afforded by D&O policies for its individual directors and officers as well as itself through an intentionally-developed D&O

program. That program should be designed with a catastrophic event in mind so as to maximize protection for the company and its directors and officers should such an event occur.

A recent decision in the bankruptcy case of the parent company of Silicon Valley Bank, SVB Financial Group (SVB), pending before the United States Bankruptcy Court for the Southern District of New York (the "Court") provides a cautionary tale for all businesses and illustrates the need for companies to maintain well-designed and well-funded D&O programs. *In re: SVB Fin. Group, No. 23-10367 (Bankr. S.D. N.Y. May 22, 2023)*.

SVB's Insurance Program

SVB maintained a $150 million D&O insurance tower which provided Side A coverage for its individual directors and officers in the absence of indemnification from the company; Side B coverage for reimbursement on account of indemnification SVB makes to directors or officers; and Side C coverage for securities claims asserted against SVB. SVB also maintained $50 million in separate Side A coverage for the individual officers and directors which was in addition to the $150 million main D&O tower.

The D&O policies in the $150 million tower included a "Priority of Payments" provision, which granted individual directors and officers priority - that is, first rights – to the policy proceeds over SVB.

Class Action Lawsuits, Regulatory Proceedings, and the Executive Requests for Coverage

SVB and various directors and officers were sued in seven class actions arising from Silicon Valley Bank's failure. Several regulatory actions also were commenced.

The individual directors and officers sought payment of their respective legal fees through SVB's D&O insurance program. The individual directors and officers were represented by 14 separate law firms. Their legal fees are expected to be very significant – running into the tens of millions of dollars – which, if covered, would make a serious dent in SVB's D&O program.

SVB's chapter 11 estate declined the individual directors' and officers' requests for advancement of defense costs on the ground that the bankruptcy filing precluded such reimbursement absent court approval. The directors and officers submitted claims directly to the D&O insurers who similarly required the Court's approval.

Consequently, the individual officers and directors filed a motion for relief from the automatic stay specifically for the purpose of using D&O proceeds to pay for their legal expenses. The official committee of unsecured creditors (the "Committee") objected to the modification of the stay asserting the D&O proceeds were property of the bankruptcy estate and depletion of the estate's assets would interfere with the chapter 11 case. The Committee posited that "uncontrolled

payment of defense costs has the potential to severely diminish" the D&O proceeds which otherwise would be available to pay for the claims asserted against SVB which would then inure to the benefit of the unsecured creditors.

Court Ruling

The Court held the individual officers and directors were entitled to access the D&O policy to pay for their legal expenses.

The Court noted that a party (such as the individual officers and directors) seeking access to proceeds from a debtor's insurance program must establish "cause" to modify the automatic stay if the insurance program is deemed property of the debtor's bankruptcy estate. The Court also noted that, generally, a company's insurance policies which also provide coverage to directors and officers are considered property of the bankruptcy estate where (as here) "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." Nevertheless, the Court found it need not determine if the policy proceeds are property of the estate, because cause existed to lift the automatic stay even if they were property of the estate.

The Court found the individual directors and officers established "cause" principally on the ground that the priority of payment provision in the D&O policies clearly and expressly gave the individual directors and officers first rights to the policy proceeds. The Court recognized the defense costs which the individual officers and directors would incur could deplete most or all of the D&O policy proceeds, thereby leaving insufficient or even no policy funds for the estate to apply to claims asserted against SVB. Nevertheless, the Court concluded the priority of payments provision dictated this result stating: "even if it is true that the Directors' and Officers' will deplete the policy, they are entitled to use the proceeds first . . . . the Debtor is last in line for the insurance proceeds." Therefore, where the directors and officers use of the proceeds would not interfere with the bankruptcy case and the need for defense costs was a significant harm, cause existed to lift the stay.

Takeaways

It is unclear whether *SVB* will have sufficient D&O proceeds to cover the claims asserted directly against it. On the surface, a $150 million principal tower and $50 million Side A tower appears significant. On the other hand, the legal fees alone associated with seven class action lawsuits and multiple regulatory actions involving 14 separate law firms likely will run into the tens of millions of dollars if not more.

The *SVB* decision provides some key lessons for all companies and their insurance professionals.

First, it is essential for companies to maintain a robust D&O insurance program. That program

should include policy limits sufficient to cover an *SVB*-type situation – that is, multiple claims asserted against multiple individual directors and officers and additional claims asserted against the company. Appropriate limits will lessen the prospect of multiple insureds competing for policy proceeds with the company and amongst themselves. This will, in turn, allow the individuals and the company to focus their efforts jointly on defending the claims at hand.

Second, it is essential for a company to have a clear and unambiguous priority of payments clause so that the company and its individual directors and officers understand how the company's insurance program will pay out on significant claims. That understanding will permit the company and the individual officers and directors to develop a well-developed risk management program which meets the needs of the company and its directors and officers and avoid the type of multi-party disputes at issue in *SVB*.

Third, bankruptcy counsel, whether representing the debtor, the committee, or individual directors and officers, must be cognizant of the debtor's D&O program and the key provisions addressing how policy proceeds will be distributed among the various insureds. It would be prudent for such counsel to consult with and engage insurance coverage specialists to assist with the insurance-related issues in the bankruptcy context. Even before a filing, when a company is in distress, it should have experienced insurance and bankruptcy counsel review its insurance program.

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