IN THE UNITED STATES DISTRICT COURT FOR
THE EASTERN DISTRICT OF PENNSYLVANIA

IN RE:	**CIVIL ACTION**
LEONARD A. PELULLO,	
DEBTOR	**NO. 98-6181**

M E M O R A N D U M

Broderick, J. **September 29, 1999**

Presently before this Court is an appeal of an Order of the Bankruptcy Court in the above-captioned bankruptcy, in which Leonard A. Pelullo is the debtor. This appeal is brought by the Trustee of Pelullo's bankruptcy estate, David A. Eisenberg (the "Trustee"), as well as The Central States, Southeast and Southwest Areas Pension Fund ("Central States"), Olympia Holding Corporation, a/k/a P-I-E Nationwide, Inc. ("PIE"), and Lloyd T. Whitaker ("Whitaker"). Central States and PIE are creditors in the Pelullo bankruptcy, and Whitaker is the Trustee of Olympia Holding Corporation/PIE, which is itself in bankruptcy. National Union Fire Insurance Company of Pittsburgh, Pa. ("National Union") has filed a brief in support of the February 24, 1998 Order of the Bankruptcy Court.

On July 21, 1997, Pelullo filed a motion in the Bankruptcy Court, pursuant to § 554(b) of the Bankruptcy Code, for an order directing the Trustee to abandon interest in certain insurance

policy proceeds. The Trustee, Central States, and Mr. Whitaker objected to this motion. On February 24, 1998, the Bankruptcy Court granted Pelullo's motion and entered an order directing the Trustee to abandon interest in the insurance policy proceeds. This appeal followed. For the reasons stated below, this Court will affirm the Bankruptcy Court.

Background

On March 22, 1990, National Union Fire Insurance Company of Pittsburgh, Pennsylvania ("National Union"), issued a Directors' and Officers' Insurance and Company Reimbursement Policy (the "Policy") to PIE. (#12, Ex. A) The Policy provided insurance coverage to PIE's current and former directors and officers for any alleged Wrongful Act (as that term is defined in the Policy) committed in their respective capacities as directors and officers of PIE during the Policy period. The Policy states that National Union:

> shall pay the Loss of each and every Director or Officer of the Company arising from any claim or claims first made against the Directors or Officers and reported to the Insurer during the Policy Period . . . for any alleged Wrongful Act in their respective capacities as Directors or Officers of the Company . . . The Insurer shall. . .advance to each and every Director and Officer the Defense Costs of such claim or claims prior to their final disposition. . . . 'Defense Costs' means reasonable and necessary fees, costs and expenses consented to by the Insurer...resulting solely from the investigation, adjustment, defense and appeal of any claim against the Insureds..."

(Policy at 1).

In August of 1994, National Union commenced an interpleader proceeding in the United States District Court for the Northern District of Georgia (the “Georgia Action”) in order to resolve multiple, conflicting claims to the proceeds of the Policy. Pelullo served as a Director and Vice Chairman of the Board of Directors of PIE during the Policy period, and was named as a Defendant in the Georgia Action. In this Action, Pelullo asserted claims against the Policy for the advancement of defense costs in two criminal actions against him, one in Newark, New Jersey, and one in Jacksonville, Florida (the “Jacksonville Action”).

Central States, as a judgment creditor of Pelullo, intervened as a Plaintiff in the Georgia Action to assert a judgment lien against any monies which might be due from National Union to Pelullo under the Policy. Central States had an unsatisfied $45 million judgment against Pelullo obtained on August 26, 1991 in the United States District Court for the Northern District of Illinois. On March 8, 1996, the Georgia Court issued an order granting Central States’ motion for a default judgment against Pelullo. Central States later filed a motion asking the Georgia Court to amend its judgment against Pelullo to reflect that any proceeds payable to Pelullo under the Policy should be paid directly to Central States. On June 4,

1996, the Georgia Court denied Central States' motion. The Court noted that Pelullo had filed for personal bankruptcy in the Bankruptcy Court in Pennsylvania, and went on to state that:

> [t]he status of this Bankruptcy proceeding, and any impact that it may have on Central States' claims or the default judgment, are not clear at this time. This court is unable and unwilling to make a determination as to the relative rights and priorities of Central States with regard to any proceeds Pelullo may be awarded under the Policy.

(Georgia Ct. Order of June 4, 1996 at 8-9).

On October 29, 1996, the Georgia Court entered Final Judgment in the Interpleader Action, holding that defendant Pelullo was entitled to coverage under the policy only for defense costs incurred on his behalf in the Jacksonville Action. In an Amended Judgment of January 13, 1997, the Georgia Court specified that "National Union is obligated to reimburse or advance out of policy proceeds those reasonable and necessary fees, costs and expenses which are determined by the Bankruptcy Court of the Eastern District of Pennsylvania to be defense costs resulting solely from the investigation, adjustment, defense and appeal on behalf of Leonard A. Pelullo in the [Jacksonville Action]." Central States subsequently moved to amend this Amended Judgment on the ground that the Amended Judgment of January 13, 1997, did not clearly provide that the disbursement of policy proceeds for the advancement of Pelullo's defense costs in the Jacksonville Action were to be paid as directed by the

Bankruptcy Court. The Georgia Court accordingly amended the Final Judgment to read:

> National Union is obligated to reimburse or advance out of policy proceeds those reasonable and necessary fees, costs and expenses which may be determined to be defense costs resulting solely from the investigation, adjustment, defense and appeal on behalf of Leonard A. Pelullo in the federal criminal action in the United States District Court for the Middle District of Florida [the Jacksonville Action], and that the defense costs for the defense of Leonard Pelullo in the Jacksonville action are to be paid as directed by the United States Bankruptcy Court for the Eastern District of Pennsylvania.

(Georgia Ct. Order of March 27, 1997 at 7-8).

In July of 1997, Pelullo filed a motion in the Bankruptcy Court pursuant to § 554(b) of the Bankruptcy Code requesting an order directing the Trustee to abandon his interest, if any, in the Policy issued by National Union with respect to the Jacksonville Action defense costs. The Trustee, Mr. Whitaker, and Central States filed objections to the motion, contending that the Policy proceeds payable to Pelullo for defense costs in the Jacksonville Action are property of the bankruptcy estate, and therefore should be held in the bankruptcy estate for eventual distribution to the various creditors in the bankruptcy estate.

The Bankruptcy Court granted Pelullo’s motion, ruling that, “the proceeds of the insurance policy in question are not property of the estate under 11 U.S.C. § 541(a) since debtor does

not have a right to receive and keep the proceeds when the insurer pays on the claim", Houston v. Edgeworth, 993 F.2d 51, 55 (5th Cir. 1993); see also First Fidelity Bank v. McAteer, 985 F.2d 114, 116 (3d Cir. 1993). Further, the Bankruptcy Court held that "to the extent that it might be determined that the proceeds of the insurance policy in question do constitute property of the estate under 11 U.S.C. § 541(a), these proceeds constitute an extremely limited property interest under section 541(a)." The Bankruptcy Court granted Pelullo's motion requesting that the court direct the Trustee to abandon his interest in these proceeds because "the proceeds have only inconsequential value, if any, to the estate, cannot possibly benefit the unsecured creditors of the estate and are burdensome to the estate." (Bankr. Ct. Order of Feb. 24, 1998 at 2).

The Trustee, Mr. Whitaker, and Central States subsequently filed a motion with this Court for leave to appeal the Bankruptcy Court's rulings, which this Court granted.

In general, when the district court reviews a decision of the Bankruptcy Court on a question of law, it applies a plenary standard of review. However, a district court cannot overturn the Bankruptcy Court's findings of fact unless they were "clearly erroneous." Bankruptcy Rule 8013; In Re Morrissey, 717 F.2d 100, 104 (3d Cir. 1983). Because this case turns on a construction of

section 541(a) of the Bankruptcy Code, it presents questions of law that are reviewed de novo. Houston v. Edgeworth, 993 F.2d 51, 53 (5th Cir. 1993).

The issue before this Court is whether the proceeds of the National Union Policy payable for Pelullo's defense costs in the Jacksonville Action should be considered property of Pelullo's Chapter 7 bankruptcy estate pursuant to 11 U.S.C. § 541(a). Section 541(a)provides: "Such estate is comprised of . . . (1) all legal or equitable interests of the debtor in property as of the commencement of the case." 11 U.S.C. § 541(a). The Supreme Court has broadly construed this provision. United States v. Whiting Pools, Inc., 462 U.S. 198, 204-05 (1983). This broad construction, however, is not unlimited. In First Fidelity Bank v. McAteer,985 F.2d 114, 117 (3d Cir. 1993), the Third Circuit held that an "estate in bankruptcy only includes property to which the debtor would have had a right if the debtor were solvent." Likewise, in Houston v. Edgeworth, 993 F.2d at 55-56, the Fifth Circuit in 1993 held that "When a payment by the insurer cannot inure to the debtor's pecuniary benefit, then that payment should neither enhance nor decrease the bankruptcy estate."

In this case, the insurance proceeds at issue cannot inure to Pelullo's pecuniary benefit. The insurance policy issued by National Union obligates National Union to pay only "those

reasonable and necessary fees, costs and expenses which may be determined to be defense costs resulting solely from the investigation, adjustment, defense and appeal on behalf of Leonard A. Pelullo in the federal criminal action in the United States District Court for the Middle District of Florida [the Jacksonville Action]." Georgia Ct. Order of March 27, 1997. As pointed out by the Fifth Circuit in Houston v. Edgeworth, "[t]he overriding question when determining whether insurance proceeds are property of the estate is whether the debtor would have a right to receive and keep those proceeds when the insurer paid on a claim." Id. at 55.

In Edgeworth, the Fifth Circuit faced the issue of whether proceeds from debtor's malpractice liability policy were property of the debtor's estate. The court held that the proceeds of the policy were not property of debtor's estate because the debtor had no cognizable interest in them. Id. at 56. The court noted that such proceeds "will normally be payable only for the benefit of those harmed by the debtor under the terms of the insurance contract." Id. The proceeds at issue in the case at bar are payable for the sole benefit of those who have performed work in defense of Pelullo's Jacksonville action. No claim is made in this appeal, in the Bankruptcy Court below, or in the record of the Georgia action that Pelullo is seeking reimbursement for the recovery of defense costs in connection with the Jacksonville

action. Thus, the Bankruptcy Court correctly found that Pelullo has no right to receive and keep the proceeds from the National Union Policy.

In First Fidelity Bank v. McAteer, 985 F.2d 114 (3d Cir. 1993), the Third Circuit had to determine whether the proceeds of a credit life insurance policy collected after debtor died were property of the beneficiary of that policy, First Fidelity, or property of the debtor's estate. Because First Fidelity was entitled to receive and keep the proceeds of the policy, the court held that the proceeds could not be property of the bankruptcy estate. Id. at 118-19. As heretofore pointed out, the First Fidelity court made clear that the estate in bankruptcy only includes property to which debtor would have a right if debtor were solvent. Id. at 117.

Likewise, in In re Berger Steel, 51 B.R. 59 (Bankr. N.D. Ind. 1985), the court considered whether liability policies held by debtor corporation, under which insurer was obligated to pay on claims of successful tort plaintiffs were of inconsequential value to the estate and were burdensome to it. In holding that the policies should be abandoned, the court noted that abandoning the policies would not have any impact on the estate because the policies could only be accessed by tort claimants' judgments or settlements. Id. at 60.

This Court thus agrees with the Bankruptcy Court's holding

that:

> (1) the proceeds of the insurance policy in question are not property of the estate under 11 U.S.C. § 541(a) since debtor does not have a right to receive and keep the proceeds when the insurer pays on the claim . . . and (2) to the extent that it might be determined that the proceeds of the insurance policy in question do constitute property of the estate under 11 U.S.C. § 541(a), these proceeds constitute an extremely limited property interest under section 541(a) and . . .the court finds that the proceeds have only inconsequential value, if any, to the estate, cannot possibly benefit the unsecured creditors of the estate and are burdensome to the estate

(Bankr. Ct. Order of Feb.24, 1998 at 1-2).

For the reasons stated, the Bankruptcy Court’s order of February 24, 1998, requiring the Trustee to abandon his interest in the proceeds of the National Union Policy, is affirmed. An appropriate Order follows.

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O R D E R

AND NOW, this 29th day of September, 1999; Appellants David A. Eisenberg, Central States, Southeast and Southwest Areas Pension Fund, and Lloyd T. Whitaker having brought this appeal of the Bankruptcy Court's order granting Debtor Leonard A. Pelullo's motion to abandon interest in certain insurance policy proceeds and Appellees Leonard A. Pelullo and National Union Fire Insurance Company's response thereto; for the reasons set forth in this Court's accompanying memorandum of this date;

IT IS ORDERED that the Order of the Bankruptcy Court dated February 24, 1998 granting Appellee Pelullo's motion and directing the Trustee to abandon interest in the insurance policy proceeds is **AFFIRMED**.

RAYMOND J. BRODERICK, J.