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Recommended Citation
Elizabeth H. Winchester, Expanding the Bankruptcy Code: The Use of Section 362 and Section 105 to Protect Solvent Executives of Debtor Corporations, 58 Brook. L. Rev. 929 (1992).
Available at: http://brooklynworks.brooklaw.edu/blr/vol58/iss3/7

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NOTES

EXPANDING THE BANKRUPTCY CODE: THE USE OF SECTION 362 AND SECTION 105 TO PROTECT SOLVENT EXECUTIVES OF DEBTOR CORPORATIONS

The fact that a proceeding is equitable does not give the judge a free-floating discretion to redistribute rights in accordance with his personal views of justice and fairness, however enlightened those views may be.¹

INTRODUCTION

Every bankruptcy petition filed by or against a debtor triggers the automatic stay.² The automatic stay is a prophylactic

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¹ In re Chicago, Milwaukee, St. Paul & Pac. R.R., 791 F.2d 524, 528 (7th Cir. 1986) (Posner, J.). Judge Posner went on to describe the purpose behind equitable proceedings in bankruptcy:

The function of equitable considerations in a bankruptcy proceeding is to guide the division of a pie that is too small to allow each creditor to get the slice for which he originally contracted. . . . Hence, if the bankrupt is solvent the task for the bankruptcy court is simply to enforce creditors' rights according to the tenor of the contracts that created those rights . . . .

Id. This Note will address circumstances where a solvent, individually liable third party obtains bankruptcy protection under 11 U.S.C. section 362 and 11 U.S.C. section 105. As a result of this protection, creditors are precluded from seeking to recover against joint tortfeasors. This result is even more contrary to the equitable function of the bankruptcy courts envisioned by Judge Posner.

² The filing of a voluntary as well as an involuntary petition operates as a stay against the actions described in section 362(a). The automatic stay is codified at 11 U.S.C. section 362 and is considered "one of the fundamental debtor protections provided by the bankruptcy laws." H.R. REP. No. 955, 95th Cong., 1st Sess. 340 (1977); S. REP. No. 989, 95th Cong., 2d Sess. 49, reprinted in 1978 U.S.C.C.A.N. 5787, 5963, 6298-97. Section 362(a) provides:

(a) Except as provided in subsection (b) of this section, a petition filed under section 301, 302, or 303 of this title . . . operates as a stay, applicable to all entities, of—

(1) the commencement or continuation, including the issuance or em-
device that stops a broad range of proceedings against the debtor immediately upon the bankruptcy filing. The stay protects the debtor during the duration of the bankruptcy proceeding by enjoining creditors and other parties from, among other things, seeking payment from the debtor for claims that arose before the commencement of the case. Additional injunctive re-

ployment of process, of a judicial, administrative, or other action or proceeding against the debtor that was or could have been commenced before the commencement of the case under this title, or to recover a claim against the debtor that arose before the commencement of the case under this title;

(2) the enforcement, against the debtor or against property of the estate, of a judgment obtained before the commencement of the case under this title;

(3) any act to obtain possession of property of the estate or of property from the estate or to exercise control over property of the estate;

(4) any act to create, perfect, or enforce any lien against property of the estate;

(5) any act to create, perfect, or enforce against property of the debtor any lien to the extent that such lien secures a claim that arose before the commencement of the case under this title;

(6) any act to collect, assess, or recover a claim against the debtor that arose before the commencement of the case under this title;

(7) the setoff of any debt owing to the debtor that arose before the commencement of the case under this title against any claim against the debtor; and

(8) the commencement or continuation of a proceeding before the United States Tax Court concerning the debtor.


a The automatic stay goes into effect without any notice to creditors. The policy behind this dramatic restraint without notice to the affected creditors or parties in interest is to promote orderly administration of the estate. A voluntary or involuntary petition is a non-public event. No one knows of the petition save the clerk of the bankruptcy court and the debtor. The bankruptcy court must have an opportunity to sort matters out and begin an orderly administration of the estate without interference by anxious creditors . . . . It is clear that the automatic stay is imposed upon the filing of the petition with no notice given directly or indirectly to the affected parties in interest. Richard I. Aaron, Bankruptcy Law Fundamentals § 5.01(1) (1992).

b The automatic stay bars any action against the debtor and property of the estate on a claim that arose before the filing of the bankruptcy petition. The Code broadly defines the term “claim” and thus very few causes of action may proceed against the debtor. The Code defines claim as:

(A) right to payment, whether or not such right is reduced to judgment, liquidated, unliquidated, fixed, contingent, matured, unmatured, disputed, undisputed, legal, equitable, secured, or unsecured; or

(B) right to an equitable remedy for breach of performance if such breach gives rise to right to payment, whether or not such right to an equitable remedy is reduced to judgment, fixed, contingent, matured, unmatured, disputed, undis-
BANKRUPTCY PROTECTION & SOLVENT PARTIES

lief is also available to the debtor under section 105 of the Bankruptcy Code ("Code"). Section 105 grants the bankruptcy court discretionary power to enjoin conduct that would adversely affect the debtor, but which is not prevented by the automatic stay.

A situation occurring with increasing frequency—and the focus of this Note—is the use of section 105 and the automatic stay to enjoin suits against solvent third parties who may, as a result of the suit, have an indemnification claim against the debtor that may diminish the estate and consequently, the recovery of other creditors. This Note addresses whether these

5. Section 105(a) provides:
The court may issue any order, process, or judgment that is necessary or appropriate to carry out the provisions of this title. No provision of this title providing for the raising of an issue by a party in interest shall be construed to preclude the court from, sua sponte, taking any action or making any determination necessary or appropriate to enforce or implement court orders or rules, or to prevent an abuse of process.


7. For the purposes of this Note, a solvent third party will include: an officer, director, majority shareholder or partner of an insolvent company or partnership. This Note will not address the issue of protection for guarantors and co-debtors. For a comprehensive discussion of co-debtor stay principles and their application, see Barry L. Zaretsky, Co-Debtor Stays in Chapter 11 Bankruptcy, 73 CORNELL L. REV. 213 (1988).

8. This situation primarily arises when a creditor brings an action against the executives of a debtor corporation. Since the debtor would have to pay any judgment recovered against the executive under an indemnification agreement, a suit against the solvent third party would in effect be a suit against the debtor. As a result, the stay would foreclose suits against the solvent third party. A right to indemnification can arise by statute of the state of incorporation or by contract with the debtor corporation. See Robert L. Jennings & Kenneth A. Horby, Indemnification of Corporate Officers and Directors, 15
third parties are entitled to the derivative protection of the debtor's petition and if so, under what section of the Bankruptcy Code the action should be stayed and after what threshold showing.

The tests developed by courts to gauge the effect of actions against third parties vary widely. The traditional standard, under Federal Rule of Civil Procedure 65 which demands a showing of imminent and irreparable harm to the debtor, is required by some courts before issuing an injunction. A consider-
ably more lenient approach merely requires the debtor to show the existence of an indemnification agreement between itself and the third party to demonstrate potential impact on the reorganization.\footnote{See North Star Contracting Corp. v. McSpedon (In re North Star Contracting Corp.), 125 B.R. 368 (S.D.N.Y. 1991) (existence of indemnification agreement authorized stay protecting debtor's president); Lomas Fin. Corp. v. Northern Trust Co. (In re Lomas Fin. Corp.), No. 89-6602A (Bankr. S.D.N.Y. Jan. 11, 1990). The Lomas court held that:}

Resolution of this issue is critical as the number of bankruptcies involving potential indemnification claims increases.\footnote{In 1991, 87,723 businesses filed for bankruptcy protection, an increase of 100\% since 1981. 1992 \textit{FEDERAL OFFICE OF STATISTICS}, Ann. Rep. 32. Concurrently, the number of officer liability suits has also grown. \textit{See} David W. Ichel \& Sharon O. Thompson, \textit{Directors' and Officers' Insurance Coverage: An Overview and Current Issues}, 334 PLI/Ltr 257 (1987) ("During the past two decades, lawsuits against corporate officers and directors have increased dramatically, reflecting in part the explosion in hostile contests for corporate control, large-scale bankruptcies of major corporations and the growth of the plaintiffs' securities bar."). The increase in corporate officer liability can also be attributed to the landmark corporate governance case of Smith v. Van Gorkum, 488 A.2d 858 (Del. 1985). In that case, the court held nine Trans Union directors personally liable}

\begin{enumerate}
\item irreparable harm if the injunction is not granted;
\item a likelihood that the moving party will prevail on the merits;
\item a balance of equities favor granting the injunction;
\item an injunction would not be adverse to the public interest.
\end{enumerate}

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The lenient standard for extension of the stay has been used by some as a shield for their allegedly fraudulent acts. This Note argues that when the automatic stay is used to protect solvent third parties, the plain meaning and legislative intent of the statute is violated, the protection granted overbroad and the stayed party harmed. First, this Note develops the background and legislative history of sections 362 and 105. Next, it reviews how courts have interpreted third party stays under sections 362 and 105. This Note then argues that section 362 stays should be restricted to the debtor and property of the estate. Finally, that section 105 injunctions should be available only in those cases where the debtor can satisfy a Rule 65 standard. When section 105 injunctive protection is extended without a Rule 65 threshold showing, unwarranted injunctions are issued which grant undeserved immunity from suit and further harm the enjoined party.

I. SECTION 362: LEGISLATIVE HISTORY AND INTENT

Section 362 protects the debtor for the duration of the bankruptcy proceeding, acting like a preliminary injunction, barring any action against the debtor or the estate. The exceptions

for failing to exercise adequate business judgment in approving a merger. The holding in that case resulted in a "'record number' of cases holding directors and officers liable for breaches of their duties of care and loyalty." Pamela H. Bucy, Indemnification of Corporate Executives Who have been Convicted of Crimes: An Assessment and Proposal, 24 IND. L. REV. 279, 329 (1991).

This Note argues that the increase in bankruptcy filings combined with an increase in corporate officer liability suits demands a uniform approach to these suits.


to the stay are limited\textsuperscript{15} so that the estate is protected to the greatest extent possible in order to achieve the primary purpose of debtor even though debtor had already transferred property, holding that, rather than seeking damages for fraud, the creditors' action was in reality seeking to enforce a judgment against the estate); Cement Antitrust Litig. v. Penn-Dixie Indus., Inc. (\textit{In re Penn-Dixie Indus., Inc.}), 6 B.R. 832 (Bankr. S.D.N.Y. 1980) (court denied creditor relief from the stay in order to seek discovery from debtor, holding that compliance with the request would violate the purpose behind the automatic stay).

\textsuperscript{15} The exceptions to the conduct barred by 11 U.S.C. section 362(a) are contained in section 362(b) which provides in part:

The filing of a petition \ldots does not operate as a stay—

(1) under subsection (a) of this section, of the commencement or continuation of a criminal action or proceeding against the debtor;

(2) under subsection (a) of this section, of the collection of alimony, maintenance, or support from property that is not property of the estate;

(3) under subsection (a) of this section, of any act to perfect an interest in property to the extent that the trustee's rights and powers are subject to such perfection under section 546(b) of this title or to the extent that such act is accomplished within the period provided under section 547(e)(2)(A) of this title;

(4) under subsection (a)(1) of this section, of the commencement or continuation of an action or proceeding by a governmental unit to enforce such governmental unit's police or regulatory power;

(5) under subsection (a)(2) of this section, of the enforcement of a judgment, other than a money judgment, obtained in an action or proceeding by a governmental unit to enforce such governmental unit's police or regulatory power;

(6) under subsection (a) of this section, of the setoff by a commodity broker, forward contract merchant, stockbroker, financial institutions, or securities clearing agency of any mutual debt and claim under or in connection with commodity contracts, as defined in section 761(4) of this title, forward contracts, or securities contracts, defined in section 741(7) of this title, that constitutes the setoff of a claim against the debtor for a margin payment, as defined in section 101(34), 741(5), or 761(15) of this title, or settlement payment, as defined in section 101(35) or 741(8) of this title, arising out of commodity contracts, forward contracts, or securities contracts against cash, securities, or other property held by or due from such commodity broker, forward contract merchant, stockbroker, financial institutions, or securities clearing agency to margin, guarantee, secure, or settle commodity contracts, forward contracts, or securities contracts.

\textsuperscript{15} 11 U.S.C. § 362(b) (1992). For interpretations of section 362(b) see Corporacion de Servicios Medicos Hospitalarios de Fajardo v. Mora (\textit{In re Corporacion de Servicios Medicos Hospitalarios de Fajardo}), 805 F.2d 440 (1st Cir. 1986) (action by governmental unit to recover on a contractual claim was barred as it did not fall within police powers exception section 362(b)(4)); Freeman v. Commissioner, 789 F.2d 1091 (5th Cir. 1986) (after debtor filed for chapter 11, court of appeals affirmed a lower court tax ruling against the debtor holding that, as the debtor initiated the appeal, which was thus not a "proceeding against the debtor," the stay did not bar affirmation of the judgment); Commonwealth Oil Ref. Co. v. E.P.A. (\textit{In re Commonwealth Oil Ref. Co.}), 805 F.2d 1175 (5th Cir. 1986) (automatic stay does not bar EPA actions requiring compliance with environmental law).
of the bankruptcy code: rehabilitation of the debtor.\textsuperscript{16}

Section 362 of the Bankruptcy Code gives immediate relief, granting the debtor an opportunity to reorganize and implement an orderly administration of the estate.\textsuperscript{17} The stay protects the debtor from any attempt by a creditor to obtain possession or perfect a lien or security interest on estate property.\textsuperscript{18} Barring a grant of relief by the court, the stay lasts until the debtor is discharged from bankruptcy.\textsuperscript{19}

\textsuperscript{16} Rehabilitation of the debtor is the primary purpose of a chapter 11 business reorganization.

\textsuperscript{17} "Section 362 provides for a broad stay of litigation, lien enforcement, and other actions, judicial or otherwise, which would affect or interfere with property of the estate, property of the debtor, or property in the custody of the estate." LAWRENCE P. KING ET AL., 2 COLLIER ON BANKRUPTCY \textsection{362.0, at 362-8 (15th ed. 1988). For the text of 11 U.S.C. section 362(a), see supra note 2.

\textsuperscript{18} See 11 U.S.C. \textsection{362(a). The scope of what constitutes property of the estate has been the focus of numerous cases in recent years. See, e.g., Advanced Ribbons & Office Prods., Inc. v. Interstate Distrib., Inc. (\textit{In re} Advanced Ribbons & Office Prods., Inc.), 125 B.R. 259 (Bankr. 9th Cir. 1991) (shares of corporate debtor not deemed to be property of estate and therefore post-petition sale of 100\% of debtor's stock was upheld); Crysen/Montenay Energy Co. v. Esselen Assocs., Inc. (\textit{In re} Crysen/Montenay Energy Co.), 902 F.2d 1098 (2d Cir. 1990) (prepetition tort action held to belong to estate, not to agent/debtor and not to principal/seller); \textit{In re} S.I. Acquisition, 817 F.2d 1142 (5th Cir. 1987) (alter ego cause of action is property of the estate); \textit{In re} Hooker Int'l, Inc., 116 B.R. 375 (Bankr. S.D.N.Y. 1990) (prepetition tort claim could not be commenced by co-assignee, cause of action deemed property of the estate); \textit{In re} Cardinal Indus., Inc., 109 B.R. 748 (Bankr. S.D. Ohio 1989) (stay prohibited lender from foreclosing on property held by limited partnership where general partner was debtor); Official Comm. of Unsecured Creditors v. PSS Steamship Co. (\textit{In re} Prudential Lines, Inc.), 114 B.R. 27 (Bankr. S.D.N.Y. 1989) (court stayed sole shareholder of debtor from taking post confirmation worthless stock deduction prior to confirmation of a plan), \textit{aff'd}, 928 F.2d 565 (2d Cir. 1991).

\textsuperscript{19} The automatic stay expires when any of the following occur: (1) when the case is closed; (2) when the case is dismissed; or (3) if a discharge is granted or denied under a chapter of title 11. 11 U.S.C. \textsection{362(c)(2) (1983). A discharge operates to relieve the debtor from any future actions that seek restitution on claims that could have been brought before the commencement of the case. See 11 U.S.C. \textsection{524 (1983). As a result,
Although the benefits of the stay seem to weigh heavily in favor of the debtor, the stay also protects the majority of creditors from the few that would otherwise be able to secure payment at the majority's expense.\(^2\) Absent section 362, creditors would be forced to rush to court to file actions and obtain judgments against the debtor.\(^2\) Thus, the section 362 stay ensures that bankruptcy will be an orderly proceeding where all creditors are treated equally.\(^2\)

While the general purpose of the stay—to provide immediate and broad injunctive relief to the debtor and the estate—is largely accepted, the scope of the automatic stay is controversial because it goes into effect immediately without any notice to creditors and often at the eleventh hour of the debtor's financial problems. As a result, the stay has been labeled the "flashpoint" of the bankruptcy proceeding.\(^2\) Protection afforded by the stay when the stay expires at discharge, the discharge works to enjoin permanently any recovery by the creditor for a prepetition claim against the debtor. What remains unclear is whether staying actions against third parties for the duration of the bankruptcy proceeding has the effect of permanently enjoining the action. This result occurs when a creditor who has a potential claim against a solvent executive is enjoined from pursuing the action during the reorganization since the debtor is a joint tortfeasor with the executive. When a stay expires upon the confirmation of a plan, the resulting discharge does not affect the rights or obligations of solvent third parties. But see In re A.H. Robins Co., 131 B.R. 292 (E.D. Va. 1991) (debtor's plan provided for a permanent injunction barring any future medical malpractice claims against doctors relating to injuries suffered as a result of the Dalkon Shield).

If the automatic stay did not exist to protect the debtor in a bankruptcy proceeding, the first creditor to obtain and docket a judgment against the debtor's assets would be able to recover the full amount of its claim at the expense of other creditors. The stay also gives the debtor a chance to reorganize, pay off the claims over an extended period of time and potentially pay a higher percentage of the claims than it would in a liquidation. A successful reorganization also preserves jobs and capital. See COLLIER ON BANKRUPTCY, supra note 17, ¶ 362.01 at 362-8.

The race to the courthouse occurs because, under most state laws, creditors are paid according to the time they docket their judgments against the debtor. See e.g., N.Y. CIV. PRACT. L. & R. 5201 (McKinney 1991).

One scholar describes the breadth of the stay as also enticing debtors to invoke bankruptcy as a last effort to stave off creditors. Lawyers know of too many instances where the debtor seeks counsel at the eleventh hour. The foreclosure sale may be scheduled for the following morning when the debtor first seeks help. The bankruptcy court clerk is accustomed to receiving hastily and hand drawn bankruptcy petitions the clear objective of which is to stay some action by creditors scheduled a few hours hence. Understandably, then, the automatic stay is the first flashpoint in any bankruptcy case. The creditor has gone through a long and expensive process...
will even impinge on state law foreclosure rights of creditors that have already commenced such proceedings.\textsuperscript{24}

The legislative intent behind section 362 is briefly stated. The language of section 362 refers only to the debtor and not to co-debtors or third parties.\textsuperscript{25} Congress described section 362 as one of the fundamental debtor protections provided by the bankruptcy laws. It gives the debtor a breathing spell from his creditors. It stops all collection efforts, all harassment, and all foreclosure actions. It permits the debtor to attempt a repayment or reorganization plan, or simply to be relieved of the financial pressures that drove him into bankruptcy.\textsuperscript{26}

The stay explicitly protects the debtor, as the plain-meaning interpretation suggests, and implicitly protects the creditor, as the legislative history suggests.\textsuperscript{27} What remains unclear is whether the stay was intended to protect the interests of solvent third parties.\textsuperscript{28}

II. SECTION 105: LEGISLATIVE HISTORY AND INTENT

The automatic stay applies to all actions against the debtor and property of the estate. However, it does not necessarily

\footnotesize{\textsuperscript{24} See In re Madison Hotel Assocs., 749 F.2d 410 (7th Cir. 1984) (creditor obtained judgment of foreclosure under Wisconsin law before debtor filed chapter 11 petition, yet foreclosure proceeding was automatically stayed upon filing of petition).}

\footnotesize{\textsuperscript{25} For the text of section 362(a), see supra note 2.}


\footnotesize{\textsuperscript{27} The stay protects creditors by preventing an erosion of estate assets by other creditors enforcing judgments. The legislative history states: The automatic stay also provides creditor protection. Without it, certain creditors would be able to pursue their own remedies against the debtor's property. Those who acted first would obtain payment of the claims in preference to and to the detriment of other creditors. Bankruptcy is designed to provide an orderly liquidation procedure under which all creditors are treated equally. H.R. Rep. No. 595, 95th Cong., 1st Sess. 340 (1977), reprinted in 1978 U.S.C.C.A.N. 593, 6297; S. Rep. No. 989, 95th Cong., 2d Sess. 49, reprinted in 1978 U.S.C.C.A.N. 5787, 5835.}

\footnotesize{\textsuperscript{28} Some courts are reluctant to extend stay protection to solvent third parties. See, e.g., Nofziger Communications, Inc. v. Birks, 767 F. Supp. 80 (D.D.C. 1991) (court denied a motion made by nonbankrupt co-assignees to consolidate an action with a similar one brought against debtor co-assignees, holding that consolidation was inappropriate on the theory that consolidation would entitle nonbankrupt assignees to automatic stay protection).}
cover all situations that are detrimental to the debtor's rehabilitation.\textsuperscript{29} In anticipation, Congress enacted section 105 which enabled courts to enjoin actions not covered by the automatic stay.\textsuperscript{30} Section 105 grants authority to the bankruptcy court to "issue any order, process or judgment that is necessary to carry out the provisions of this title."\textsuperscript{31} It differs significantly from a

\textsuperscript{29} There are a number of potential situations not covered by the automatic stay that can have a detrimental impact on the reorganization of the debtor. One example is a suit by a creditor to recover on a guaranty. See, e.g., Otoe County Nat'l Bank v. W & P Trucking, Inc., 754 F.2d 881 (10th Cir. 1985) (automatic stay was not extended to include guarantor of debtor); GATX Aircraft Corp. v. M/V Courtney Leigh, 763 F.2d 711 (5th Cir. 1985) (court denied stay to co-guarantors of insolvent guarantors, holding automatic stay only protects the debtor); Bill Roderick Distrib., Inc. v. A.J. Mackay Co. (In re A.J. Mackay Co.), 50 B.R. 756 (D. Utah 1985) (since principal of debtor did not file for bankruptcy protection, court lacked jurisdiction over him and could not extend stay protection to him); Flessey Precision Metals Inc. v. Metal Ctr., Inc. (In re Metal Ctr., Inc.), 31 B.R. 458 (Bankr. D. Conn. 1983) (automatic stay protection denied to guarantor because debtor would not be bound by any judgment recovered on the guaranty).

Potential damage to the reorganization arises when the guarantor volunteers to aid the reorganization if given protection from actions to recover on the guarantee. If protection is denied, the reorganization is in jeopardy. See Gathering Restaurant, Inc. v. First Nat'l Bank of Valparaiso (In re Gathering Restaurant, Inc.), 79 B.R. 992 (Bankr. N.D. Ind. 1986) (granting limited injunction to protect guarantor because funding from guarantor was only means to reorganize debtor).

Another example of an action that threatens the reorganization but is not prevented by the automatic stay is the enforcement of liens against nonestate property which is required for a successful reorganization. See In re Monroe Well Serv., Inc., 67 B.R. 746 (Bankr. E.D. Pa. 1986) (action was not prevented by the automatic stay, but section 105 authorized an injunction where failure to enjoin action would result in irreparable harm to the debtor).

\textsuperscript{30} \textsc{2 Collier on Bankruptcy, supra} note 17, ¶ 105.02, at 105-5 ("[T]he actions and conduct against non-debtor parties which are not protected by the automatic stay may be subject to specific injunctive relief under section 105(a).").

\textsuperscript{31} \textsc{11 U.S.C. section 105(a).} For the full text of section 105(a), see \textsc{supra} note 5. The pertinent legislative history of section 105 was tersely stated in committee at the passing of section 362: "[T]he court has ample other powers to stay actions not covered by the automatic stay. Section 105, of proposed title 11, derived from Bankruptcy Act section 2a(15), grants the power to issue orders necessary or appropriate to carry out the provisions of title 11." H.R. Rep. No. 595, 95th Cong., 1st Sess. 342, \textit{reprinted in} 1978 U.S.C.C.A.N. at 5963, 6298. Section 105 can be used to fill in gaps in section 362 but "does not authorize the bankruptcy court to create rights not otherwise available under applicable law." Southern Ry. v. Johnson Bronze Co., 758 F.2d 137, 141 (3d Cir. 1985). \textit{See also In re Johns-Manville Corp.,} 40 B.R. 219 (Bankr. S.D.N.Y. 1984) (court enjoined discovery of debtor by codefendants who were unable to stay litigation, utilizing the broad injunctive power of the bankruptcy court under section 105); Zenith Lab., Inc. v. Sinay (In re Zenith Lab., Inc.), 104 B.R. 659 (D.N.J. 1989) (in a shareholder action against corporate directors and officers, court held that policy purchased to indemnify officers was not property of the estate and therefore suit did not fall within the purview of section 362; however, the action was enjoined under section 105 as a threat to a suc-
section 362 stay in that a section 105 injunction does not arise automatically upon the filing of a bankruptcy petition. Section 105 empowers a bankruptcy court to enjoin conduct that may adversely affect the reorganization of the debtor but which is not prevented by the automatic stay.\textsuperscript{32} The focus of this Note is what the proper showing of harm should be before a court can enjoin a creditor from proceeding against an officer of a debtor company. Harm to the estate may arise, for example, if the officer has an indemnification agreement with the debtor. The new burden on the estate is that of reimbursing the officer for litigation costs and any potential judgment arising out of the litigation. This type of suit may be enjoined by section 105 since, in certain circumstances, the risk of indemnification would place a new burden on the estate and might adversely affect the reorganization.\textsuperscript{33}

\textsuperscript{32} See \textsc{Collier on Bankruptcy}, \textit{supra} note 17, ¶ 105.02, at 105-5. Section 105 is similar to the All Writs Statute, 28 U.S.C. § 1651, which empowers the federal courts to “issue all writs necessary or appropriate in aid of their respective jurisdictions and agreeable to the usages and principles of law.” \textit{Id.} The All Writs Statute was made applicable to bankruptcy courts under section 213 of the Bankruptcy Reform Act of 1978. Section 213 was repealed by the 1984 Amendments to the Bankruptcy Code. Pub. L. No. 98-353, 98 Stat. 333 (1984). This effectively left section 105 as the sole statutory basis for the exercise of All Writs power.

\textsuperscript{33} The new burden on the estate is the indemnification claims arising as a result of the action against the third party. The court in \textit{A.H. Robins Co. v. Piccinin (In re A.H. Robins Co.)}, 788 F.2d 994 (4th Cir. 1986), enjoined actions against officers of the debtor, stating:

\begin{quote}
[In great measure the suits being pursued against [Robins'] officers and employees are in reality derivative of identical claims brought against [Robins], which if sustained against the officers and employees would expose the estate "to claims for contribution and indemnification" and might result in collateral estoppel against the debtor "in subsequent actions." \ldots It [is] \ldots proper to stay these actions and discovery "against [such] non-debtors which would frustrate the statutory scheme or impact adversely on a debtor's ability to formulate a plan or on debtor's property."
\end{quote}


The argument is made that the risk of impact in \textit{Robins} and \textit{Manville} was so vast as to make them the exceptional cases for broad injunctive power. Both \textit{Manville} (asbestos) and \textit{Robins} (Dalkon Shield intrauterine device “I.U.D.”) involved thousands of injured plaintiffs seeking to recover for permanent injuries, pain, suffering and, in many cases, wrongful death. The impact in “normal” bankruptcy proceedings where thousands of actions are not pending against the debtor discounts the breadth of these interpreta-
Section 105 has primarily been used to define the scope of the bankruptcy court's injunctive power. The 1978 expansion of bankruptcy jurisdiction grants bankruptcy courts the power to maintain the integrity of the Code under section 105. With its broadened grant of jurisdiction, the Code permits a court to

\[\text{See All Seasons Resorts, Inc. v. Milner (In re All Seasons Resorts, Inc.), 73 B.R. 901 (Bankr. C.D. Cal. 1987). In assessing the impact of an action against the debtor's codefendants who were officers and agents of the corporation, the All Seasons court stated:}

This is not a case of special circumstances. Although there is a closeness between debtor and codefendants by reason of their officer and agent status and their right to indemnification pursuant to debtor's bylaws, the magnitude of the harm to debtor if no stay is in force does not approach the scope of the potential injuries besetting the debtors in Robins and Johns-Manville.

\[\text{Id. at 904.}

The statutory parent of section 105 was section 2(a)(15) of the Bankruptcy Act of 1898. In 1978 Congress passed the Bankruptcy Reform Act which replaced section 2(a)(15) with section 105. 2 Collier on Bankruptcy supra note 17, ¶ 105.01, at 105-4. Section 105 has primarily been used as a source of injunctive power for the bankruptcy court. Under the tradition standard, a court issued a section 105 injunction only when the movant met the stiff requirements outlined in Rule 65 of the Federal Rules of Civil Procedure. See Glassman v. Electronic Theatre Restaurants Corp. (In re Electronic Theatre Restaurants Corp.), 53 B.R. 458 (N.D. Ohio 1985) (district court reversed a section 105 injunction because the bankruptcy court failed to establish risk of irreparable harm); Codfish Corp. v. FDIC (In re Codfish Corp.), 97 B.R. 132, 135 (Bankr. D.P.R. 1988) (court granted section 105 injunction to protect debtor's president only after strict Rule 65 standard was met plus movant must establish clear and convincing evidence warranting an injunction); In re Trails End Lodge, Inc., 45 B.R. 597, 601 (Bankr. D. Vt. 1984) (court denied section 105 protection to officer and shareholder guarantors of debtor, citing failure to meet standard for a preliminary injunction); Venture Prop., Inc. v. Norwood Group, Inc. (In re Venture Prop., Inc.), 37 B.R. 175 (Bankr. D.N.H. 1984) (court denied section 105 injunction to prevent sale of real property owned by partnership of which debtor was general partner due to lack of irreparable injury to debtor).

The broadening of bankruptcy courts' equitable power derives primarily from the 1977 changes to the jurisdictional provisions of the Bankruptcy Code. The 1938 bankruptcy act, which substantially revised the Bankruptcy Act of 1898, confined the jurisdiction of courts to “the debtor and his property, wherever located.” Act of June 22, 1938, ch. 575, § 1, 52 Stat. 906 (1938). The Bankruptcy Act of 1893 was repealed by the Bankruptcy Code of 1978. The revision of bankruptcy jurisdiction expanded the jurisdiction of the court to include “all civil proceedings arising under title 11 or arising in or related to cases under title 11.” 28 U.S.C. § 1334(b); H.R. Rep. No. 555, 95th Cong., 1st Sess. 445 (1977), reprinted in 1978 U.S.C.C.A.N. 5963, 6400. The 1994 changes to the Bankruptcy Code followed the Supreme Court decision in Northern Pipeline Constr. Co. v. Marathon Pipe Line Co., 458 U.S. 50 (1982). In Marathon the Supreme Court overruled 28 U.S.C. section 1471(b) which granted bankruptcy courts jurisdiction over “all civil proceedings arising under title 11 or arising in or related to cases under title 11.” Id. at 54. This Note does not address the jurisdictional issues raised by the Supreme Court in Marathon and the resulting changes passed by Congress.

For a comparison of section 105 to the All Writs Act, see supra note 32.
extend protection to third parties when the integrity of the estate is at risk. The text of section 105, however, does not provide a standard to determine what conduct threatens the integrity of the estate. The legislative history of the Code and the Code itself, however, do provide significant insight into the standard required for section 105 relief.

When Congress enacted section 362, it took the opportunity to describe the operation of section 105, stating that injunctions which are not automatic could "be granted or issued under the usual rules for the issuance of injunctions." Congress apparently intended a different standard for injunctive relief under section 105 than under section 362. The only clear requirement for a section 362 stay is to file for bankruptcy; section 105 relief, on the other hand, requires a showing under "the usual rules for the issuance of an injunction." The "usual rules" for granting injunctive relief in general civil litigation are provided in the Federal Rules of Civil Procedure. A number of the Federal Rules of Civil Procedure have been incorporated into the Bankruptcy Procedural Rules. Rule

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37 Describing the power of section 105, COLLIERS states:
Section 105 is much broader [than its predecessor], and constitutes a major departure from that law in that it is in no way circumscribed by possession or custody of a res. Unlike the restriction under prior law that an order of a bankruptcy court must be "necessary for the enforcement of the provisions of this title," section 105 authorizes the bankruptcy court to also issue orders "appropriate to carry out the provisions of this title." This change evidences Congress' intent that bankruptcy courts would, under the Bankruptcy Code, deal with all phases and aspects of a bankruptcy case.

2 COLLIERS ON BANKRUPTCY, supra note 17, ¶ 105.01 at 105-3-4.

38 For the text of Section 105, see supra note 5.


40 The only clear means to obtain section 362 stay relief is to file for bankruptcy. The court in Minoco Group of Co.'s Ltd. v. First State Underwriters Agency of New England Reinsurance Corp. (In re Minoco Group of Co.'s Ltd.), 799 F.2d 517 (9th Cir. 1986), held that the automatic stay is effective upon filing whether or not the debtor would suffer irreparable harm in absence of the stay. Id. at 520. Thus, no standard of harm is required for section 362 injunctive relief. Rather, a bankruptcy petition merely has to be filed. By contrast, a section 105 injunction is not automatic upon filing. Congress apparently intended that section 105 injunctive protection be warranted by a Rule 65 threshold standard.

7065 of Bankruptcy Procedure makes Federal Rule 65 applicable to bankruptcy courts governing the issuance of injunctions. In fact, Rule 7065 is a verbatim repetition of Federal Rule 65.\textsuperscript{42} Thus, when Congress enacted the Bankruptcy Code in 1978, it apparently intended Rule 7065 to be interpreted in the same fashion as Federal Rule 65. Consequently, many courts require the movant to demonstrate under a Rule 65 standard that: the suit would harm the reorganization irreparably; the harm to the creditor is minimal; and that the balance of equities tips in favor of the debtor; an injunction would not be contrary to public policy.\textsuperscript{48} Nonetheless, section 105 has been interpreted by some courts as a broad grant of injunctive power with no corresponding Rule 65 limitation.\textsuperscript{44}

III. JUDICIAL INTERPRETATION: THIRD PARTY STAYS IN BANKRUPTCY

The Code does not explicitly answer whether section 362 applies to solvent third parties and how section 105 applies to solvent third parties. In \textit{In re Otero Mills},\textsuperscript{46} the seminal case interpreting the extension of sections 362 and 105 to solvent third parties, the court held that section 105 protection could extend to a debtor corporation’s president after a showing of ir-

\textsuperscript{42} Rule 7065 of the Bankruptcy Procedure Rules provides: “Rule 65 F.R.Civ.P. applies in adversary proceedings, except that a temporary restraining order or preliminary injunction may be issued on application of a debtor, trustee, or debtor in possession without compliance with Rule 65(c).” Fed. R. BANKR. P. 7065 (1992). Rule 65(c) requires that the movant post security for compensation of a party that may be wrongfully enjoined.

\textsuperscript{44} For cases that require a Rule 65 showing before the issuance of a section 105 injunction see supra note 34.

\textsuperscript{46} See \textit{In re Davis}, 730 F.2d 176 (5th Cir. 1984) (the court stayed actions related to a \textit{Manville} proceeding by holding that section 105 authorized enjoining litigants from pursuing actions that threaten the integrity of a bankrupt’s estate without meeting a rule 65 standard); \textit{Erti v. Paine Webber (In re Baldwin-United Corp.)}, 765 F.2d 343 (2d Cir. 1985) (court may use section 105 to insure the orderly conduct of reorganization proceedings); \textit{Circle K Corp. v. Marks (In re Circle K Corp.)}, 121 B.R. 257 (Bankr. D. Ariz. 1990) (to issue a section 105 injunction, court must find that balance of hardship tips in favor of debtor); \textit{Lomas Fin. v. Northern Trust Co. (In re Lomas Fin.)}, No. 89-6602A (Bankr. S.D.N.Y. Jan. 11, 1990) (section 105 stay can issue when court perceives an impairment of its jurisdiction); \textit{LTV Steel Co., Inc. v. Board of Educ. of Cleveland (In re Chateauagay Corp.)}, 93 B.R. 26 (S.D.N.Y. 1988) (under section 105, the usual grounds for injunctions such as irreparable harm need not be shown).

\textsuperscript{45} 21 B.R. 777 (Bankr. D. N.M. 1982).
reparable harm to the reorganization.46 However, the court refused to extend this protection under section 362, arguing that the automatic stay did not extend beyond the debtor and property of the estate.47

Since Otero Mills, courts have created a broad spectrum of standards to determine whether bankruptcy protection should extend to solvent third parties.48 At one end of the spectrum, some courts broadly interpret sections 362 and 105 and, as a result, stay many third party actions.49 The justification proffered for this interpretation is to protect the estate and facilitate the rehabilitation of the debtor.50 At the other end of the spectrum, section 362 is interpreted narrowly, leaving section 105 as the only protection available to solvent third parties.51 Courts

46 Id. at 778.
47 Id. at 779.
48 Compare Ripley v. Mulroy, 80 B.R. 17 (E.D.N.Y. 1987) (stay did not extend to president of debtor corporation, allowing action brought by purchaser of promissory notes alleging fraud), with Lomas Fin. Corp. v. Northern Trust Co. (In re Lomas Fin. Corp.), 117 B.R. 64 (S.D.N.Y. 1990) (stay did extend to officers of debtor corporation, enjoining action brought by bank alleging fraud); Cf. Codfish Corp. v. FDIC (In re Codfish Corp.), 97 B.R. 132 (Bankr. D. P.R. 1988) (section 105 injunction can issue upon a showing of clear and convincing evidence that estate would be affected substantially and adversely by continued action), with LTV Steel Co., Inc. v. Board of Educ. of Cleveland (In re Chateaugay Corp.), 93 B.R. 26 (S.D.N.Y. 1988) (a section 105 injunction can issue when the court is satisfied that the proceeding would impair its jurisdiction, irreparable harm need not be shown).
49 See e.g., A.H. Robins v. Piccinin (In re A.H. Robins), 788 F.2d 994 (4th Cir. 1986) (sections 105 and 362 prevent actions against third parties when there is such an identity between the third party and the debtor that the debtor can be said to be the real party in interest); North Star Contracting Corp. v. McSpedon (In re North Star Contracting Corp.), 125 B.R. 368 (S.D.N.Y. 1991) (action against president of company violated automatic stay, even though president was not a debtor, because it would seriously affect both reorganization efforts and assets of debtor); Lesser v. A-Z Assoc. (In re Lion Capital Group), 44 B.R. 690 (Bankr. S.D.N.Y. 1984) (stayed defendants from proceeding with their district court actions to avoid injury to the estate); Lomas Fin. Corp. v. Northern Trust Co. (In re Lomas Fin. Corp.), 117 B.R. 64, 66 (S.D.N.Y. 1990) (affirming a bankruptcy court order extending protection to solvent executives of the debtor under both section 362 and section 105).
50 See Eastern Air Lines, Inc. v. Airline Pilots Ass'n Int'l (In re Ionosphere Clubs, Inc.), 105 B.R. 773, 777 (Bankr. S.D.N.Y. 1989) ("The purpose of the protection provided by Chapter 11 is to give the debtor a breathing spell, an opportunity to rehabilitate its business and to enable the debtor to generate revenue.").
51 The following courts have held that section 362 applies to the debtor and property of the estate and not to solvent third parties. Consequently, the only statutory alternative for protecting solvent third parties is section 105. See Teachers Ins. & Annuity Ass'n of America v. Butler, 803 F.2d 61 (2d Cir. 1986); CAE Indus. Ltd. v. Aerospace Holdings Co., 116 B.R. 51 (S.D.N.Y. 1990); In re Crazy Eddie Securities Litig., 104 B.R.
adoption this approach generally limit the scope of section 362 to actions against the debtor and property of the estate, issuing third party stays under section 105 only after a traditional Rule 65 standard is met.\textsuperscript{52}

A. \textit{The Broad Approach: Section 362}

The scope of section 362 was transformed with the Fourth Circuit's opinion in \textit{A.H. Robins v. Piccinin}\textsuperscript{53} and the birth of the "unusual circumstances" test. A.H. Robins filed for bankruptcy protection in response to the "avalanche of actions" filed against it as a result of injuries sustained through the use of Dalkon Shield I.U.D.s.\textsuperscript{54} The issue presented was whether the automatic stay applied to A.H. Robins's solvent codefendants.\textsuperscript{55}

\footnotesize
\begin{itemize}
  \item 52 See \textit{Codfish}, 97 B.R. at 135-36. The \textit{Codfish} court enjoined an action against the president of the debtor under section 105 after a Rule 65 showing had been met and clear and convincing evidence had been presented that continuation of the action would substantially and adversely harm the debtor. Section 362 was held to apply only to the debtor and not to solvent co-parties. See also \textit{Zenith Lab., Inc. v. Sinay (In re Zenith Labs.),} 104 B.R. 659, 662 (D.N.J. 1989). Respondents in this case had filed actions against solvent officers of the debtor alleging securities laws violations. The bankruptcy court stayed the actions against the officers under section 362 and stayed discovery requests from the debtor under section 105.
  \item 53 788 F.2d 994 (4th Cir. 1986).
  \item 55 Certain injured plaintiffs had named defendants other than A.H. Robins in their products liability suit and, after A.H. Robins's bankruptcy filing, sought to sever A.H. Robins and proceed against the other defendants. The remaining codefendants were: (1) Aetna, as the holder of A.H. Robins's liability coverage; (2) corporate officers of A.H. Robins; (3) A.H. Robins' directors; (4) A.H. Robins' shareholders; (5) A.H. Robins' employees; and (6) A.H. Robins' agents.
\end{itemize}
In extending the stay, the court reasoned that in “unusual circumstances” injunctive relief should be available to nonbankrupt codefendants.\(^5\) “Unusual circumstances” exist when a judgment against a solvent party would in fact be a finding against the debtor.\(^6\) Since A.H. Robins was required to indemnify certain codefendants, allowing litigation to proceed against those codefendants would have the ultimate effect of further taxing the debtor’s estate and potentially jeopardizing the reorganization.\(^7\) The court’s justification for protecting these codefendants was the fact that they were derivatively liable with A.H. Robins on the plaintiffs’ claim and they were only being sued by virtue of their positions as officers and employees of Robins, and not due to any individual liability. Since these codefendants could not be found individually liable to the plaintiffs, any judgment against them would essentially be a judgment against Robins by virtue of the indemnification agreements.\(^8\)

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Robins; and (3) the inventors of the Dalkon Shield, Dr. Hugh J. Davis and Dr. Frederick A. Clark. Robins, 788 F.2d at 1007.

\(^6\) Id. at 999. The court quoted Royal Trucks & Trailer, Inc. v. Armadora Meritina Salvadorena, S.A., 10 B.R. 488 (N.D. Ill. 1981) (“[S]omething more than the mere fact that one of the parties to the lawsuit has filed a Chapter 11 bankruptcy petition must be shown in order that proceedings be stayed against nonbankrupt parties."). At first glance, the “something more” in Robins appeared to be the risk of indemnification claims to the estate. However, the court held that the codefendants should be protected because they were not individually but rather derivatively liable with Robins on the plaintiffs’ claim. Robins, 788 F.2d at 999 citing In re Metal Center, 31 B.R. 458 (D. Conn. 1983).

\(^7\) Robins, 788 F.2d at 999. The court held that when there is “such [an] identity between the debtor and the third-party defendant that the debtor may be said to be the real party defendant and that a judgment against the third-party will in effect be a judgment or finding against the debtor,” section 362 can be used to stay actions against the third party. Id.

\(^8\) Id. at 1007-08.

\(^9\) The Robins court protected the derivatively liable third parties because no dispute existed as to whether they would be entitled to indemnification by Robins, thereby diminishing the estate.

That there are thousands of Dalkon Shield actions and claims pending is a fact established in the record and the limited fund available under Robins’s insurance policy is recognized in the record. It seems incontestable that, if the suits are permitted to continue and discovery allowed, any effort at reorganization of the debtor will be frustrated, if not permanently thwarted. It is obvious from the record that if suits are permitted to proceed against indemnitees on the claims on which the indemnitees are entitled to indemnity by Robins, either a binding judgment against the debtor will result or, as the court in Metal Center said, inconsistent judgments will result, calling for the exercise of the court’s equitable powers.
Consequently, the Robins court stayed the litigation against these solvent codefendants under section 362.\textsuperscript{60}

Following the spirit of Robins, courts that chose to construe section 362 broadly looked only for the presence of an indemnification agreement to measure whether third party litigation would result in any impact on the debtor.\textsuperscript{61} Lomas Financial v. Northern Trust\textsuperscript{62} typifies this approach. Lomas involved a motion to enjoin a fraud action commenced by an unsecured creditor against two Lomas executives.\textsuperscript{63} The issue before the court

\textit{Id. at 1008.}

\textsuperscript{60} The Robins court found that the claimants were trying to circumvent the section 362 stay by bringing an action against officers of the debtor and stated that "congressional intent to provide relief to debtors would be frustrated by permitting indirectly what is expressly prohibited in the Code." \textit{Id. at 999.} In staying actions against Aetna as the liability insurer, the court reasoned that A.H. Robins would have to pay directly if the insurance policy limits were exceeded, and held that the insurance policy is property of the estate and therefore protected under section 362(a)(3). \textit{Id. at 1001-02.} Section 362(a)(3) stays "any act to obtain possession of property of the estate or of property from the estate or to exercise control over property of the estate." 11 U.S.C. § 362(a)(3).

In light of the number of product liability suits that had been filed (the court estimated that 5000 injury suits had been filed as of the time of the filing of the bankruptcy petition), the insurance policy was clearly "the most important asset of the debtor's estate." Robins, 788 F.2d at 1001 (citing \textit{In re Johns-Manville Corp.}, 40 B.R. 219, 229 (S.D.N.Y. 1984)). The court further recognized the inequitable result to a majority of the injured plaintiffs if only a few plaintiffs were awarded insurance policy proceeds in preference to other injured plaintiffs. This would occur if plaintiffs were allowed to proceed against the insurance company and collect on the policy on a first come, first serve basis. Robins, 788 F.2d at 1001.

The court found that the actions against the solvent third parties were essentially actions against the estate because "there is such an identity between the debtor and the third party defendant that the debtor may be said to be the real party defendant . . . ." \textit{Id. at 999.} Consequently, the court granted them the protection of the section 362 stay without requiring that they file personal petitions. In arriving at the conclusion that the stay should be extended to the insurance policy and to solvent officers, the court focused on the "unusual circumstances" present in the case. \textit{Id. at 999-1001.}

\textsuperscript{61} See, e.g., Hillsborough Holding Corp. v. Celotex Corp. (\textit{In re Hillsborough}), 123 B.R. 1004 (M.D. Fla. 1990) (stay extended to officers due to existence of indemnification agreement); Circle K Corp. v. Marks (\textit{In re Circle K}), 121 B.R. 257 (Bankr. D. Ariz. 1990) (stay extended to officers due to existence of indemnification and insurance policy agreement).


\textsuperscript{63} The facts of Lomas are as follows: In March, 1988 The Northern Trust Co. ("Northern") executed an agreement with Lomas Financial Corp. ("Lomas") which provided that Northern would lend Lomas $20 million upon receiving a representation that Lomas' net worth was at least $500 million at the time of the loan request and would not drop below that amount during the duration of the loan. See Defendants-Appellants Brief at 4 n.2, Lomas Fin. Corp. v. Northern Trust Co. (\textit{In re Lomas Fin. Corp.}), 932
was whether Northern's suit was "a poorly disguised effort to end run the automatic stay." Northern argued that the officers were individually liable for damages resulting from Northern's reliance on the officers' misrepresentation. The court ruled in favor of the debtor, extending the automatic stay and a section 105 injunction, due to the risk of cost to the estate as a result of the officers' indemnification agreements. The court never considered the merits of Northern's fraud claim or the likelihood that

F.2d 147 (2d Cir. 1991) (No. 90-5059).

The two officers charged with fraudulent misrepresentation were Byerley, the Vice President-Finance and Treasurer of Lomas and Hall, an Assistant Treasurer. Id. at 3. In June, 1989 Byerley and Hall misrepresented the financial condition of Lomas to Northern in order to trigger Northern's obligation to advance $20 million under the loan agreement. Northern relied on the misrepresentation that was made both orally and in writing and advanced the funds to Lomas on June 26, 1989. Id. at 3-4.

Only three days after the funds were transferred, Lomas announced that its actual net worth was only $263 million, despite the terms of the agreement with Northern requiring it to maintain a net worth above $500 million. In September, 1989, only 90 days after Northern made the loan to Lomas, Lomas filed for bankruptcy protection under Chapter 11. Id. at 4.

Northern then instituted a state court action (Northern filed a complaint in the district court for the Northern District of Texas, Northern Trust Co. v. Byerley, No. CA3-89-3055-G (N.D. Tex. Nov. 29, 1989)) charging that the two officers of the debtor made negligent or fraudulent misrepresentations concerning Lomas's financial condition and that the bank relied to its detriment on these representations and thus was entitled to recover damages in the amount of the loss on the loan. Id. at 3-4. Lomas then applied to the bankruptcy court for an order under section 362 or, alternatively, under section 105, to extend injunctive protection to the solvent defendants of the Northern suit. See Defendants-Appellants Brief at 5, Lomas Fin. Corp. v. Northern Trust Co. (In re Lomas Fin. Corp.), 932 F.2d 147 (2d Cir. 1991) (No. 90-5059).

64 See Lomas slip op. at 7.

65 See Northern's Complaint at 6, Northern Trust Co. v. Byerley, No. 89-6602A (N.D. Tex. Nov. 29, 1989). A right of indemnification arises only for suits resulting from corporate conduct. See N.Y. BUS. CORP. LAW § 721 (McKinney 1992) (nonexclusivity section prohibits indemnification for deliberately dishonest acts, even if the corporation benefitted, as in the Lomas case).

If an officer is derivatively liable on the claim with the corporation, the conduct had to be corporate in nature and consequently the officer would be eligible for indemnification from the corporation. Therefore, the action will have the effect of diminishing estate assets and risking the reorganization. Where an officer is independently liable on the creditor's claim, the conduct could not have been corporate in nature and any right to indemnification may be barred due to conduct limitations in the indemnification agreement. See infra note 151.

Another device to stay an action against officers of a debtor corporation is a determination that the debtor is an indispensable party to the creditor's suit against the officer. The court in In re Related Asbestos Cases, 23 B.R. 523 (N.D. Cal. 1982), addressed this issue, holding "[j]oint tortfeasors are not considered indispensable parties under federal law." Id. at 530 (citing Field v. Volkswagenwerk AG, 626 F.2d 293 (3d Cir. 1980)).
Lomas would complete a successful reorganization.66 Indeed, the court held that the mere existence of a Director and Officer ("D&O") insurance policy, even one which limited Lomas's liability to $10,000, was sufficient to extend the stay.67 The court rested on the possibility that if the insurance policy proceeds were consumed by litigation, the debtor might be forced to indemnify the officers.68

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66 Lomas Fin. Corp. v. Northern Trust Co. (In re Lomas), No. 89-6602A, slip op. at 9 (Bankr. S.D.N.Y. Jan. 11, 1990). For a Chapter 11 business reorganization to be successful, creditors must have confidence in the debtor's executives and their ability to run the company. The majority of a creditor's claim is usually paid over time, after the confirmation of the plan. If a creditor who holds a large claim, like Northern in Lomas, loses confidence in the ability of the executives to reorganize successfully, it may be difficult to negotiate the terms of a plan, as the creditor will doubt the ability of the debtor to pay the claim over time.

If the creditors' committee loses confidence in the ability of the executives to reorganize, the court can, upon a motion, appoint a trustee. Section 1104(a) provides that:

At any time after the commencement of the case but before confirmation of a plan, on request of a party in interest or the United States trustee, and after notice and a hearing, the court shall order the appointment of a trustee—

(1) for cause, including fraud, dishonesty, incompetence, or gross mismanagement of the affairs of the debtor by current management, either before or after the commencement of the case, or similar cause, but not including the number of holders of securities of the debtor or the amount of assets or liabilities of the debtor; or

(2) if such appointment is in the interests of creditors, any equity security holders, and other interests of the estate, without regard to the number of holders of securities of the debtor or the amount of assets or liabilities of the debtor.

11 U.S.C. § 1104(a) (1983). This section grants the court the authority to appoint a trustee in a chapter 11 case where the current management has been fraudulent or dishonest in managing the business.

67 Lomas slip op. at 5. Lomas's D & O policy had a deductible of $10,000. The court failed to account for the minimal effect a $10,000 judgment would have upon the reorganization when the estate had liabilities in excess of $500 million. Id.

68 Lomas, slip op. at 9. Since a debtor corporation is precluded from accessing insurance proceeds to pay unsecured creditors, one could argue that an action against an individually liable officer would have the effect of reducing a claim against the estate by the amount recovered by the creditor from the insurance policy. For example, in Lomas, if Northern had been able to recover the full amount of its loan ($20 million) from the two officers, the result would have been a reduction in the amount of unsecured claims against the assets of Lomas equal to the amount Northern recovered from the insurance policy. In cases where an officer is derivatively liable, this would be inequitable to the other unsecured creditors, allowing a similarly situated creditor to recover the full amount of its claim, potentially from the D & O insurance. If, however, the officer is individually liable on the creditor's claim, the result would not be inequitable to the rest of the creditors since this particular creditor suffered an injury that would not serve to reduce the amount of insurance because a derivatively liable officer is not eligible for indemnification.
The Lomas rationale has been used by other courts to extend the stay when an indemnification agreement exists. One particularly egregious example is In re Vitarine. There the stay was extended to protect the debtor's president from a suit brought by preferred stockholders and other officers of the debtor corporation for securities fraud, common law fraud, civil RICO, breach of contract, breach of warranty and negligent misrepresentation. At the hearing, Vitarine's president presented evidence showing that an indemnification agreement existed between himself and the debtor corporation. The court refused to hear any evidence to support the merits of the plaintiffs' action against the president. Nor did it seek any evidence to support the notion that Vitarine would complete a successful reorganization. Instead, the court, in an analysis similar to that in Robins and Lomas, focused on the risk that the litigation might exhaust the officer liability insurance policies and that subsequent judgments would have to be paid out of the estate.

B. The Narrow Approach: Section 362

The myopic approach that extends automatic stay protection whenever an officer indemnification agreement exists, without determining the actual harm to the estate or the possible inequity that would result if the stay were to issue, has been rejected by a number of courts. These courts have engaged in

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70 Complaint at 11-17, Bondy v. Vitarine Pharmaceuticals, Inc. (CV-91-1631) (E.D.N.Y. May 3, 1991). The complaint alleged that Roger Jordan, president of Vitarine Pharmaceutical, fraudulently induced the plaintiffs to sell their respective pharmaceutical companies to Vitarine in exchange for cash and preferred stock. The inducement Jordan allegedly made to the plaintiffs was that Vitarine had obtained Federal Drug Administration (“FDA”) approval to produce a number of generic drugs and once that was underway, the preferred stock would be worth much more than its current $12 per share. In reality, the complaint alleged, Jordan had sent recoated name brand drugs to the FDA as Vitarine's generics. This position was supported by affidavits of laboratory technicians who personally substituted the name brand drugs for the FDA samples. On October 3, 1989, the FDA learned of the false filings and withdrew approval of the distribution application. Shortly thereafter the value of Vitarine stock plummeted, plaintiffs instituted this action and Vitarine filed for protection under chapter 11 of the bankruptcy code. Id. at 8-10.
72 Id. at 64-70.
73 For cases that limit the application of section 362 to the debtor and property of
strict statutory construction of both the text of section 362 and its legislative history. They hold that Congress intended section 362 to be limited to the debtor and property of the estate and that any injunction affecting third parties should be issued under section 105.

The classic case enunciating this position is *In re Johns-Manville Corporation.* Johns-Manville and other manufacturers of asbestos were being sued for injuries resulting from exposure to asbestos. In response to these actions, Johns-Manville filed for chapter 11 and, as a result, Manville was severed from the tort actions by operation of section 362. The codefendants sought an extension of Manville's bankruptcy stay. The court denied them an extension under section 362, ruling that the automatic stay applied to the debtor only. The court would have the estate, see *supra* note 6.

The court in Ripley v. Mulroy, 80 B.R. 17 (E.D.N.Y. 1987), held that the stay did not protect the sole shareholder of the debtor from a fraud action brought by a purchaser of the debtor's promissory notes. In defining the scope of section 362, the court stated that "[t]he automatic stay provision was intended by Congress to apply to the debtor only, and not to others. A 'debtor' under the Bankruptcy Code, is the 'person... concerning which a case under [the Bankruptcy Code] has been commenced.'" *Id.* at 19 (citations omitted). Here, the sole shareholder was found not to be a debtor, and therefore the section 362 stay provision did not apply.

The court in Supermercado Gamboa, Inc. v. Camara De Comerciantes Mayoristas De Puerto Rico, Inc. (*In re Supermercado Gamboa, Inc.*), 68 B.R. 230 (Bankr. D.P.R. 1986), held that section 362 did not extend to solvent officers and shareholders of the debtor and that section 105 was the only statutory alternative to section 362. *Id.* at 233-34.


The court estimated that the Manville codefendants were named in approximately 11,000 personal injury cases at the time of the bankruptcy case. *Id.* at 407.

*Id.* at 406.

*Id.* at 408. The codefendants of Manville in personal injury and property damage cases were: GAF Corporation, Keene Corporation, Armstrong World Industries, Inc., H.K. Porter Company, Inc., Pittsburgh Corning Corp., Garlock, Inc., Celotex Corp. and Fiberboard Corp. *Id.* These codefendants argued that they would seek contribution from Manville's estate for any recovery by the tort claimants and that, as a result, Manville was an indispensable party to the actions. The court held that joint tortfeasors are not considered indispensable parties. *See In re Related Asbestos Cases*, 23 B.R. 523 (N.D. Cal. 1982).

*Manville*, 26 B.R. at 411. The court concluded that "[i]n the Code, the automatic stay applies only to the debtor." *Id.* The court was specifically referring to the existence of co-debtor protection in chapter 13 and the lack of co-debtor protection in chapter 11. The *Manville* court held that the legislative comment accompanying section 362, (see *supra* note 26), was controlling. In so doing, it stated "the legislative history of the statute, the well-settled interpretation of the predecessor
granted an injunction to these codefendants if they had been able to show that a lawsuit against them would have caused irreparable harm to Manville or its estate.  

Two recent decisions that have adopted the Manville holding that section 362 does not extend beyond the debtor and its property are Teachers Ins. & Annuity Association of America v. Butler and In re Crazy Eddie Securities. In both of these actions, the officers of the debtor were being sued by creditors for damages resulting from fraud. The officers sought to have the actions stayed under section 362. This motion was denied by both courts, holding that section 362 protects only the debtor and property of the estate. The Crazy Eddie court did not address the issue of whether the action may be stayed under section 105. The Second Circuit in Teachers ruled that a stay may issue under section 105, providing the officers could show that their actions were free from fraud. The officers were unable to do so and thus the fraud action was allowed to proceed.

Act by cases and commentary and the clear language of Section 362 makes it quite clear that, in chapter 11, the protections afforded the bankrupt are designed for the debtor-bankrupt only.” Id. at 410-11, quoting Royal Trucks & Trailer v. Armadora Meritina Salvadorenna, 10 B.R. 488, 490 (N.D. Ill. 1981).

The Manville codefendants argued that the actions represented similar issues of law and fact (i.e., all of the suits were for personal injury damages stemming from exposure to asbestos of which Manville was the largest producer). Since the threshold issue of asbestos causation was the same in all the suits, they should not proceed without Manville. The Manville court refused to extend the stay to solvent codefendants of Manville because the actions would not adversely impact the debtor, stating that “in the instant case no such inextricable intertwining has been proven as to each and every individual case by the codefendants. This is because the only relationship demonstrated between the codefendants is that of joint tortfeasor.” Manville, 26 B.R. at 413.

The Teachers court stated that “[i]t is well-established that stays pursuant to section 362(a) are limited to debtors and do not encompass non-bankrupt co-defendants.” Teachers, 803 F.2d at 65. The court in Crazy Eddie cited Teachers for the same proposition. 104 B.R. at 583.

The court held that section 105 would not extend to the solvent partners: While we decline to define under what circumstances, if any, a bankruptcy court may properly exercise § 105 jurisdiction to issue a stay with respect to non-bankrupt co-defendants, it is clear that any such jurisdiction cannot extend to efforts made in bad faith by non-bankrupt co-defendants in order to escape from the liability imposed by an adverse district court judgment.

Id.
C. The Use of Section 105 to Enjoin Third Party Actions

A court that is unwilling to extend protection to third parties under section 362 may be persuaded to extend the protection under section 105. As the legislative intent makes clear, Congress was not so hubristic as to assume that it could anticipate all circumstances where an injunction should issue and enacted section 105 to address these situations. Courts are split, however, on what section 105 standard is required before the issuance of an injunction. Some focus on the legislative comment to section 362 which demands that Rule 65 be met before granting a section 105 injunction. Others require no demonstration of irreparable harm before issuing a section 105 injunction. This Note would adopt a Rule 65 standard before the issuance of a section 105 injunction.

1. The Minimal Showing for Section 105 Relief

In recent years courts have tended to allow section 105 injunctions to issue without requiring the movant to make a show-

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89 For legislative comment of section 362 see infra text accompanying note 26.
90 Compare Garrity v. Leffler (In re Neuman), 71 B.R. 567 (S.D.N.Y. 1987) (no irreparable harm showing required for a section 105 injunction); Lomas Fin. Corp. v. Northern Trust Co., Docket No. 89-6602A (Jan. 11, 1990) (section 105 injunction can issue if court is satisfied that such a proceeding would impair its jurisdiction) with University Medical Ctr. v. American Sterilizer Co. (In re University Medical Ctr.), 82 B.R. 754 (Bankr. E.D. Pa. 1988) (section 105 injunction can issue only after a four-prong Rule 65 standard is met); TRS Inc. v. Peterson Grain & Brokerage Co. (In re TRS, Inc.), 76 B.R. 805 (Bankr. D. Kan. 1987) (section 105 injunction requires a heavy burden, supported by substantial evidence, and every factor of a strict Rule 65 standard must be met).
91 The court in In re Arrow Huss, 51 B.R. 853 (Bankr. D. Utah 1985), requiring the movant to meet a heavy Rule 65 burden before the issuance of a section 105 injunction, stated:

Clearly, something more than the mere fact that one codefendant has filed a Chapter 11 petition must be shown in order to warrant a stay of proceedings against a nondebtor codefendant. If the litigation against the nondebtor merely has an indirect or insignificant effect on the reorganization, a stay is likewise unwarranted. The power to prevent creditors from proceeding against non-debtors must only be used in extraordinary cases, and not simply to "assist" the debtor in reorganizing or to relieve general "pressure" on the debtor.
Id. at 858 (citations omitted).
Courts that have adopted this approach argue that because injunctions under section 105 are authorized by statute, no irreparable harm threshold has to be met. Instead, they reason that the text of section 105 requires merely that courts be “satisfied that such a proceeding would defeat or impair its jurisdiction with respect to a case before it.” In short, they rely on the absence of any standard within the text of section 105 to permit injunctions to issue on what amounts to an arbitrary basis.

A low section 105 threshold was first developed in In re Neuman. In Neuman the court granted an injunction preventing the transfer of a certificate of operation, the final step in the sale of a nursing home. At issue was whether the certificate was

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93 See Garrity v. Leffler (In re Neuman), 71 B.R. 567 (S.D.N.Y. 1987). An injunction issued against a party seeking to obtain property in which the debtor's rights had expired. The Neuman court stated that “[s]ince injunctions in bankruptcy cases are authorized by statute, the usual equitable grounds for relief, such as irreparable damage, need not be shown.” Id. at 571. For a comprehensive look at New York State's degradation of the traditional standards for injunctive relief, see David Frey, Note, The Yellowstone Injunction, or "How to Vex Your Landlord Without Really Trying," 58 Brook. L. Rev. 155 (1992).

94 Holding that a section 105 injunction requires no irreparable harm showing, the Neuman court relied on legislative intent stating, “[s]ection 105(a) contemplates injunctive relief in ‘precisely those instances where parties are attempting to obstruct the reorganization.’” 71 B.R. at 571-72 (citation omitted) (quoting In re Johns-Manville Corp., 91 B.R. 225, 228 (Bankr. S.D.N.Y. 1988)).


96 The standard employed by these courts gives a great deal of discretion to the bankruptcy judge to determine whether a third party action will have any impact on the reorganization. The standard of whether an act “will defeat or impair” the court's jurisdiction is too vague and overbroad to provide any guidance to creditors considering whether they have a cause of action against a third party. For an example of how this rationale can be slippery see Lomas, slip. op. at 15.


98 In 1984 Carl Neuman, the owner of a nursing home, entered into an agreement with Edward Leffler's to transfer title of the home to Leffler. This contract was contingent upon Leffler's obtaining a new operating certificate within two years. Shortly after the contract was signed, Neuman filed for chapter 11. For nearly two years Leffler operated the home on a full time basis as the owner. Before the certificate could be formally passed to Leffler, the trustee obtained an injunction preventing the transfer and declared the certificate property of the estate. At the time, New York State law was unclear as to whether the certificate was property of the estate or merely a licensing right granted by the state. The injunction prevented Leffler from completing the contract and thus the trustee was able to reclaim the entire home which had been all but transferred almost two years before. Neuman appealed this decision arguing that the bankruptcy court had
a license and thus without value to the estate, or a property interest and thus a part of the estate. The District Court, on appeal, held that the court need not reach the issue of whether the certificate was part of the estate. All the trustee needed to show was that its transfer might fall within the jurisdiction of the Bankruptcy Code. Thus the court, without a showing of harm to the estate, without proof of a successful reorganization and without regard to the assignee's interest in owning the nursing home he contracted for and had operated previously, enjoined the action.

The result in Neuman was inequitable because the court effectively stripped the debtor and the assignee of the right to bring an action to determine the status of the operating certificate without requiring the trustee to show a risk of irreparable harm to the estate. The Neuman standard only requires the bankruptcy court to determine that the action in question would defeat or impair its jurisdiction.

The Neuman approach has been adopted by a number of courts. In Lomas the court extended a section 105 injunction

 exceed its jurisdiction in interpreting New York Public Health Law and that the trustee failed to show the irreparable harm in letting the certificate pass to Leffler since the home had effectively already been passed. The district court rejected this argument, holding that while the law was unclear concerning the property rights of a certificate of operation, it was within the power of the bankruptcy court to make this determination. Moreover, the court concluded that even if the certificate were not a property right and hence not part of the debtor's estate, it still had the power to enjoin the transfer under section 105 merely because such transfer may constitute an infringement upon the jurisdiction of the bankruptcy court. Thus, the court required no showing of hardship or irreparable harm, nor did it require any showing of success on the merits. Id. at 563.

99 Id. at 570.
100 Id. at 571.
101 Id.
102 Id. at 574.
103 The Neuman court defined impairment of its jurisdiction as the risk that a contrary outcome (contrary to the Trustee) of the state court proceeding would throw the Trustee's operation of the home "into disarray, even if only temporarily." Id. at 572. Thus, the court issued a section 105 order enjoining a third party state court action to avoid a temporary inconvenience to the court. Certainly the bankruptcy court has a strong interest in determining what constitutes property of the estate. In a case such as this, if the interest of the debtor was that critical, a Rule 65 standard could be met.

104 In the case of LTV Steel Co. v. Cleveland Board of Educ. (In re Chateaugay Corp.), 93 B.R. 26 (S.D.N.Y. 1988), the court held that the bankruptcy court had the power to enjoin a state court action brought by a school board seeking post-petition payment of property taxes without requiring the debtor to show irreparable harm to the reorganization. Since the debt arose post-petition, the debtor was not protected under
to solvent officers who allegedly defrauded creditors into lending the debtor $20 million. The Lomas court did not require the debtor corporation to demonstrate that irreparable harm would ensue if the action against the officers were allowed to proceed. Nor did the court explain how the balance of equities favored allowing the solvent, allegedly fraudulent officers to enjoy bankruptcy protection, while denying the creditor's pleas for relief. In the same vein, the court did not require the debtor to show that it had a substantial chance of successfully reorganizing. Last, the court did not address the public policy concerns of allowing executives to use the sanctuary of bankruptcy after allegedly defrauding creditors. In short, the court required a standard substantially lower than the Rule 65 standard.

2. The Narrow Approach to Section 105 Injunctive Relief

Courts that adopt the narrow approach to section 105 require that a traditional rule 65 standard be met before the issuance of a section 105 injunction. These courts require the mo-
vant to demonstrate that: (1) the debtor will suffer irreparable harm if the injunction does not issue; (2) there is a likelihood that the reorganization will be successful; (3) the balance of equities tips decidedly in favor of the movant, and; 4) an injunction would not violate public policy. In a majority of suits against corporate officers of debtor corporations this burden can be met. However, where the officers have committed acts of fraud, or are otherwise independently liable to the creditor, and where a Rule 65 standard cannot be met, an injunction should not issue.

The counterintuitive result in Lomas is avoided when the courts require the movant to meet a Rule 65 standard before issuing an injunction. In re University Medical Center involved a debtor medical partnership that had a large number of medical malpractice suits pending. The injured plaintiffs sought to bring their claims against the individual physicians who had not filed for bankruptcy. The physicians moved to enjoin this action under sections 362 and 105. The court held that section 362 protects only debtors and property of the estate. It refused to extend injunctive relief to the doctors under section 105 because they failed to meet the four-pronged Rule 65 test. This

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105 stay to officers and stockholders who had guaranteed the debtor's promissory notes. When creditors sought to recover against the solvent guarantor-officers, they moved to enjoin recovery under section 105. The court denied the protection, stating:

In effect the movants would have the bankruptcy court hold [the creditors] at bay, suspended in mid-air, while they sit coyly by awaiting manna from heaven in the eternal hope that it will solve their self-created financial difficulties. In sum, they are requesting this court to endow them with newly created rights. Even though section 105 does grant to the bankruptcy court broad powers to "issue any order, process, or judgment that is necessary to carry out the provisions of the Bankruptcy Code" it does not empower this court to fashion substantive rights out of thin air.

Id. at 603.

109 For cases that require a Rule 65 showing prior to issuing a section 105 injunction, see supra note 34.

110 In the majority of cases corporate officers are derivatively liable on the creditors' claims. For the officer to be independently liable, the officer must have acted either in an individual capacity or outside the scope of employment, e.g., as in fraud. The Manville court pointed out that where an officer is derivatively liable, the creditor is pursuing an identical, inextricably interwoven claim against the officer as it could against the debtor. Manville, 26 B.R. at 418.


112 Id.

113 Id. at 756 (citing Delaware River Port Auth. v. Transamerican Trailer Transp.,
result is equitable.\textsuperscript{114} The injured patients need to be compensated for their additional medical bills and for their suffering.\textsuperscript{115} They were not pursuing their claims against the debtor partnership, but against solvent physicians who were individually liable on their claims and had malpractice insurance sufficient to cover any claims against them.\textsuperscript{116}

There are instances where it is proper for the court to issue an injunction to bar an action against an officer who is independently liable. One such example is \textit{In re TRS},\textsuperscript{117} in which a creditor was enjoined from executing a default judgment against the president and sole managing officer of a debtor corporation.\textsuperscript{118} The president was able to show that his time was nearly 100 percent occupied with the reorganization efforts of the debtor and that the suit would detract from that function.\textsuperscript{119} He further argued that a judgment entered against him would lead to personal bankruptcy, resulting in the loss of his substantial stock interest in the debtor, thereby rendering any further efforts on his part to reorganize the debtor fruitless.\textsuperscript{120} Thus, the court found that an action against the officer would substantially and irreparably harm the reorganization.\textsuperscript{121}

\textquote{In re University Medical Ctr., 82 B.R. at 756.} Clearly the court investigated any risk of irreparable harm, found none and denied the injunctive protection sought.\textsuperscript{115} \textit{Id.} at 755.

\textquote{The physicians admitted to having $150,000 of medical insurance each.} \textit{Id.} at 756.\textsuperscript{116} \textsuperscript{117} 76 B.R. 805 (Bankr. D. Kan. 1987).\textsuperscript{118} \textit{Id.} at 806. The officer in this case was independently liable under a guaranty agreement.\textsuperscript{119} \textit{Id.}\textsuperscript{120} \textit{Id.}\textsuperscript{121} Holding that the injunction in this case did not violate public policy, the court stated, "[t]he public interest is clearly served by reorganizing chapter 11 debtors whenever possible. A reorganization case should not be summarily torpedoed by the actions of a single unsecured creditor who just happens to have a guaranty of the debtor's principal agreement."
IV. **Analysis**

A. **Corporate Executive Protection under the Automatic Stay**

The extension of section 362 to protect solvent third parties is incorrect for a number of reasons. It is contrary to the plain meaning and legislative history of the automatic stay. Under a section 362 analysis, a court is under no obligation to address the interests of the party being stayed and as a result, it does not account for the equities involved in the proceeding. Extending section 362 to protect solvent executives focuses purely on the relationship between the officer and the debtor: if there is a contractual relationship between the two, the court will extend the stay. But the impact of a third party suit is often so attenuated that it really has no impact at all. On the other hand, limiting section 362 to actions against the debtor and property of the estate and requiring the debtor under section 105 to satisfy a Rule 65 standard forces the court to evaluate both the likelihood that the debtor will be harmed and level of harm the debtor may face, and the possible harm to other creditors.

1. **Section 362: Strict Statutory Interpretation**

The text of section 362 limits stay protection to the debtor and property of the estate. Confining the scope of section 362 in this manner is consistent with the plain meaning and legislative history of the statute. Congress acknowledged the limited shareholder and managing officer.” *Id.* at 809.

122 The text of section 362 refers exclusively to the debtor and property of the estate. For the text of section 362, see *supra* note 2. For a discussion of the legislative intent of section 362, see *infra* notes 126-36 and accompanying text.

123 For a discussion on the focus of a section 362 extension to solvent third parties, see *infra* notes 153-63 and accompanying text.

124 For a discussion of derivative and independent liability, see *infra* notes 143-63 and accompanying text.

125 For a discussion of this standard, see *infra* notes 175-84 and accompanying text.

126 For a discussion of extending protection to solvent third parties under section 362 simply on the basis of the existence of an indemnification agreement, see *infra* notes 137-63 and accompanying text.

127 The *Manville* court stated: “The language of Section 362 clearly refers only to actions against the debtor and does not relate to any other interparty claims... A literal interpretation of this language comports with the rationale behind the formulation of an automatic stay in this statutory scheme...” *GAF Corp. v. Johns-Manville Corp.* (*In re Johns-Manville Corp.*), 26 B.R. 405, 409 (Bankr. S.D.N.Y. 1983). See also Leslie
scope of section 362 in its legislative comment and provided an alternative for debtors who seek injunctive relief from those actions not covered by the automatic stay:

The court has ample other powers to stay actions not covered by the automatic stay. Section 105, of proposed title 11, derived from Bankruptcy Act section 2a(15), grants the power to issue orders necessary or appropriate to carry out the provisions of title 11 . . . . Stays or injunctions issued under these other sections will not be automatic upon the commencement of the case, but will be granted or issued under the usual rules for the issuance of injunctions.126

When Congress limited section 362 to actions against the debtor and property of the estate it achieved two goals. First, it insured that the automatic trigger129 of section 362 would be limited to acts that Congress already determined would result in irreparable harm to the debtor.130 Second, recognizing it could


129 The automatic aspect of section 362 results in an instantaneous ex parte injunction upon filing against any creditor seeking to recover on a claim or perfect a security interest on property of the estate. For the text of section 362, see supra note 2.

130 The legislative comment for section 362 states the purpose behind preventing the conduct outlined in section 362(a):

The purpose of this provision is to prevent dismemberment of the estate. Liquidation must proceed in an orderly fashion. Any distribution of property must be by the trustee after he has had an opportunity to familiarize himself with the various rights and interests involved and with the property available for distribution.


The court in Minoco Group of Co.'s, Ltd. v. First State Underwriters Agency of New England Reinsurance Corp. (In re Minoco Group, Ltd.), 799 F.2d 517 (9th Cir. 1986), held that regardless of a showing of irreparable harm, the automatic stay goes into effect. This supports the argument that Congress had already deemed that the actions in section 362(a) met the injunctive requirement of irreparable harm.
not anticipate all actions that could potentially harm the debtor, Congress included section 105 as the catchall provision, allowing courts to determine on a case-by-case basis what actions could harm the reorganization. In addition, Congress required a threshold showing before courts could enjoin actions not covered by the automatic stay: "the usual rules for the issuance of injunctions," namely the Rule 65 standard.

The existence of co-debtor protection in other chapters of the Code and its absence from chapter 11 and section 362 supports the view that section 362 was intended to protect debtors and property of the estate exclusively. Chapters 12 and 13 of the Bankruptcy Code explicitly extend protection to certain co-debtors, specifically co-debtors on consumer loans. This co-

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131 For a discussion of the legislative comment to section 105, see supra note 31.

132 See King et al., 2 Collier on Bankruptcy, supra note 17, 105.02, at 105-5-15. Collier analogizes a section 105 injunction to a preliminary injunction, stating that "[b]ecause a request for an injunction pursuant to section 105 is akin to a request for a preliminary injunction, the party seeking injunctive relief must satisfy the requirements of Rule 65 of the Federal Rules of Civil Procedure as applied to bankruptcy by Bankruptcy Rule 7065." Id. ¶ 105.02, at 105-8. See also In re Trails End Lodge, Inc., 45 B.R. 597 (Bankr. D. Vt. 1984) (section 105 standard should be the same as that for preliminary injunctions).

133 See 11 U.S.C. § 1201 (1992); 11 U.S.C. § 1301 (1992). This extension is limited to those who are jointly liable on consumer debts. The reason for this protection is that most consumer debts occur within the context of a family, where a husband, wife or other family member will co-sign for an extension of credit. As a result, the extension of protection to third parties in this context is logical since many consumer loans are co-signed by a family member and are not arms-length transactions. The protection afforded co-debtors in chapters 12 and 13 is not all encompassing since a chapter 12 or 13 debtor will not exclusively have consumer debts. A consumer debt is defined by Bankruptcy Code section 101(7) as a debt incurred by an individual primarily for personal, family or household purposes. A family farm corporation, engaged in the business of farming, while eligible to use chapter 12, could not obtain a co-debtor stay of actions on the personal guarantees of the shareholders because a corporate debt could not be a consumer debt. For a more comprehensive discussion of chapter 12 and 13 co-debtor stays, see Aaron, supra note 3, at § 5.01(3).

Section 1301(a) provides, in pertinent part:
(a) Except as provided in subsections (b) and (c) of this section, after the order for relief under this chapter, a creditor may not act, or commence or continue any civil action, to collect all or any part of a consumer debt of the debtor from any individual that is liable on such debt with the debtor, or that secured such debt, unless—
   (1) such individual became liable on or secured such debt in the ordinary course of such individual's business; or
   (2) the case is closed, dismissed, or converted to a case under chapter 7 or 11 of this title.
debtor protection is absent from the text of chapter 11 and section 362.134 Under the ordinary rules of statutory construction, the inclusion of co-debtor stay protection under chapters 12 and 13 and the exclusion of any protection under chapter 11 suggest that Congress intended to exclude stay protection to co-parties in chapter 11.135 Consequently a number of circuits have held that the section 362 stay only applies to debtors and not to solvent co-parties.136 To protect solvent third parties as well as debtors and the reorganization itself, Congress enacted section 105.

2. The Risk of Indemnification to the Reorganization

An action that does not expressly violate the automatic stay, but can violate its purpose, is one against the solvent officers of a debtor corporation.137 Although actions against executives are not explicitly barred by the language of section 362,138 corporate officer indemnification agreements make actions against officers essentially actions against the debtor.139 Depend-
ing on the terms of the agreement, potentially all costs and any judgment against the officer would have to be paid by the corporate debtor. Consequently, under certain circumstances, if a creditor's action is allowed to proceed against an executive, the estate will be diminished and the reorganization may be jeopardized. In A.H. Robins v. Piccinin the Fourth Circuit fash-

meets the requirements for indemnification set forth in the state's law of incorporation or by the terms of a Director and Officer Liability insurance policy. Corporations are permitted to execute indemnification agreements with officers and directors under provisions in the applicable state's law of incorporation. Thus, when the state of incorporation prohibits indemnification by the corporation for certain types of conduct, the officer has no right of indemnification for litigation arising out of that conduct. However, most states, including Delaware, have nonexclusive laws concerning indemnification and allow corporations to indemnify executives in circumstances other than those contained in the statute. See Delaware General Corporation Law section 145(a) provides that:

A corporation may indemnify any person who was or is a party or is threatened to be made a party to any threatened, pending or completed action suit or proceeding, whether civil, criminal, administrative or investigative (other than an action by or in the right of the corporation) by reason of the fact that he is or was a director, officer, employee or agent of the corporation ... against expenses (including attorney's fees), judgments, fines and amounts paid in settlement actually and reasonably incurred by him in connection with such action, suit or proceeding if he acted in good faith and in a manner he reasonably believed to be in or not opposed to the best interests of the corporation, and, with respect to any criminal action or proceeding, had no reasonable cause to believe his conduct was unlawful.


Indemnification agreements generally provide that the corporation will reimburse the executive for litigation and judgment expenses arising out of conduct in an official capacity. In response to the virtual explosion of corporate officer and director liability actions (some due to large corporate bankruptcies), many corporations purchase Director and Officer Liability Insurance ("D & O"). Corporations, though often limited by the conduct requirements of the indemnification provisions in the state laws of incorporation, are permitted to purchase liability insurance regardless of whether the corporation would be able to indemnify the officer under state statute. Delaware's D & O Insurance Policy statute provides:

A corporation shall have power to purchase and maintain insurance on behalf of any person who is or was a director, officer, employee or agent of the corporation, or is or was serving at the request of the corporation as a director, officer, employee or agent of another corporation, partnership, joint venture, trust or other enterprise against any liability asserted against him and incurred by him in any such capacity, or arising out of his status as such, whether or not the corporation would have the power to indemnify him against such liability under the provision of this section.

DEIL CODE ANN. tit. 8, § 145(g) (1991) (emphasis added).

The limiting circumstances that prevent an action against the executive from diminishing the estate are the limiting clauses in indemnification agreements that only allow reimbursement for liability on acts that were in good faith and made in the best
ioned the “unusual circumstances” test to prevent this result.

a. Stay Protection and the Existence of “Unusual Circumstances”

The holding in *Robins*, extending protection to executives of the debtor, was consistent with the purposes of the Code because the officers were not independently liable to the plaintiffs. Since the officers were derivatively liable on the claim against Robins, no dispute existed as to whether they would be entitled to indemnification for their costs and any potential judgment. Consequently, if the action against the officers had been allowed to continue, the plaintiffs would have circumvented the stay and done indirectly what they could not do directly. Protecting corporate officers under the circumstances present in *Robins* is proper because the officers were not independently liable to the plaintiffs and therefore the estate would incur the cost of the third party litigation.

The *Robins* court limited extension of the stay, however, to those situations where the officer is derivatively liable on the claim: “[If] the third-party defendant was ‘independently liable’ as, for example, where the debtor and another are joint tortfeasors or where the nondebtor’s liability rests upon his own breach of duty, . . . the automatic stay would clearly not extend to such nondebtor.” The *Robins* court distinguished between corporate officers who are independently liable to plaintiffs, that

143 *Id.* at 996. For the purposes of this Note, independent liability is defined as any situation where an officer would otherwise be individually liable for damages arising from his or her own conduct.
144 *Id.* at 999. The officers of A.H. Robins were being sued as a consequence of their positions as officers and not as a result of any individual breach of duty. As a result, they would be entitled to indemnification from the debtor. Consequently any finding of liability against the officers would be a finding against the debtor. Recognizing this inequitable result, the court stated: “‘Clearly the debtor’s protection must be extended to enjoin litigation against others if the result would be binding upon the debtor’s estate,’ and this is so, whether the debtor is a party or not.” *Id.* at 999 (quoting *In re Metal Ctr.*, Inc., 31 B.R. 458, 462 (Bankr. D. Conn. 1983)).
145 *In re Metal Ctr.*, Inc., 31 B.R. at 462 (“Congressional intent to provide relief to debtors would be frustrated by permitting indirectly what is expressly prohibited in the Code.”).
146 *Robins*, 788 F.2d at 999 (emphasis added) (quoting *In re Metal Ctr.*, Inc., 31 B.R. at 462).
is, those who have breached an individual duty and those who are perceived liable because of their positions as officers of the debtor.\textsuperscript{147} Robins held that officers who are derivatively liable should be protected because they are automatically entitled to indemnification. Those who are individually liable should not be protected.\textsuperscript{148} Despite the Robins court holding that the automatic stay would not protect those who are “independently liable,” the automatic stay and the “unusual circumstances” test have been extended by a number of courts to officers who were alleged to be individually liable on the creditor’s claim.

b. Extending the Stay in Less than “Unusual Circumstances”

The recent extension of the automatic stay from “unusual circumstances” to those that are mundane goes against the explicit language of section 362 and also frustrates its purpose.\textsuperscript{149}

\textsuperscript{147} Id.

\textsuperscript{148} Id. In the case of University Sav. Ass’n v. Burnap, 786 S.W.2d 423 (Tex. Ct. App. 1990), the court addressed precisely the issue of whether an officer could be indemnified for unlawful conduct that was unquestionably within the scope of employment. The facts of the case are as follows: Burnap was a shareholder, officer and director of Austin Savings Association (“ASA”). He participated in the negotiation of the sale of shares of ASA common stock to another savings and loan. Seven ASA stockholders who participated in the sale then sued Burnap, alleging a variety of state and federal securities violations in his capacity as director. Burnap won each of the suits on motions for summary judgment.

Burnap then sought indemnification from ASA as provided for in the by-laws which granted indemnification to any party defendant if “such person is made a party solely by reason of his being or having been a director, officer or employee of this association.” \textit{Id.} at 424. The bank denied indemnification, arguing that any allegedly unlawful activity could not have been in the performance of his duty as a director. If Burnap had been performing as merely a shareholder, however, he would have had no duty to inform the other shareholders of his plans and therefore could not be held to breach a duty he did not have. In determining whether indemnification should be granted, the court framed the critical issue as whether the claimant would have been named as a defendant if he were not a director and \textit{not} whether the claimant was acting within his capacity as a director. The court compelled indemnification, holding that Burnap was named to the complaint solely due to his position as a director. \textit{See} Robert F. Gray, Jr. & Gregory J. Sergesketter, \textit{Corporations}, 45 Sw. L.J. 227 (1991).

\textsuperscript{149} Extending stay protection to officers who are independently liable on the creditor’s claim frustrates the automatic stay because the stay refers exclusively to the debtor and property of the estate. For a discussion of the legislative intent of section 362 see \textit{supra} notes 127-37 and accompanying text. This extension further frustrates the purposes of the Code by expanding the holding in Robins to situations where the officer is liable as a result of his own breach of duty. The Robins court sought to preserve the equitable goal of section 362 by making the distinction between independently and de-
Corporate officer indemnification is one factor that enables courts to infer eventual harm to the debtor from third party litigation.\textsuperscript{150} Harm does not befall the debtor, however, if the executive's conduct makes her ineligible for indemnification. Executives who are individually liable on a creditor's claim would potentially not be eligible for indemnification at all.\textsuperscript{151} If an officer has no right to receive indemnification, there would be no impact on the debtor resulting from the creditor's suit. Thus, depending on the success of the creditors' fraud claim, the officer may or may not be entitled to indemnification. Despite the possibility that a debtor might be wholly unaffected, courts have been willing to utilize the "unusual circumstances" exception outlined in Robins to extend protection to individually liable corporate officers.\textsuperscript{152}

rivatively liable officers. Extension of the Robins rationale to circumstances where an executive is a joint tortfeasor (as in the case of fraud) with the corporate debtor frustrates the equitable underpinnings of the Bankruptcy Code. The Manville court addressed the issue of protecting joint tortfeasors stating:

That Manville is basically indifferent to the co-defendants' requested relief is suggestive of a perception of a lack of irreparable harm to the debtor's estate if the injunction does not issue. Failure to extend the stay herein would not adversely or detrimentally influence or pressure Manville through the co-defendants. This is because the interests of Manville and the co-defendants at the individual trial level are not so interwoven as to create that undue influence. Thus, at least conceptually, a creditor does not impact Manville directly by proceeding against the co-defendants.

GAF Corp. v. Johns-Manville Corp. (In Re Johns-Manville Corp), 26 B.R. 405, 417 (Bankr. S.D.N.Y. 1983). The only difference between the Manville joint tortfeasors and the fraudulent officers is that Manville was not bound by an indemnification agreement but rather could only be held for contribution. Similarly, in the case of an executive who has injured creditors through fraud, that executive would not be eligible for indemnification because of the conduct requirements.

\textsuperscript{150} See supra note 7.

\textsuperscript{151} This is due to the good faith requirement in most state indemnification statutes.

State indemnification statutes offer a variety of standards that permit corporate officer indemnification. There are nonexclusive, partially exclusive and completely exclusive indemnification statutes. Nonexclusive statutes allow states to indemnify in circumstances other than those in the statute. Exclusive statutes do not allow corporations to indemnify conduct not covered in the statute. Some states have adopted partially exclusive statutes. See, e.g., N.Y. Bus. Corp. Law § 721 (McKinney 1986). All indemnification statutes require that the executive's conduct be in good faith and reasonably believed to be in the best interests of the corporation. See Bucy, supra note 12, at 283.

\textsuperscript{152} Courts that extend stay protection in questionable circumstances usually recognize that a strict interpretation of section 362 will work a hardship on the estate and the reorganization. The Code, however, must be adhered to, as Congress has enacted a Bankruptcy Code with a fairly complicated system of statutory checks and balances designed to further a variety of interests. The
The court in *Lomas v. Northern Trust* is a primary culprit, erroneously extending the *Robins* test to protect independently liable officers. The *Robins* court was careful not to extend section 362 to instances where the executives were independently liable to a creditor of the debtor. The expansion employed by the *Robins* court comported with the text, intent and provisions of the Code. However, the *Lomas* court extended stay protection to the officers, despite a strong showing of fraud, reasoning that the mere risk of indemnification claims to the debtor would diminish the debtor’s estate.

The *Lomas* court fashioned an argument that it claimed fell within the “unusual circumstances” outlined in *A.H. Robins*. This reliance was disingenuous as the *Lomas* court made no mention of the *Robins dicta* which exempted the application of section 362 to those situations where a defendant was “indepen-

problem arises when the bankruptcy judge believes, rightly or wrongly, that strict compliance with the letter of the statute may defeat rather than further the underlying policy of favoring reorganizations.


104 For a discussion of the *Robins* holding, see supra notes 53-59 and accompanying text.


106 *Lomas*, slip op. at 13.

107 The bankruptcy court held that since the facts in *Lomas* fell within the “unusual circumstances” test if the Northern Trust Lawsuit is not enjoined, Lomas’ estate and creditors will incur the burden of litigation for an alleged pre-petition cause of action. This is precisely the type of activity and burden which § 362 of the Code was intended to alleviate. The Northern Trust Lawsuit is a transparent attempt to end run the automatic stay. The Northern Trust Lawsuit which seeks, inter alia, damages of $20 million from two Lomas officers, “in their individual capacities,” is an attempt by Northern Trust to collect on a prepetition loan of $20 million made to Lomas.

*Id.* at 9.
The officers in *Lomas* were, in all probability, independently liable for the damages incurred by Northern.\(^{158}\) Were the fraud action to be successful, their fraudulent conduct would make them ineligible for indemnification.\(^{160}\) Thus, the risk that the Lomas estate would be affected adversely by the action was slim. Therefore, under *Robins*, the automatic stay should not have been extended to protect the executives in *Lomas*.

A section 362 analysis of third party claims focuses solely on the relationship of the officer to the debtor (i.e., the existence of a right to indemnification)\(^{161}\) and not the potential impact on

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\(^{158}\) *Robins*, 783 F.2d at 999.

\(^{159}\) A cause of action for deceit is comprised of the following elements:

1. A false representation made by the defendant. In the ordinary case, this representation must be one of fact.

2. Knowledge or belief on the part of the defendant that the representation is false—or, what is regarded as equivalent, that he has not a sufficient basis of information to make it. This element often is given the technical name of "scienter."

3. An intention to induce the plaintiff to act or refrain from action in reliance upon the misrepresentation.

4. Justifiable reliance upon the representation on the part of the plaintiff, in taking action or refraining from it.

5. Damage to the plaintiff, resulting from such reliance.


In *Lomas* Northern alleged damage arising out of the misrepresentations made by Lomas officers regarding the loan agreement that was executed between them. The Lomas officers knew that their representation concerning the net worth of Lomas would induce Northern to advance $20 million under its obligation in the loan agreement.

Delaware General Corporation Law section 145 provides that a corporation can indemnify an officer provided that "he acted in good faith and in a manner he reasonably believed to be in or not opposed to the best interests of the corporation. In a criminal proceeding, which can include a fraud action, the officer can be indemnified if he had no reasonable cause to believe his conduct was unlawful." Bucy, *supra* note 12, at 56. The Lomas financial officers knew their misrepresentation of Lomas's net worth would induce Northern to lend the $20 million. There was no other reason for the representation than to trigger Northern's obligations under the loan agreement.

\(^{160}\) Because of the conduct restrictions on indemnification agreements and D & O insurance policies, an officer who has voluntarily committed an act that was either in bad faith or dishonest (as defined by the insurance or indemnification agreement) is not eligible for reimbursement from either source. This officer is deemed to have independent liability to the creditor on the claim. See Globus v. Law Research Serv., Inc., 418 F.2d 1276 (2d Cir. 1969) (corporate officer was not entitled to indemnification because one cannot be insured against voluntary conduct), *cert. denied*, 397 U.S. 913 (1970).

\(^{161}\) Because section 362 prevents any action against the debtor and property of the estate, extending section 362 protection to solvent executives requires a finding that the action is really against the debtor. Some courts refer to this as the identity of interest
the creditor bringing the action.\textsuperscript{162} As a result, a section 362 analysis disrupts the delicate balance between the rights of the damaged creditor to recover and the needs of a debtor to reorganize. This is problematic because section 362 gives very little discretion to the court to tailor the stay to the facts in a particular petition.\textsuperscript{163} Consequently, extending the stay to solvent third parties provides overbroad protection from suit. Limiting the scope of section 362 to actions against the debtor and property of the estate mitigates the risk that courts will extend overbroad and potentially unwarranted immunity from suit to solvent executives.

c. Property of the Estate: Director and Officer Liability Insurance

Many courts have rejected the analysis of Lomas.\textsuperscript{104} These
Courts limit section 362 to actions against the debtor and property of the estate. An issue that arises—even when the scope of the stay is limited to the debtor and property of the estate—is whether Director and Officer liability insurance ("D & O") proceeds constitute property of the estate and if so, whether an action against an insured officer is essentially an action to obtain possession of estate property in violation of the automatic stay. Courts that stay these actions conclude that the creditor is only seeking to recover from the officers in order to obtain a judgment from the D & O insurance policy, thereby collecting a larger judgment than would otherwise be recovered under a plan action and the facts present in both Manville and Robins); In re Crazy Eddie Securities Litig., 104 B.R. 582 (E.D.N.Y. 1989) (automatic stay did not bar action against solvent defendants where liability rested on individual breach); Ripley v. Mulroy, 89 B.R. 17 (E.D.N.Y. 1987) (a fraud action commenced by a creditor against the president and controlling shareholder of the debtor was not in violation of section 362(a) as the claims asserted in the fraud action were distinct from those brought against the debtor); All Seasons Resorts, Inc. v. Milner (In re All Seasons Resorts, Inc.), 79 B.R. 501 (Bankr. C.D. Cal. 1987) (citing lack of "special circumstances" that justify extension of automatic stay to solvent third parties, despite existence of indemnification agreement); Supermercado Gamboa, Inc. v. Camara De Commerciantes Mayoristas De Puerto Rico, Inc. (In re Supermercado Gamboa, Inc.), 68 B.R. 230 (Bankr. D. P.R. 1986). The Supermercado court denied the debtor's motion for an extension of section 362, stating:

   If Congress intended to expand the scope of this extraordinary statutory provision, imposing an ex parte injunction upon the world as to actions against the debtor and its property, it would I believe have used more precise language to achieve that result. Indeed, where expanded scope of the automatic stay against codebtors was intended ... Congress did make explicit the further stay of actions against codebtors who themselves were not debtors in the bankruptcy proceeding.

Supermercado, 68 B.R. at 232.

In both Robins and Johns-Manville the courts extended stay protection to the insurers and the respective policies on the theory that the liability insurance is the most valuable asset of the estate in mass tort litigation. The Manville court stated:

   To permit the third party actions to continue against Manville's insurance carriers will result in a multiplicity of positions and defenses on the part of the insurance carriers and will most likely result in inconsistent decisions and rulings concerning the coverage and liability of the insurance carriers to the third party claimants and to Manville. Such a disorganized and fragmented procedure for resolving such major issues will undermine Manville's attempt at reorganization.


By deeming the D & O policy property of the estate, an action by a creditor against an officer who is covered by the policy can be interpreted as essentially an act to obtain property of the estate in violation of the automatic stay. See 11 U.S.C. § 362(a)(3), supra note 2.
of reorganization.\textsuperscript{167}

The status of D & O insurance in bankruptcy is muddled at best.\textsuperscript{168} Some courts hold that D & O insurance is property of the estate under all circumstances.\textsuperscript{169} Other courts evaluate the relationship between the policy and the debtor more critically to determine the maximum obligation the debtor could incur under the policy.\textsuperscript{170} One court has gone so far as to hold that since the policy did not increase the debtor's assets or reduce its liabilities, the policy was not property of the estate.\textsuperscript{171}

But determining whether D & O insurance policies are property of the estate in the abstract is an impossible task. Courts are far better off examining the specific circumstances—the conduct of the officers under the policy and the likelihood that the debtor will incur costs as a result of judgment against the officers—in determining whether potential harm to a debtor triggers a stay.\textsuperscript{172} In situations like 	extit{Lomas}, where the

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\textsuperscript{167} See Circle K Corp. v. Marks (\textit{In re Circle K Corp.}), 121 B.R. 257 (Bankr. D. Ariz. 1990) (staying creditors actions against solvent officers, deeming D & O insurance property of the estate); but see Zenith Lab., Inc. v. Sinay (\textit{In re Zenith Lab., Inc.}), 104 B.R. 659, 665 (D.N.J. 1989) (refusing to extend protection under section 362 despite existence of D & O insurance policy stating that an insurance policy is only property of the estate “to the extent that it increases the debtor’s worth or diminishes its liabilities”).

\textsuperscript{168} Compare Minoco Group of Co.’s, Ltd. v. First State Underwriters Agency (\textit{In re Minoco Group of Co.’s, Ltd.}), 799 F.2d 517 (9th Cir. 1986) (holding that D & O insurance policy was property of the estate) with Louisiana World Exposition, Inc. v. FDIC (\textit{In re Louisiana World Exposition, Inc.}), 832 F.2d 1391 (5th Cir. 1987) (D & O policy proceeds were not property of the estate, but rather belonged to the officers covered under the policies).

\textsuperscript{169} See Circle K Corp. v. Marks (\textit{In re Circle K Corp.}), 121 B.R. 257, 258-59 (Bankr. D. Ariz. 1990) (holding D & O insurance proceeds to be property of the estate because of: (1) the difficulty of attracting and retaining competent personnel to serve as officers and directors if the policies were canceled; and (2) the increase in claims against the debtor’s estate resulting from claims for indemnification).

\textsuperscript{170} See, e.g., \textit{In re Metro Transp. Co.}, 82 B.R. 351, 353-54 (Bankr. E.D. Pa. 1988) (court expressly agreed to lift stay if plaintiffs agreed to limit claims to the amount of the insurance policy).

\textsuperscript{171} See Zenith Lab., Inc. v. Sinay (\textit{In re Zenith Lab., Inc.}), 104 B.R. 659 (D.N.J. 1989). The court failed to find the D & O insurance policies property of the estate, stating that something is property of the estate “only to the extent that it increases the debtor’s worth or diminishes its liabilities.” Id. at 655.

\textsuperscript{172} The requirement of good faith in indemnification statutes has a corollary in D & O insurance known as the dishonesty clause. Just as indemnification statutes bar recovery for acts made in bad faith, most D & O policies contain dishonesty clauses. The following is a sample D & O dishonesty clause:

The insurer shall not be liable to make any payment for loss in connection with any claim or claims made against the insureds . . . brought about or con-
plaintiffs made a strong showing of fraud, it was doubtful that the officers would have been eligible for either indemnification or insurance.173 Restricting the scope of section 362 to actions against the debtor, particularly when a solvent executive is individually liable on the claim, prevents the confusion of determining whether in the abstract the D & O insurance is property of the estate. By determining whether the exhaustion of a D & O insurance policy would result in irreparable harm to the estate under section 105 and Rule 65, courts are compelled to balance the competing risks: the greater the likelihood the policy will be depleted and the debtor will be forced to indemnify, the greater the level of harm to the debtor and one more reason for a stay to issue.174 Conversely, the less likely that the officer is eligible for insurance or indemnification on account of her conduct, the less harm the estate will suffer and therefore, the less likely an injunction should issue. In short, section 105 and Rule 65 force a better inquiry than section 362: whether there is a risk of harm to the debtor under the insurance contracts is a far better question than whether an insurance contract that neither increases a debtor's assets nor depletes its liabilities is property of the estate.

tributed to by the fraudulent, dishonest or criminal acts of the insureds, however the provisions of this exclusion shall not apply unless a judgment or other final adjudication thereof adverse to the insureds shall establish fraud, dishonesty or criminal acts.

Bucy, supra note 12, at 26. These clauses are included and enforced under the argument that one cannot be insured against voluntary conduct. Id.

173 If an officer is not eligible for indemnification due to the nature of the conduct, and if the insurance policy contains a dishonesty clause, it is doubtful that the executive would be entitled to recover reimbursement from the policy proceeds.

174 In CAE Industries Ltd. v. Aerospace Holdings Co., 116 B.R. 31 (S.D.N.Y. 1990), the debtor's president made a motion to extend the stay to a tortious interference claim brought against him by creditors of the debtor corporation. Despite the existence of an indemnification agreement between the officer and the debtor, the court refused to extend the stay. Evaluating the motion under section 362, the court reasoned that "if an extension of the stay 'would work a hardship on plaintiffs, by giving an unwarranted immunity from suit to solvent co-defendants', which would contravene the purposes underlying the automatic stay, then the stay should be denied." Id. at 32 (quoting Fortier v. Dona Anna Plaza Partners, 747 F.2d 1324, 1330 (10th Cir. 1984)). This reasoning is sound because the court viewed the officer and the debtor corporation jointly and severally liable for the injuries to the parties seeking to recover, thereby making them joint tortfeasors and not indispensable parties. This analysis is more consistent with a section 105 inquiry into a balancing of interests than with a section 362 evaluation of only the impact to the estate.
B. Section 105: The Appropriate Standard

The only statutory alternative in extending bankruptcy protection to solvent corporate officers is section 105 of the Code. Courts are split, however, on what standard should be applied before the issuance of a section 105 injunction.\(^\text{176}\) One group requires the movant to meet the four-pronged test of Rule 65 as applied to the Bankruptcy Code through Bankruptcy Procedure Rule 7065.\(^\text{176}\) The other group does not require that any of the Rule 65 factors be met before issuing a section 105 injunction, not even a showing of irreparable harm.\(^\text{177}\) This latter approach is faulty because it deprives a creditor from bringing a cause of action against a third party without a corresponding show of harm to the debtor’s estate.\(^\text{178}\) A strict section 105 standard before the issuance of an injunction meets both the needs of creditors and debtors by only staying actions that would actually harm the debtor’s estate.

\(^{176}\) For a comparison of judicial interpretations of section 105, see supra, notes 92-120.


1. that movant is likely to suffer irreparable injury if relief is denied; and
2. that there is either likelihood of success on the merits or sufficiently serious questions going to the merits to make them fair ground for litigation, with balance of hardships tipping decidedly in applicants favor.

\(^{177}\) The court in Green v. Drexler (In re Feit & Drexler, Inc.), 760 F.2d 406 (2d Cir. 1985) interpreted the bankruptcy Rule 65 test to require:

1. that movant is likely to suffer irreparable injury if relief is denied; and
2. that there is either likelihood of success on the merits or sufficiently serious questions going to the merits to make them fair ground for litigation, with balance of hardships tipping decidedly in applicants favor.

\(^{178}\) In describing the heavy burden a movant must show before the issuance of an injunction, the court in Costa & Head Land Co. v. National Bank of Commerce (In re Costa & Head Land Co.), 68 B.R. 296 (N.D. Ala. 1986) stated:

[T]he cases all make it clear that injunctive relief is an extraordinary and drastic remedy with the burden of proof being on the debtor to establish under the traditional requirements that it is entitled to injunctive relief. If the debtor fails to satisfy this burden, the injunction may not issue.

\(^{1992}\)
1. Requiring the Risk of Irreparable Harm to the Estate

Injunctive relief should be issued sparingly and in extraordinary circumstances only when no remedy at law exists. A showing of irreparable harm is the threshold requirement for both a Rule 65 injunction and a section 105 stay.

The court in In re Arrow Huss, Inc., 51 B.R. 853 (Bankr. D. Utah 1985) described the burden under section 105:

The movant's burden of proof is a heavy one and must be supported by substantial evidence, the quantum of which will necessarily vary depending on the scope and duration of the stay sought. The movant must make out a clear showing of hardship and adverse impact on the reorganization case if there is even a fair possibility that the stay will prejudice an adverse party.

Id. at 859. An extreme example of an attempt to extend section 105 was a motion made by Integrated Resources, Inc. (the limited partnership syndicator and manager then operating in chapter 11) against Beigel & Sandler, Ltd., a plaintiffs class action firm then representing approximately 2,600 of the estimated 29,000 Integrated limited partners nationwide. The motion sought to enjoin Beigel & Sandler, under section 105, from advising their clients to stop payment on the clients' promissory notes because Integrated was defaulting on its obligations under the terms of the notes. Integrated argued that by advising their clients to stop payment on the notes, Beigel & Sandler was preventing Integrated from upstreaming the cash in order to facilitate its reorganization. As a result, Integrated argued, Beigel & Sandler was interfering with Integrated's reorganization and should be enjoined under section 105. See Plaintiff's Complaint & Memorandum of Law, Integrated Resources, Inc. v. Beigel & Sandler, Ltd. (In re Integrated Resources, Inc.), No. 90 B 10411 (Bankr. S.D.N.Y. July 26, 1991). At the hearing on the motion, the bankruptcy court advised Integrated that it should negotiate a resolution to the problem with Beigel & Sandler as it would not be satisfied with the result if it forced the court to make a determination on the applicability of section 105. See Hearing Transcript, Integrated Resources, Inc. v. Beigel & Sandler, Ltd. (In re Integrated Resources, Inc.), No. 90 B 10411 (Bankr. S.D.N.Y. Aug. 15, 1991).

See GAF Corp. v. Johns-Manville Corp. (In re Johns-Manville Corp.), 26 B.R. 405 (Bankr. S.D.N.Y. 1983) (in order for a section 105 injunction to issue, the movant must satisfy the requirements of Federal Rule Civil Procedure 65); Tucker Anthony Realty Corp. v. Schlesinger, 888 F.2d 969 (2d Cir. 1989) (a preliminary injunction is only proper after a showing of irreparable harm and a likelihood of success on the merits or the balance of equities tipping decidedly in favor of the movant). Justice Cardozo stated in Landis v. North American Co., 299 U.S. 248 (1936), that:

[T]he suppliant for a stay must make out a clear case of hardship or inequity in being required to go forward, if there is even a fair possibility that the stay for which he prays will work damage to some one else. Only in rare circumstances will a litigant in one case be compelled to stand aside while a litigant in another settles the rule of law that will define the rights of both.

Id. at 255. A case that adopted this strict standard is Pension Benefit Guar. Corp. v. LTV Corp. (In re Chateaugay Corp.), 76 B.R. 945 (S.D.N.Y. 1987). The court vacated a bankruptcy court order enjoining actions against the debtor's pension plans. The court held that one of the prongs of Rule 65—that the activity enjoined would cause harm to the estate and its reorganization—had not been met and that issuance of the injunction should therefore fail. Id. at 949. By resisting the lure of an overbroad reach of section 105, bankruptcy courts that adopt the narrow view and remain within the confines of...
court, however, stated that "[s]ince injunctions in bankruptcy cases are authorized by statute, the usual grounds for relief, such as irreparable damage need not be shown." The Lomas court erroneously read out of section 105 the requirement of irreparable harm and thus took the teeth out of what should be an otherwise heavy burden for the movant.

Section 105 was never intended by Congress to give bankruptcy courts free reign to enjoin parties not before them. Where an injunction issues under section 105, the standard should be the same as that "for the usual issuance of injunctions": the Rule 65 standard. When an injunction is issued to stop an action between two parties who have not sought the protection of the

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182 The case cited for the proposition that irreparable harm need not be shown before a section 105 injunction is issued is In re Neuman, 71 B.R. at 571. The Neuman court reasoned that since section 105 is exempted from the Anti-Injunction Act, 28 U.S.C. § 2283 (1978), which prohibits federal courts from enjoining state court actions in most circumstances, and that since this exception was "expressly authorized," Neuman, 71 B.R. at 571 (citing S. REP. No. 989, 95th Cong., 2d Sess., reprinted in 1978 U.S.C.C.A.N. 5787, 5815), then the usual equitable grounds for relief, such as irreparable damage, need not be shown. Neuman, 71 B.R. at 571.

The Neuman court cited Henderson v. Burd, 133 F.2d 515, 517 (2d Cir. 1943), for the proposition that the moving party need not show a risk of irreparable harm. This reliance was misplaced. In Henderson the court was faced with a suit under the Emergency Price Control Act of 1942, (The Emergency Price Control Act of 1942 is codified in 50 U.S.C. appendix section 901) as to whether an alleged violator of the Act could be enjoined from selling pantyhose at above maximum prices. The court held that the conduct could be enjoined absent a showing of irreparable harm, because "[w]here an injunction is authorized by statute it is enough if the statutory conditions are satisfied." Henderson, 133 F.2d at 517 (citing SEC v. Torr, 87 F.2d 446, 450 (2d Cir. 1937)).

It is erroneous to apply this rule to section 105. The statutory conditions of section 105 are not explicitly stated, but rather are implicit in the legislative commentary that accompany it: the Rule 65 standard. The most critical element of a rule 65 injunction is the showing of irreparable harm to the movant if the injunction does not issue. Accordingly, the precedent of the Emergency Price Control Act of 1942 is erroneous because that Act specifically did away with an irreparable harm requirement under certain circumstances. That is not the case with section 105. The legislative comment to section 105 requires an irreparable harm standard.

183 Explaining this heavy burden, the Manville court stated: "The suppliant for a stay must make out a clear case of hardship or inequity in being required to go forward, if there is even a fair possibility that the stay for which he prays will work damage to someone else . . . ." GAF Corp. v. Johns-Manville. (In re Johns-Manville), 26 B.R. 405, 417 (Bankr. S.D.N.Y. 1983) (quoting In re Mass. Asbestos Cases, M.D.L. Nos. 1 & 2 (D. Mass. Sept. 28, 1982), slip op. at 3).
court, equity demands that the court be very circumspect before issuing an injunction. Through misinterpretation of precedent courts have dismissed the irreparable harm requirement, depriving a creditor's right of action against a third party without a corresponding showing of irreparable harm.

2. A Strict Section 105 Standard: Equitable Results

Demanding that a movant satisfy a Rule 65 threshold before enjoining actions against a solvent officer is particularly necessary when the officer is independently liable to the creditor. Under these circumstances, the creditor is pursuing a separate cause of action against the officer, whose liability rests on individual conduct and not derivative liability. Permitting a harmed creditor to proceed against a tortfeasor, e.g., an officer of a debtor corporation, is equitable. If, however, the suit will cause irreparable harm to the estate, the debtor can establish under a strict Rule 65 analysis that an injunction protecting the officer from suit should issue. Without a requirement of irreparable harm before the issuance of a section 105 injunction, actions are stayed infringing upon creditors rights. This result is particularly inequitable in situations where potential harm to the debtor is minimal thus making the injunction unwarranted.

CONCLUSION

The Bankruptcy Code attempts to balance three competing interests: that of the debtor, seeking to reorganize; that of the creditor, seeking to recoup losses; and that of the public, seeking to preserve valuable enterprises and prevent the misuse of capital. These interests must be balanced to achieve equitable re-

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184 See Venture Properties, Inc. v. Norwood Group, Inc. (In re Venture Properties, Inc.), 37 B.R. 175, 177 (Bankr. D. N.H. 1984) (denying injunctive relief to debtor stating "[i]t has been a cardinal principle of bankruptcy law from the beginning that its effects do not normally benefit those who have not themselves 'come into' the bankruptcy court with their liabilities and all their assets").

185 The officer and the debtor are joint tortfeasors, meaning that they are jointly and severally liable as in Manville, and the creditor is merely pursuing the party not protected by the bankruptcy stay.

186 Costa & Head Land Co. v. National Bank of Commerce (In re Costa & Head Land Co.), 68 B.R. 296, 303 (N.D. Ala 1986). The Head Land court held that partners of the debtor had failed to meet the stiff requirements of section 105 and were not entitled to an injunction. Discussing the difference between the public interest and the purpose
sults. The current trend of extending sections 362 and 105 to enjoin actions against third parties without a corresponding Rule 65 threshold showing of harm elevates the interests of the debtor over those of the creditor and the public. Under Rule 65, the court is required to address all three of these interests before granting an injunction, thereby maintaining the delicate statutory balance.

The Bankruptcy Code's overriding purpose to rehabilitate the debtor does not grant uninhibited injunctive power to bankruptcy courts. Limiting the application of section 362 to the debtor and property of the estate and requiring a Rule 65 standard for section 105 injunctions not only complies with Congress's intent in enacting the code, but also serves the significant public interest in deterring fraudulent executives from seeking the protection of bankruptcy court.

Elizabeth H. Winchester

of the bankruptcy code, the court stated:

There is, or should be, a distinction between the "public interest" and the "overall philosophy of the Bankruptcy Code." If the bankruptcy court can be said to have found that its injunction will not adversely affect the public interest that finding is no more than an expansion upon the theme that whoever interferes with the affairs of a bankrupt debtor, however tangential or indirect that "interference" may be, trespasses upon the concept of debtor protection and therefore trespasses upon the "public interest." The philosophy of the Bankruptcy Code and the "public interest" do not constitute an absolute and inevitable equation.

Id. at 303.