IN THE UNITED STATES BANKRUPTCY COURT
FOR THE NORTHERN DISTRICT OF ILLINOIS
EASTERN DIVISION

In re:	)	**Chapter 11**
	)	
CORUS BANKSHARES, INC.	)	**Case No. 10-26881**
	)	
Debtor.	)	
	)	
	)	
CORUS BANKSHARES, INC.	)	
	)	
Plaintiff.	)	**Honorable Pamela S. Hollis**
	)	
v.	)	**Adversary No. 10-01357**
	)	
TRACY JONES, ET AL.	)	(Relates to Docket Nos. 3, 4 and 11)
	)	
Defendants.	)	
	)	

REPLY IN SUPPORT OF MOTION
OF THE DEBTOR TO EXTEND THE AUTOMATIC STAY
OR, IN THE ALTERNATIVE, FOR INJUNCTIVE RELIEF

The above-captioned debtor and debtor in possession and the plaintiff in this Adversary Proceeding (the "Debtor" or the "Plaintiff"), submits this reply in support of its motion to extend the automatic stay or, in the alternative, for injunctive relief.

INTRODUCTION

This is a simple matter. At the outset of this case, the Debtor asked this Court to extend the automatic stay, or in the alternative, to enjoin the prosecution of the *Jones* Complaint[1] against the Individual Defendants because (i) the *Jones* Complaint threatens assets of the Debtor's estate; (ii) claims arising out of the *Jones* Complaint against the Individual Defendants could

[1] All capitalized terms used but not defined herein shall have the meaning ascribed to them in the Debtor's *Memorandum in Support of its Motion to Extend the Automatic Stay or, in the Alternative, for Injunctive Relief* [Dock. # 4].

result in additional claims against the Debtor's estate; (iii) the Debtor could be precluded from denying liability for the actions of its officers and/or directors in subsequent litigation; and (iv) if allowed to proceed, the *Jones* Complaint would distract individuals critical to the Debtor's reorganization. Clearly these facts justify, if not require, the imposition of a stay against the continued prosecution of the *Jones* Complaint to both protect the corpus of the Debtor's estate and to provide the Debtor with the necessary "breathing spell" intended by the automatic stay.

Not surprisingly, the class plaintiffs object to the Debtor's requested relief, claiming that the "prejudice" they would suffer by any delay from a stay outweighs the harm that they will inflict upon the estate as a result of the litigation they intend to wage against the Individual Defendants. The class plaintiffs essentially make three arguments:

- ***First***, the Debtor's contractual reversionary interest in $7.7 million dollars is not an asset of the Debtor's estate entitled to protection by this Court.
- ***Second***, the Debtor cannot prove that participation and oversight of extensive discovery and litigation in a multi-million dollar class action lawsuit will consume time and resources of the Debtor's management and its professionals.
- ***Third***, any claims generated against the Debtor as a result of the *Jones* Complaint will not have any "real impact" on the Debtor's estate because all such claims will be subordinated pursuant to § 510(b) of the Bankruptcy Code.

As explained in detail below, none of the class plaintiffs' arguments has any merit and the class plaintiffs' objection (the "Objection") provides no basis to justify denying the Debtor its requested relief.

ARGUMENT

I. The Debtor's Reversionary Interest In The Insurance Proceeds Are An Asset Of The Estate.

As an initial matter, contrary to class plaintiffs' first argument, the Debtor's contractual right to recover up to $7.7 million from its insurer is plainly an asset of the Debtor's estate. It is axiomatic that "property of the estate includes all legal and equitable interests of the debtor in property ... 'in fact, every conceivable interest of the debtor, future, nonpossessory, contingent, speculative, and derivative, is within the reach of § 541.'" *In re Labrum & Doak, LLP*, 227 B.R. 391, 405 (Bankr. E.D. Pa. 1998) quoting *Carlson v. Brandt*, 1997 WL 534500, *2, 1997 U.S. Dist. LEXIS 12821, *28 (N.D. Ill. Aug. 22, 1997). Notably, class plaintiffs fail to cite to a single case holding that a reversionary interest (like the Debtor's here) falls outside of § 541's broad scope, and that is not the law. To the contrary, courts uniformly hold that reversionary interests in property are assets of a debtor's estate. *See e.g., In re Spring Ford Indus., Inc.*, 338 B.R. 255, 260 (E.D. Pa. 2006) (reversionary interest in workers' compensation fund constitute assets of the estate); *citing In re Wray*, 258 B.R. 777, 785 n. 8 (Bankr. D. Idaho 2001) (finding reversionary interest in real estate property of bankruptcy estate); *In re Hernando Healthcare, Inc.*, 157 B.R. 701, 703-04 (Bankr. M.D. Fla. 1993) (finding reversionary interest in reserve fund to be part of bankruptcy estate).

Unable to establish that reversionary interests are not assets of the Debtor's estate, the class plaintiffs offer three reasons why, in this case, the Court should ignore the clear application of § 541: (i) the Debtor's right to the reversionary interest has not yet accrued (Objection pg. 16); (ii) where a debtor's only interest in insurance proceeds is for reimbursement of indemnification costs, such proceeds are not assets of a debtor's estate (Objection pg. 10-13); and (iii) the Debtor's reversionary interest has been eliminated by a "triggering event" that

occurred prior to the bankruptcy (Objection pg. 16-21). Each of these arguments is fatally deficient.

A. The Reversionary Interest Is An Asset Regardless Of Whether The Right To Payment Has Yet Matured.

The class plaintiffs' argument that the Debtor's reversionary interest in the D&O Policy proceeds is not estate property because it "would not even arise until three and one half years from now" is frivolous. "Every conceivable interest of the debtor, ***future, nonpossessory, contingent***, speculative, and derivative, is within the reach of § 541." *Carlson v. Brandt*, 1997 WL 534500, *7, 1997 U.S. Dist. LEXIS 12821, *28 (N.D. Ill. Aug. 22, 1997) (emphasis added). That the right to payment on that interest has not yet accrued is irrelevant with respect to whether the present interest (created by the D&O Policy attached to the Motion) is an asset of the Debtor's estate. *See e.g. In re Bagen*, 186 B.R. 824, 829 (Bankr. S.D.N.Y. 1995) (holding that "Congress intended to encompass contingent future payments that were subject to a condition precedent on the date of bankruptcy.")

B. *Louisiana World Exposition* And Its Progeny Are Wholly Inapposite.

The class plaintiffs next argue that the rulings in *In re Louisiana World Exposition, Inc.*, 832 F.2d 1391 (5th Cir. 1987) and *In re CHS Elecs., Inc.*, 261 B.R. 538 (Bankr. S.D. Fla. 2001) establish that the D&O Policy proceeds cannot be estate assets because the Debtor has no direct liability coverage under the policy. But neither *Louisiana World Exposition* nor *CHS Elecs.* stands for the proposition that a debtor's contractual reversionary interest in insurance proceeds is not property of a debtor's estate under § 541. Rather, *Louisiana World Exposition* and *CHS Elecs.* hold that, where the debtors had no right to ever directly recover on available insurance proceeds, such proceeds were not estate assets. *Louisiana World Exposition, Inc.*, 832 F.2d at 1400-1 (holding that where payment of insurance proceeds to directors and officers could not

diminish available assets of the estate, such proceeds were not property of the estate); *In re CHS Elecs., Inc.*, 261 B.R. at 541 (holding "where the liability coverage covers the exposure of the directors and officers of the Debtor, and ***only is payable for the benefit of those directors and officers***, it is they, and not the estate, that have a property interest in the liability proceeds for bankruptcy purposes.") (emphasis added). That is not this case. Accordingly, *Louisiana World Exposition* and *CHS Elecs.* are completely inapposite.

Unlike the debtors in either *Louisiana World Exposition* or *CHS Elecs.*, the Debtor here is entitled to direct and independent recovery from the D&O Policy proceeds pursuant to the D&O Policy's Return Premium Endorsement. To quote another case cited by class plaintiffs, the D&O Policy proceeds are an asset that "increases the debtor's worth." *See* Objection at 11-12 citing *In re Zenith Labs., Inc.*, 104 B.R. 659, 665 (D. N.J. 1989). That is, the available D&O Policy proceeds provide the Debtor with a potential $7.7 million dollars to distribute to its creditors in general—separate and apart from the Debtor's right to seek reimbursement for indemnification payments to its former directors and officers (the sole right of the debtors in *Louisiana World Exposition* and *CHS Elecs.*).

As such, rather than bearing any relation to the cases relied upon by class plaintiffs, this case is more analogous to cases like *In re Vitek, Inc.*, 51 F.3d 530 (5th Cir. 1995) (addressing whether insurance proceeds available to both directors and officers and the debtor constitute estate assets subject to protection under § 362). As explained in *Vitek*, courts uniformly hold that a debtor's competing interest in the available insurance proceeds under a policy renders all of the proceeds property of the Debtor's estate. *See Vitek*, 51 F.3d at 534, n. 17, distinguishing *Louisiana World Exposition* and holding

> Faced with the typical situation in which a debtor corporation's liability policies provide the debtor and thus the estate with direct

> coverage against third party claims, virtually every court to have considered the issue has concluded that the policies and clearly the proceeds of those policies are part of debtor's bankruptcy estate, irrespective of whether those policies also provide liability coverage for debtor's directors and officers. Furthermore, the court limits the holding of the LWE case to the "narrow factual context" in which it arose, noting that the issues addressed by LWE are "in ferment" and that its holding has "not been broadly applied...."

Id; see also In re Sacred Heart Hosp. of Norristown, 182 B.R. 413 (Bankr. E.D. Pa. 1995) (finding where debtor had direct pecuniary interest in insurance proceeds, such proceeds constituted assets of the debtor's estate). Like the debtors in *Vitek* and *Sacred Heart*, the Debtor here has a separate and independent interest in the D&O Policy proceeds. This independent interest (which is wholly distinct from any right to indemnification of the Debtor's former directors and officers), no matter how "future or contingent", is an asset of the Debtor's estate under § 541. *Carlson v. Brandt*, 1997 WL 534500, *7, 1997 U.S. Dist. LEXIS 12821, *28.

C. No "Triggering Event" Has Eliminated The Debtor's Reversionary Interest In Unspent Insurance Proceeds.

The class plaintiffs' last argument with respect to the Debtor's Reversionary Interest is that the filing of the *Jones* Complaint operated as a "triggering event" forever divesting the Debtor of its reversionary interest in the D&O Policy proceeds. This contention has no basis in fact or law. Indeed, it is a matter of simple contract construction that the Debtor remains entitled to collect its full $7.7 million from the D&O Policy proceeds.

These are the facts. Pursuant to the D&O Policy, the Debtor currently is entitled to payment of $7.7 million minus only ***actual amounts paid*** by Hartford on claims made prior to the natural termination of the policy. D&O Policy Return Premium Endorsement (No. 15), attached to Memorandum in support of Motion as **Exhibit B.** As of today's date, no payments have been made by the insurer on account of any claims pursuant to the D&O Policy.

(Declaration of R. Curtis at 4). In particular, prior to the Petition Date, all of the Individual Defendants' litigation costs were borne by the Debtor without reimbursement under the D&O Policy. (*Id*. at 5).[2] Moreover, Hartford has certainly not made any payments on account of the resolution of any claim. (*Id.* at 6). Accordingly, under the plain terms of the D&O Policy, the Debtor, to this day, ***remains entitled*** to recover the full $7.7 million under the Return Premium Endorsement if no cash is paid out to (or on account of) the Individual Defendants by the natural termination of the D&O Policy.

As such, the class plaintiffs' contention that the mere fact that they have asserted claims against the Individual Defendants (for which the Individual Defendants may or may not be entitled to ultimate coverage under the D&O Policy) somehow divests the Debtor of its reversionary interest in the D&O Policy proceeds is simply false.[3]

In sum, the Debtor's reversionary interest in the D&O Proceeds is an asset of the Debtor's estate which would be reduced, if not exhausted, if the class plaintiffs continue their prosecution of the *Jones* Complaint against the Individual Defendants. This fact alone requires granting the Debtor its requested stay of such action pending its attempts to negotiate and confirm a chapter 11 plan. *Nat'l Tax Credit Partners v. Havlik*, 20 F.3d 705, 707 (7th Cir. 1994)

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[2] If by some chance an Individual Defendant filed a claim for his costs against Hartford since the Petition Date, they would be *de minimis* given class plaintiffs have agreed to stay all discovery pending this Court's determination of this Motion.

[3] The class plaintiffs' interpretation of the Return Premium Endorsement that the Debtor's recovery is also reduced by amounts held in reserve on open claims (Objection pg. 15-16) willfully and misleadingly omits that such reserved funds must ultimately be paid to the Debtor if "the Insurer's liability for such [reserved claim] is less than the assigned value for such" claim. D&O Policy, Return Premium Endorsement (No. 15). Moreover, the Individual Defendants' right to coverage under the D&O Policy is far from certain at this time. *See* Letter from C. Butler, dated 7/8/09, attached hereto as **Exhibit A** (expressly reserving determination of coverage pursuant to allegations of the *Jones* Complaint relating to intentional fraud and monetary gain of the Individual Defendants). Accordingly, any ***actual payment*** that the insurer might make in connection with any future reserve would be highly speculative at this time.

(holding Section 362(a)(3) directs a stay of any action, whether against the debtor or third parties, to obtain possession or to exercise control over property of the debtor).

II. Protracted Discovery And Litigation Will Distract The Debtor And Expend Limited Estate Resources.

Notwithstanding that the *Jones* Complaint's threat to the Debtor's assets is sufficient by itself to mandate the Debtor's requested stay, there are additional reasons to justify the Debtor's requested relief. In particular, as stated in the Motion, the continued prosecution of the *Jones* Complaint will unquestionably distract the Debtor's current management and impair their ability to focus on the restructuring efforts at hand.

In their Objection, the class plaintiffs argue that the Debtor has failed to "present evidence" that the continued litigation will distract the Debtor's management or expend limited estate resources. This argument is pure legal sophistry. Of course, the Debtor has not (and cannot) present evidence of future events…they have not yet happened. However, the Debtor can establish that it presently has only four employees (3 full time and 1 half-time). (Declaration of R. Curtis at 7). These four employees are overseeing all aspects of the Debtor's multi-million dollar restructuring. (*Id.* at 8) The Court can appreciate that occupying even one out of these four employees with matters relating to ongoing discovery and litigation at any given time will effectively reduce the Debtor's in-house human resources by over 25%. The Court can also rely on its own experience with the discovery and litigation process relating to multi-million dollar securities class actions. This Court does not need an expert witness to testify that such litigation is expensive and time consuming for all involved, not just principal defendants (which the Debtor effectively is by virtue of the former agency relationship of the remaining defendants).

In sum, there is more than an adequate record for to this Court to find that allowing the *Jones* Complaint to proceed against the Individual Defendants during the pendency of this

chapter 11 case would distract key members of the Debtor's management and the Debtor's professionals from their focus on the successful negotiation and confirmation of a chapter 11 plan. This provides yet another justification for the Debtor's requested relief.

III. Indemnification Claims Against The Debtor Impact The Estate.

The class plaintiffs' final argument—that any claims generated by the *Jones* Complaint (either by indemnification or collateral estoppel) do not really matter because such claims will be subordinated pursuant to § 510(b) of the Bankruptcy Code—is a red herring and misses the point.

First, this argument simply ignores that the indemnification claims that could be asserted against the Debtor would be the same claims that could reduce the Debtor's reversionary interest in the D&O Policy, resulting in a very real loss of value of the estate, regardless of the priority of such claim in the Bankruptcy Case.

Second, class plaintiffs' argument ignores the impact that a potentially negative evidentiary record resulting from litigating the *Jones* Complaint could have in litigation with other creditors whose claims would not be subject to subordination. *See In re Johns Manville Corp.*, 40 B.R. 219, 225 (S.D.N.Y. 1984), holding

> [O]nce a witness has testified to a fact or what sounds like a fact, that witness may be confronted with his prior testimony under oath in a future proceeding directly involving Manville, whether or not Manville was a party to the record on which the initial testimony was taken. Once an admission against interest is made, under oath or otherwise, by the agent of a party, that admission stands for all time.

Lastly, and perhaps most importantly, the class plaintiffs' argument places the cart before the horse. Indeed, while the class plaintiffs may well stipulate that they are not entitled to a general unsecured claim against the Debtor's estate, the Individual Defendants certainly have not stipulated to the class plaintiffs' interpretation of their indemnification claims against the

Debtor's estate. Nor has this Court entered any order dictating the priority treatment of any claim for indemnification by the Individual Defendants. And, even to the extent that this Court were to express its agreement with the class plaintiffs' position on the priority of the Individual Defendants' claims at this time, there is nothing in such an advisory opinion preventing the Individual Defendants from asserting a contrary position later in this case and requiring the estate to incur costs litigating over a priority dispute.

Simply put, a claim against the estate is a claim against the estate. The class plaintiffs might want to play Nostradamus and predict the ultimate priority of claims that might arise from the *Jones* Complaint litigation, but sometimes even Nostradamus was wrong and the Debtor should not be put at risk should class plaintiffs' self-proclaimed fortune-telling talents be proven wrong.

CONCLUSION

In sum, the *Jones* Complaint has the potential to disrupt the Debtor's pending bankruptcy proceedings and impair assets of the Debtor's estate. This threatened harm to the Debtor's estate requires the imposition of the Debtor's requested stay and nothing in the class plaintiffs' Objection comes close to refuting this inescapable conclusion.

As such, the Debtor respectfully requests that this Court overrule the Objection and enter an order extending the automatic stay to the *Jones* Complaint, or, in the alternative, permanently and/or preliminarily enjoining the further prosecution of the *Jones* Complaint during the pendency of the Debtor's chapter 11 case, and granting such other and further relief as the Court deems just and proper.

Dated: July 30, 2010
Chicago, Illinois

Respectfully Submitted,

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