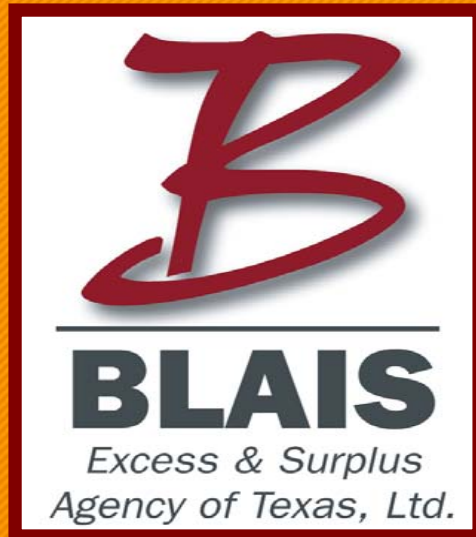


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JULY 14, 2010
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*D&O INSURANCE AND BANKRUPTCY
WEBINAR*



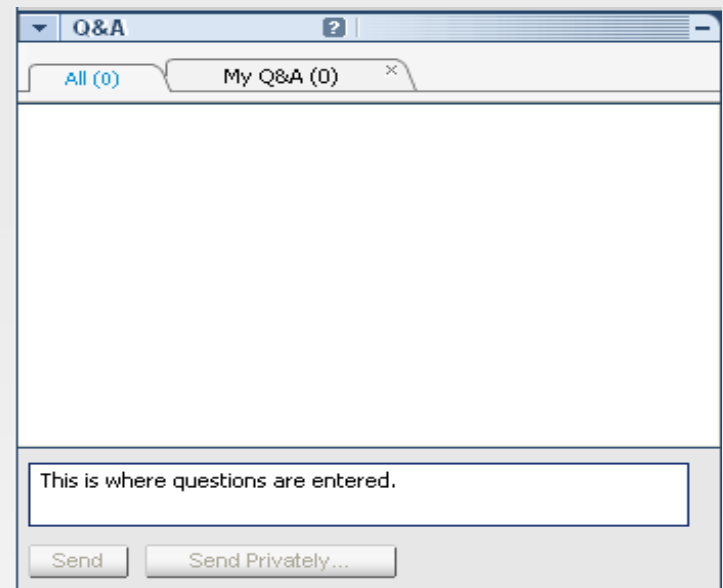
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July 14, 2010

D&O BANKRUPTCY WEBINAR DETAILS



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- **The Q&A Panel can be used throughout the presentation.**
- **Enter your question and then hit send.**



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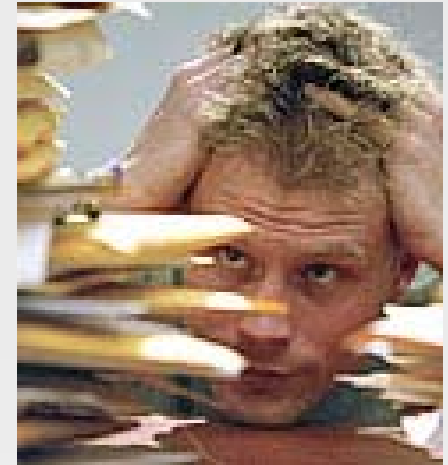
INTRODUCTION



During this webinar we will introduce and discuss:

- **Bankruptcy Process & Parties (Slides 7-9);**
- **Bankruptcy Filings (Slides 10-25);**
- **Bankruptcy and D&O Insurance Issues (Slides 26-57);**
- **Side A Coverage (Slides 58-59) and;**
- **Runoff Program Options (Slides 60-63).**

Our goal is to educate participants with information and facts as they pertain to a D&O policy and bankruptcy.



This Blais E&S webinar is one of many that have been held on topics concerning Executive Line coverages. Please visit our website for a full schedule of past and future webinars.

D&O BANKRUPTCY WEBINAR

SLIDE LOCATOR



SLIDE	TITLE	SLIDE	TITLE	SLIDE	TITLE
1	Cover Slide	20	2009 Public Bankruptcy	39	Automatic Stay
2	Webinar Details	21	2009 Public Bankruptcy	40	Automatic Stay
3	Panelist	22	2010 Public Bankruptcy	41	Automatic Stay
4	Webinar Introduction	23	Bankruptcy Filings – Quick	42	Automatic Stay
5	Slide Locator	24	Bankruptcy Filings – Chart	43	Automatic Stay
6	Slide Locator	25	Bankruptcy Filings - 11	44	Order of Payments
7	Purpose of Bankruptcy	26	Issues	45	Order of Payments
8	Bankruptcy Chapters	27	Checklist	46	Order of Payments
9	Creditor Committees	28	Checklist	47	Order of Payments
10	Major American Bankruptcies	29	Checklist	48	Order of Payments
11	Bankruptcy Facts - 12 Month	30	Checklist	49	Change of Control
12	Bankruptcy Facts - Business	31	Checklist	50	Change of Control
13	Bankruptcy Facts - Total	32	Checklist	51	Insured v Insured
14	Bankruptcy Facts - Total	33	Attorneys	52	Insured v Insured
15	Bankruptcy Facts – Map	34	Clause A & B	53	Insured v Insured
16	Bankruptcy Facts – Texas	35	Clause C	54	Insured v Insured
17	2009 Public Bankruptcy	36	Clause A – B – C Chart	55	Conduct Exclusion
18	2009 Public Bankruptcy	37	Side A Articles	56	Waiver of Stay
19	2009 Public Bankruptcy	38	Automatic Stay	57	Advancement of Defense Costs

D&O BANKRUPTCY WEBINAR

SLIDE LOCATOR



SLIDE	TITLE	SLIDE	TITLE	SLIDE	TITLE
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The Bankruptcy Process and Parties



Purpose of Bankruptcy Rehabilitation of the debtor and fairness to creditors

Bankruptcy laws help people who can no longer pay their creditors get a fresh start – by liquidating assets to pay their debts or by creating a repayment plan. Bankruptcy laws also protect troubled businesses and provide for orderly distributions to business creditors through reorganization or liquidation. Most cases are filed under the three main chapters of the Bankruptcy Code: Chapter 7, Chapter 11, and Chapter 13. Chapter 13 relates to Individual Debt adjustments and is not the focus of this presentation.

Federal courts have exclusive jurisdiction over bankruptcy cases. This means that a bankruptcy case cannot be filed in a state court.



The Bankruptcy Process and Parties



- **Chapter 7 Liquidation**

Under Chapter 7, the company stops all operations and goes completely out of business. A trustee is appointed to "liquidate" (sell) the company's assets, and the money is used to pay off the debt, which may include debts to creditors and investors.

- **Chapter 11 Reorganization**

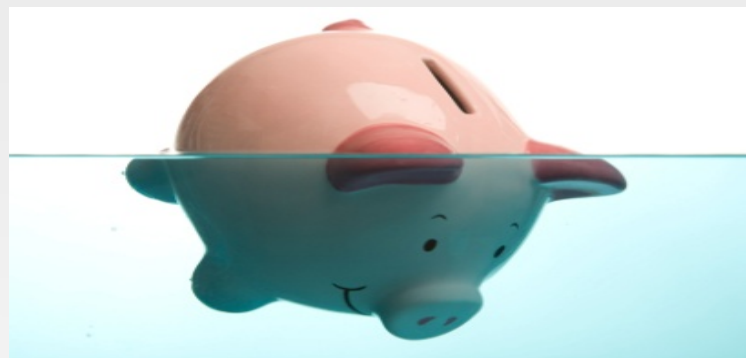
When a company files for Chapter 11, it automatically assumes a new identity as the "debtor in possession", or "DIP". The company will remain a debtor in possession and operate the business until its plan of reorganization is confirmed, the debtor's case is dismissed or converted to chapter 7.

- **Chapter 12 Family Farmers**

Family farmers can take advantage of this simplified reorganization. Modeled after Chapter 13, Chapter 12 allows the debtor to retain all property and pay creditors out of future income.

- **Chapter 13 Individual Debt Adjustment**

This chapter of the Bankruptcy Code provides for adjustment of debts of an individual with regular income. Chapter 13 allows a debtor to keep property and pay debts over time, usually three to five years.



The Bankruptcy Process and Parties



Creditor's Committee and Trustee

In a **Chapter 11** proceeding, the U.S. Trustee, the bankruptcy arm of the Justice Department, will appoint one or more committees to represent the interests of creditors and stockholders (referred to as the "creditor's committee"). The creditor's committee works with the company to develop a plan of reorganization to get out of debt. The plan must be accepted by the creditors, bondholders and stockholders and confirmed by the Court.

In a **Chapter 7** proceeding, an individual will be appointed to administer the Chapter 7 case. His role is to determine whether there are assets to liquidate and to review claims of exemption and the debtor's entitlement to a discharge. He is essentially a representative for the creditors as a group. He is appointed by the United States Trustee, an officer of the Department of Justice, who oversees his performance. He is not himself a government employee.



Bankruptcy Filings



Not only are major American companies, icons and brand-names like Enron, Texaco, Washington Mutual, WorldCom, General Motors and Lehman Brothers filing bankruptcy, but so are a number of middle market and smaller operations, both public and private.

June 2009



April 12, 1987



September 15, 2008



December 2001



July 2002



Bankruptcy Filings



- Bankruptcy filings for the 12-month period ending March 31, 2010, rose **27 percent** when compared to bankruptcy filings for the 12-month period ending March 31, 2009, according to statistics released by the Administrative Office of the U.S. Courts.
- March 2010 bankruptcy filings **totaled 1,531,997**, compared to the 1,202,395 bankruptcy cases filed in the 12-month period ending March 31, 2009.

Source: US Courts



Bankruptcy Filings



Business and Non-Business Filings

- The majority of bankruptcy filings involve predominantly non-business debts. **Non-business filings (also called personal or consumer filings)** for the 12-month period ending March 31, 2010, totaled 1,470,849, up 28 percent from the 1,153,318 bankruptcies filed in the 12-month period ending March 31, 2009.
- Filings involving business debts also rose. They **totaled 61,148, up 25 percent** from the 49,077 business bankruptcies filed in the 12-month period ending March 31, 2009.

Source: US Courts

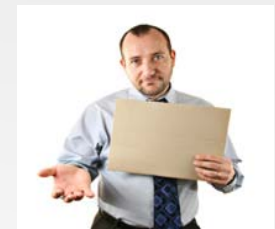


Bankruptcy Filings



Total Bankruptcy Filings by Bankruptcy Chapter Years Ended March 31, 2006-2010 Source: US Courts

<u>Year</u>	<u>7</u>	<u>11</u>	<u>12</u>	<u>13</u>
2010	1,100,032	15,251	605	415,966
2009	819,304	11,774	367	370,836
2008	560,015	6,971	343	334,551
2007	413,294	5,199	372	276,649
2006	1,432,074	6,497	366	355,756

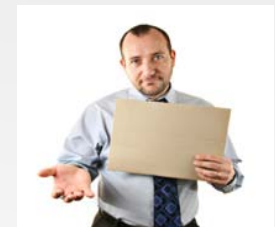


Bankruptcy Filings



Business and Non-Business Filings Years Ended March 31, 2006-2010 Source: US Courts

<u>Year</u>	<u>Total</u>	<u>Non-Business</u>	<u>Business</u>
2010	1,531,997	1,470,849	61,148
2009	1,202,395	1,153,318	49,077
2008	901,927	871,186	30,741
2007	695,575	673,615	21,960
2006	1,794,795	1,759,503	35,292



Bankruptcy Filings



Annual Business & Non Business Filings – Texas

Source: American Bankruptcy Institute

	2007	2008	2009
Total Filings	42,931	44,258	55,435
Business	2,480	3,124	4,567
Non Business	40,451	41,134	50,868



Bankruptcy Filings

2009 Noteworthy Corporate Bankruptcies



- AbitibiBowater Inc. ([ABWTQ.PK](#)) (Paper)
- Accuride Corporation ([AURD.OB](#)) (Trucking)
- Adamar Inc. dba Tropicana Casino & Resort (Gambling)
- Advanta Corp. ([ADVNA](#)) (Banking/Finance)
- Altus Pharmaceuticals ([ALTU](#)) (Pharma)
- American Community Newspapers Inc. & LLC (Newspapers)
- ARG Enterprises, Inc. (Restaurants)
- Aurora Oil & Gas Corporation ([AUEGF.PK](#)) (Energy)
- Aventine Renewable Energy Holdings, Inc. ([AVR](#)) (Energy)
- BankUnited Financial Corporation ([BKUNA](#)) (Banking)
- Barzel Industries, Inc. (Manufacturing)
- Baseline Oil & Gas Corp. (Energy)
- Bearingpoint, Inc. ([BGPT.OB](#)) (Consulting)
- BI-LO, LLC (Supermarkets)
- Bruno's Supermarkets, LLC (Supermarkets)
- Butler International, Inc. (IT Services)
- California Coastal Communities, Inc. ([CALC](#)) (Real Estate)
- Cape Fear Bank Corporation (Banking)
- Capital Corp of the West (Banking)
- Capmark Financial (Banking)
- CCS Medical, Inc. (Medical)
- Champion Enterprises, Inc. ([CHB](#)) (Real Estate)

Bankruptcy Filings

2009 Noteworthy Corporate Bankruptcies



Charter Communications, Inc. ([CHTRQ.PK](#)) (Telecom)
Chemtura Corporation ([CEMJQ.PK](#)) (Chemicals)
Chrysler LLC (Automobiles)
CIB Marine Bancshares, Inc. (Banking)
CIT Group ([CIT](#)) (Banking)
Citadel Broadcasting ([CTDB.PK](#)) (Media)
Colonial BancGroup, Inc. ([CNB](#)) (Banking)
Cooperative Bankshares, Inc. ([COOP](#)) (Banking)
Cooper-Standard Holdings (Automobile)
Crescent Resources, LLC (Real Estate)
Cynergy Data, LLC (Banking)
deCODE Genetics, Inc. ([DCGN](#)) (Biotech)
Eddie Bauer Holdings, Inc. ([EBHI](#)) (Retail)
Edge Petroleum Corporation (Oil & Gas)
Ennis Homes, Inc. (Real Estate)
Extended Stay Inc. (Hotels)
Fairpoint Communications ([FRP](#)) (Telecom)
Filene's Basement, Inc. (Retail)
Finlay Enterprises, Inc. ([FNLY](#)) (Jewelry)
Fleetwood Enterprises, Inc. ([FLE](#)) (Recreational Vehicles)
Fortunoff Holdings, LLC (Retail)

Bankruptcy Filings

2009 Noteworthy Corporate Bankruptcies



Freedom Communications Holdings, Inc. (Media)
Fulton Homes Corporation (Real Estate)
General Growth Properties, Inc. ([GGWPQ.PK](#)) (Real Estate)
General Motors Corporation ([MTLQQ.PK](#)) (Automobiles)
G.I. Joe's, Inc. (Retail)
Goody's LLC ([GDYS](#)) (Retail)
Gottschalks Inc. ([GOT](#)) (Retail)
GSI Group, Inc. ([GSIG](#)) (Semiconductors)
Guaranty Financial Group Inc. ([GFG](#)) (Banking)
Herbst Gaming, Inc. (Gambling)
Holley Performance Products, Inc. (Automotive)
ION Media Networks, Inc. ([ION](#)) (Television)
Idearc ([IDARQ.PK](#)) (Publishing)
Imperial Capital Bancorp (Banking)
Irwin Financial Corporation ([IFC](#)) (Banking)
JL French Automotive Castings, Inc. (Automotive)
Journal Register Companies ([JRC](#)) (Newspapers)
Lazy Days RV Center, Inc. (Recreational Vehicles)
Lear Corporation ([LEA](#)) (Automobile)
Lyondell Chemical Company ([LYO](#)) (Chemicals)
MagnaChip Semiconductor LLC (Semiconductors)
Magna Entertainment ([MECA](#)) (Gambling)

Bankruptcy Filings

2009 Noteworthy Corporate Bankruptcies



Majestic Star Casino, LLC (Gambling)
Masonite Corporation (Real Estate Manufacturing)
Metromedia International Group, Inc. ([MTRM.PK](#)) (Media)
Midway Games, Inc. ([MWY](#)) (Entertainment Software)
Monaco Coach Corporation ([MNC](#)) (Recreational Vehicles)
Muzak Holdings LLC (Entertainment)
Nortel Networks, Inc. ([NRTLQ.PK](#)) (Telecom)
NTK Holdings – Nortek, Inc. (Construction)
NutraCea (NTRZ.OB) (Health/Nutrition)
Oscient Pharmaceuticals Corporation ([OSCI](#)) (Pharma)
Pacific Energy (Oil & Gas)
Penn Traffic Company (Supermarkets)
Philadelphia Newspapers, LLC (Newspapers)
Proliance International, Inc. (Manufacturing)
RathGibson, Inc. (Manufacturing)
Reader's Digest, Inc. ([RDA](#)) (Media)
Recycled Paper Greetings, Inc. (Greeting Cards)
R.H. Donnelley Corporation ([RHDC.PK](#)) (Marketing)
Ritz Camera Centers, Inc. (Retail)
Samsonite Company Stores, LLC ([SAMC](#)) (Retail)
Security Bank Corporation (Banking)

Bankruptcy Filings

2009 Noteworthy Corporate Bankruptcies



Shane Company (Jewelry)
Silicon Graphics, Inc. ([SGID](#)) (IT/Computing)
Silver State Bancorp (Banking)
Simmons Company (Bedding)
Six Flags, Inc. ([SIX](#)) (Entertainment)
Smurfit-Stone Container Corporation ([SSCC](#)) (Paper Manufacturing)
Source Interlink Companies, Inc. ([SORC](#)) (Marketing)
Southern Community Bancshares, Inc. (Banking)
Spectrum Brands ([SPEB.OB](#)) (Consumer Products)
Star Tribune Companies (Newspapers)
Station Casinos, Inc. ([STN](#)) (Gambling)
Sun-Times Media Group, Inc. ([SUTM.PK](#)) (Newspapers)
Tarragon Corporation ([TARR](#)) (Real Estate)
Team Financial, Inc. (Banking)
Temecula Valley Bancorp ([TMCV](#)) (Banking)
Teton Energy Corporation (Oil & Gas)
Thornburg Mortgage, Inc. ([THMR.PK](#)) (Banking)
TLC Vision Corporation ([TLCV](#)) (Vision/Eye Care)
Trump Entertainment ([TRMP](#)) (Gambling)
UCBH Holdings ([UCBH](#)) (Banking)
U.S. Shipping Partners L.P. (Marine Transportation)
Velocity Express Corporation ([VEXP](#)) (Delivery)
Vineyard National Bancorp ([VNBC](#)) (Banking)
Visteon Corporation ([VC](#)) (Auto Supplies)
Walking Company Holdings, Inc. (Footwear)
Wall Homes, Inc. (Real Estate)
WL Homes, LLC (Real Estate)
Young Broadcasting, Inc. ([YBTVA](#)) (Television)

Bankruptcy Filings

2010 Noteworthy Corporate Bankruptcies



Affiliated Media, Inc. (Newspapers)
American Mortgage Acceptance Company (Real Estate)
Anthracite Capital, Inc. (Real Estate)
Atrium Companies, Inc. (Windows and Doors)
Beach First National Bancshares, Inc. (Banking)
Black Gaming, LLC (Gambling)
Chem Rx Corporation (Pharma Services)
Community Bancorp (Banking)
Corus Bankshares, Inc. (Banking)
Electrical Components International, Inc. (Manufacturing)
EnviroSolutions Holdings, Inc. (Waste Disposal)
Evergreen Bancorp, Inc. (Banking)
FirstFed Financial Corp. (Banking)
Haight's Cross Communications, Inc. (Publishing)
International Aluminum Corporation (Real Estate)
Mesa Air Group, Inc. (Airlines)
Morris Publishing Group, LLC (Media)
Movie Gallery, Inc. (Retail)
Neenah Enterprises, Inc. (Manufacturing)
Neff Corp. (Construction)
Orleans Homebuilders, Inc. (Real Estate)
Penton Business Media Holdings, Inc. (Media)
Point Blank Solutions, Inc. (Security)
Regent Communications, Inc. (Media)
R&G Financial Corp. (Banking)
Saint Vincent's Catholic Medical Centers (Healthcare)
Spheris Inc. (IT Services)
TierOne Corporation (Banking)
The Newark Group, Inc. (Paper)
Uno Restaurant Holdings Corporation (Restaurants)
US Concrete, Inc. (Construction/Basic Materials)
Xerium Technologies, Inc. (Paper)

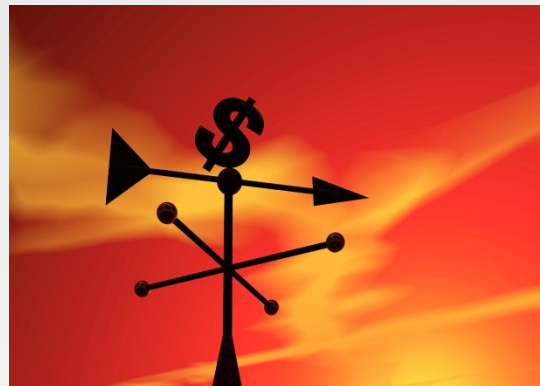
Bankruptcy Filings

Current Trends and New Filings in Bankruptcy



The current economic cycle generally is producing two types of bankruptcy cases for businesses:

- Quick, pre-packaged or pre-arranged cases, and;
- “Liquidate and litigate” cases.



Bankruptcy Filings

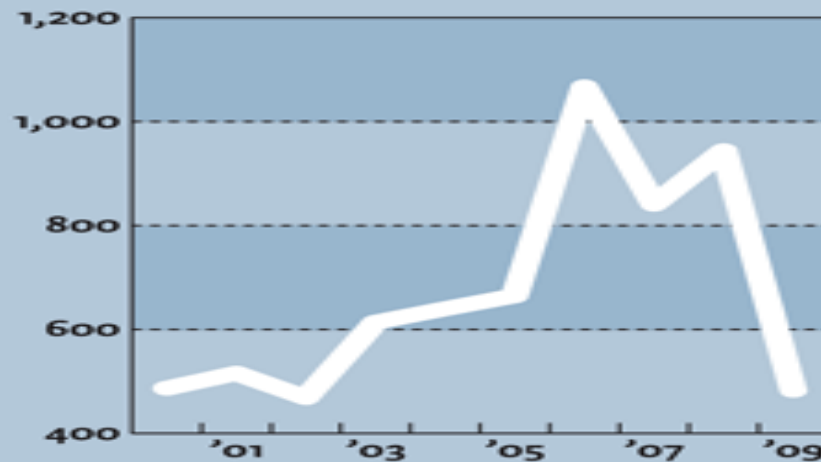
Current Trends and New Filings in Bankruptcy



The average duration of non pre-packaged, large public-company bankruptcies fell from 944 days in 2008 to 483 days in 2009, the shortest time in at least 10 years.

FAST TIMES

The average duration of non-prepackaged, large public-company bankruptcies plummeted last year.



Source: UCLA-LoPucki Bankruptcy Research Database



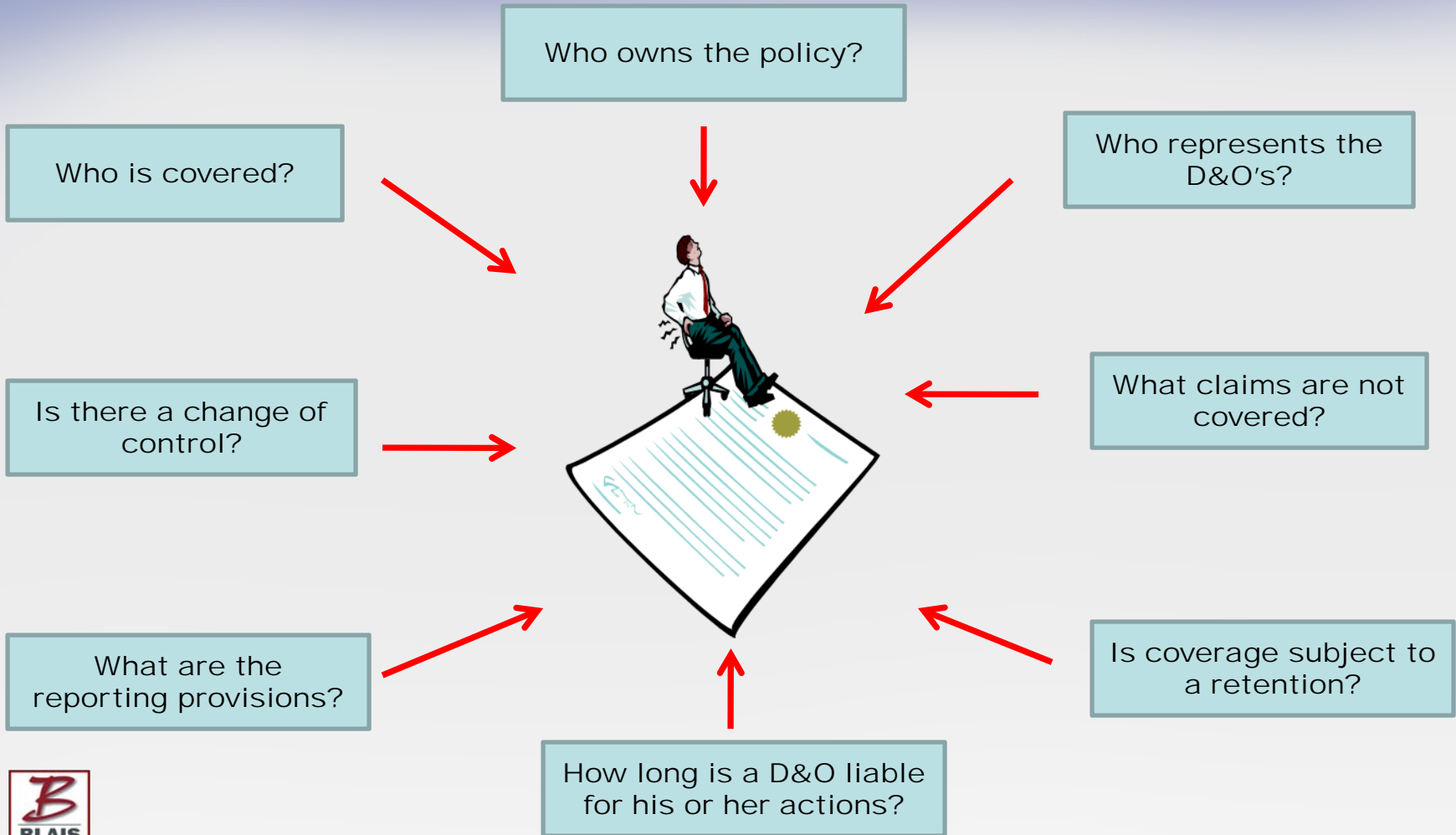


Why are companies exiting Chapter 11 sooner?

For one thing, the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 has made it almost impossible to linger in bankruptcy. Among other things, the Act reduced the exclusivity period for filing a plan of reorganization, introduced a "hard stop" in the deadline for rejecting an unexpired commercial lease, and limited the bonuses that could be offered to retain key employees while a company restructured. Also, pre-packaged bankruptcies have become more acceptable.

Bankruptcy and D&O Insurance

What are the issues?



Bankruptcy and D&O Insurance

What are the issues?



BANKRUPTCY - D&O COVERAGE CHECKLIST

1. ★	Definition of Insured	Is Debtor-In-Possession covered?
2. ★	Change of Control	Does bankruptcy trigger change of control provision?
3. ★	Insured vs Insured Exclusion	Is there a carve back for suits by a bankruptcy trustee, examiner, receiver, liquidator, rehabilitator, creditor's committee or any comparable authority?
4. ★	Order or Priority of Payments Provision	This provision is perceived to be a solution to the issue of the courts automatic stay and ensures that, in the event of bankruptcy, the policy proceeds will be available to the D&O's and not the debtor. Does the policy contain such a provision?
5.	Cancellation Clause	Policy should contain a provision that only allows the insurer to cancel coverage if the company fails to pay the premium.
6.	Regulatory Exclusion	Does the policy contain any form of regulatory exclusion that absolves the insurer of paying claims in the event of enforcement actions, investigation (formal or informal) and other fallout as a result of government oversight?



Star indicates there will be further discussion



Bankruptcy and D&O Insurance

What are the issues?



BANKRUPTCY - D&O COVERAGE CHECKLIST

7.	Non-Rescindable Clause	Is there an acceptable non-rescindable endorsement and/or wording built into the policy?
8.	Definition of Application	Is there endorsement and/or wording in the policy that narrows the definition of application? Note: A number of policies contain wording that includes all documents filed by a company with any federal or state regulatory agency.
9.	Application of Severability Provision	Is there “full severability” in connection with the policy application? The program should be structured so that any insured person’s knowledge of application misrepresentations “should not affect coverage for insured’s who were unaware” of the misrepresentations.
10.	Limits	Are the current limits adequate? Benchmark material should be reviewed in addition to specific claims to provide insureds a basis for the selection of limits.



Star indicates there will be further discussion



Bankruptcy and D&O Insurance

What are the issues?

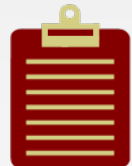


BANKRUPTCY - D&O COVERAGE CHECKLIST

11.	Advancement of Defense Costs	Is the provision acceptable? Need to review in detail (1) Control over the costs incurred and (2) when the insurer must make defense payments.
12. ★	Waiver of Automatic Stay Provision	Does the policy have a special provision or endorsement relating to waiver of stay by the corporation? This provision states that the insured organization has agreed to waive and release any automatic stay or injunction, and they agree not to oppose any relief from such stay or injunction.
13. ★	Conduct Exclusions	How are they triggered? They should be drafted to trigger only upon a final adjudication of the prohibited ...conduct.
14.	Section 11/12 Damages	Need to be sure that the definition of loss under the policy acknowledges payments under Section 11 & 12 (Restitution or Disgorgement) that may be deemed uninsurable.



Star indicates there will be further discussion



Bankruptcy and D&O Insurance

What are the issues?



BANKRUPTCY - D&O COVERAGE CHECKLIST

15. ★	Side A Coverage	Does the program structure contain a stand alone Side A layer of coverage?
16. ★	Selection of Counsel	What rights does the insured have in the selection of counsel?
17.	Extended Reporting Period Options	What are the terms of the extended reporting provision, and are they acceptable?
18.	Notice of Claim Provisions	This provision allows for not only the reporting of claims but also circumstances that could give rise to a claim. Have all claims and circumstances been reported?
19.	Primary D&O Policy Layout	Most D&O policies pivot off three Insuring Agreements A, B & C. These provisions should be reviewed in the context of bankruptcy.



Star indicates there will be further discussion



Bankruptcy and D&O Insurance

What are the issues?

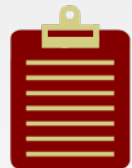


BASIC BANKRUPTCY - D&O COVERAGE CHECKLIST

20.	Excess D&O Policy Layout	Does the excess layer policies contain what is termed “Shaved Limits” riders? Are the excess policies true “follow form”?
21.	Contingent Liability Factors	The Sarbanes-Oxley Act states that the statute of limitations for Directors and Officers of corporations is five years.
22.	D&O Policy Term	What is the D&O policy term in relation to the date of the filing of bankruptcy?
23.	Global D&O Requirements	Most D&O policies apply to claims asserted worldwide. Certain countries maintain compulsory insurance requirements. Consideration needs to be given to these venues.
24.	Hammer Clause	What are the terms of the “hammer clause”?



Star indicates there will be further discussion



Bankruptcy and D&O Insurance

What are the issues?



BASIC BANKRUPTCY - D&O COVERAGE CHECKLIST

25.	Presumptive Indemnification	This provision in the D&O policy assumes that the insured companies, indemnification provisions are as broad as the law will allow. The provision typically does not apply when the insured entity is unable to indemnify its D&O's as a result of "financial insolvency" or "financial impairment".
26.	Employed Lawyer	Even if the in-house counsel satisfies the policy definition of D&O –many GCs serve as corporate secretary for example – insurers frequently raise an issue of whether coverage extends to the attorney's rendering of professional services to the company in the capacity as a non officer attorney. Either purchase a separate stand alone employed lawyers policy and/or have the D&O policy endorsed to cover the employed lawyer.



Star indicates there will be further discussion



Bankruptcy and D&O Insurance

Selection of Counsel



Some D&O policies have a provision whereby defendants have the right to choose their own legal counsel, subject to the insurance company's consent, which shall not be unreasonably withheld. Some policies contain a list of approved "panel counsel firms" that must be used. Most companies wait until after a lawsuit is filed to begin their search for a law firm and/or review the panel counsel listing. In any case (bankruptcy specifically) it is important to have this issue addressed in advance.



Bankruptcy and D&O Insurance

D&O Policy Insureds



- **Traditional D&O Coverage**

Traditionally, directors and officers liability policies provided two types of coverage:

- **Insuring Agreement A** (or “Side A Coverage”): Liability coverage payable directly to the directors and officers for claims for wrongful acts when indemnification is not permitted or not available due to insolvency; and
- **Insuring Agreement B** (or “Side B Coverage”): Coverage payable to the corporation/insured entity to reimburse it for indemnification provided to their directors and officers for claims for wrongful acts against them.



Bankruptcy and D&O Insurance

D&O Policy Insureds



- **Entity Coverage**

- **Insuring Agreement C** (or “Entity Coverage”): Liability coverage payable directly to an insured entity for its wrongful acts.
- This type of coverage is **typically limited to securities claims** in policies issued to publicly-traded companies, but it may be broader in other types of policies.

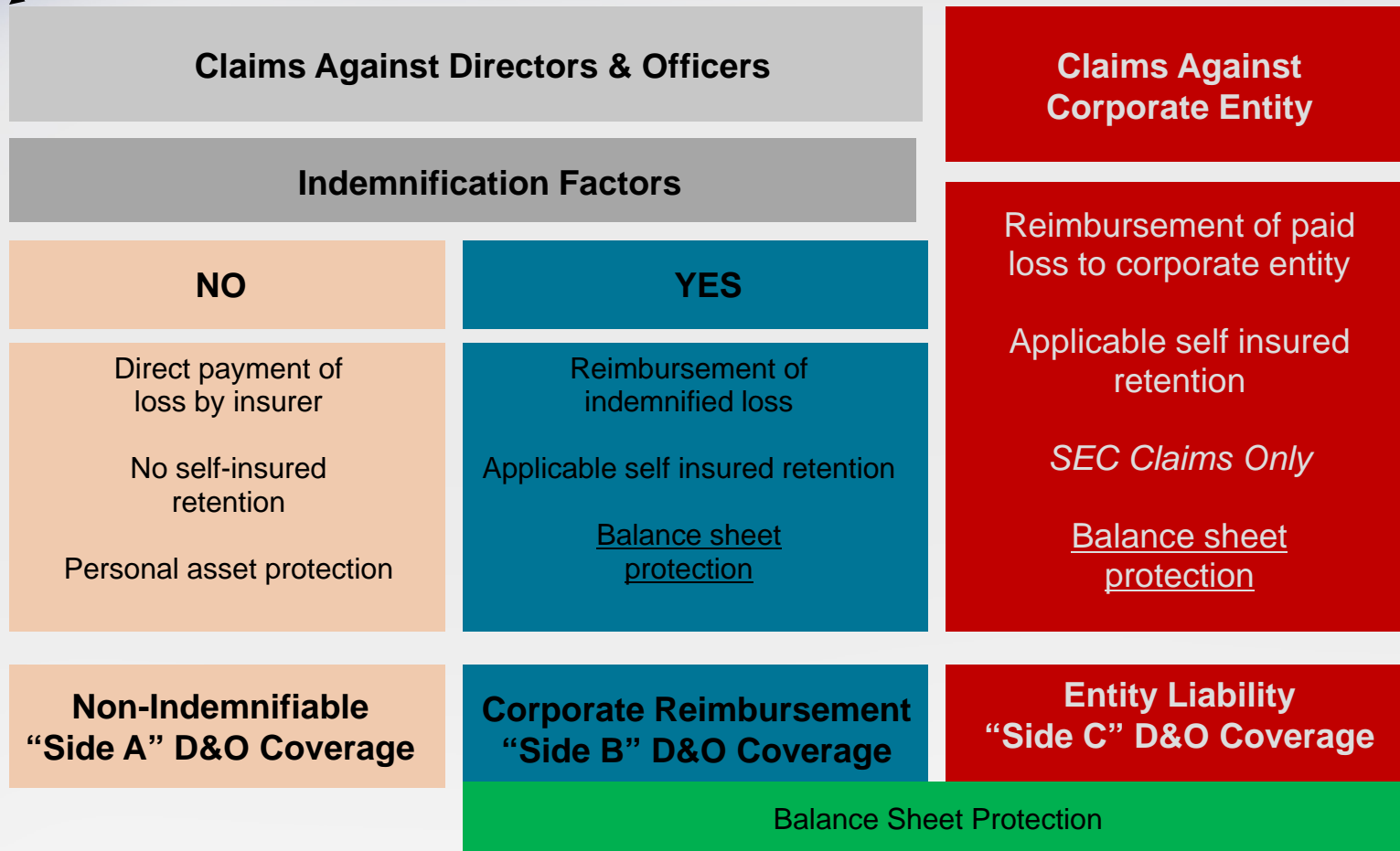


Bankruptcy and D&O Insurance

The Mechanics of a D&O Policy



AGGREGATE LIMIT OF LIABILITY



Bankruptcy and D&O Insurance

Articles Relating to Bankruptcy and D&O Insurance



Highlighted below is the typical wording found in many of the articles relating to D&O insurance and bankruptcy:

“Many directors and officers would probably be surprised to learn that, if their company purchased a D&O policy that provided entity coverage for claims against the company, there could be expensive legal battles in a bankruptcy over whether the proceeds of that policy belong to the bankruptcy estate or the individual directors and officers. The bedrock purpose of D&O insurance should be to protect individual directors and officers from personal liability, but the bankruptcy courts do not always see things that way.”

These kinds of statements do not take into consideration a number of factors such as the full purpose of D&O insurance, factors that trigger Side A coverage and/or all the case law regarding order of payments. Each account and its exposures merit specific attention.



Bankruptcy and D&O Insurance

The Bankruptcy Court's Automatic Stay



If the bankruptcy court's automatic stay applies to the insurance proceeds, the insurer also loses control over its ability to advance defense costs to individual directors and officers. The automatic stay is a powerful tool for the bankruptcy trustee because it halts any act to obtain possession of, or exercise control over, "property of the bankruptcy estate."

In practical terms, this means that if the D&O policy proceeds are considered to be "property of the bankruptcy estate," then the insurance company is stayed from "exercising control" over that property.



Bankruptcy and D&O Insurance

The Bankruptcy Court's Automatic Stay



The filing of a bankruptcy case, under any chapter of the Bankruptcy Code, triggers an injunction against the continuance of any action by any creditor against the debtor or the debtor's property. 11 U.S.C. 362.

The automatic stay gives the debtor protection from his creditors, subject to the oversight of the bankruptcy judge, and brings all of the debtor's assets and creditors into the same forum, the bankruptcy court, where the rights of all concerned can be balanced.



Bankruptcy and D&O Insurance

The Bankruptcy Court's Automatic Stay



- **Section 362(a) of the Bankruptcy Code**

- The automatic stay under Section 362(a) of the Bankruptcy Code provides that the filing of a petition in bankruptcy automatically stays certain actions directed against the debtor's property. **The automatic stay generally does not extend to actions pending against the debtor's D&O's unless it amounts to an “act to obtain possession of property of the estate” or “to exercise control over property” of the estate.** *Steyr-Daimler-Puch of America Corp. v. Pappas*, 852 F.2d 132 (4th Cir. 1988). Accordingly, in cases where the debtor and its D&O's are defendants, the lawsuit will likely be automatically stayed as to the debtor only.



Bankruptcy and D&O Insurance

The Bankruptcy Court's Automatic Stay



- **Extension of the Automatic Stay to Pending Litigation Against the Debtor's D&O's**
 - D&O's often seek to enjoin litigation pending against them under the limited exception to the rule that the stay applies to only the debtor, arguing that (1) the continued litigation is an attempt to circumvent the automatic stay; (2) an adverse judgment would increase the debtor's indemnification exposure if the debtor's insurer refused to advance defense costs or if the costs exceed policy limits; (3) the litigation would disrupt the management of the debtor or otherwise interfere with the debtor's reorganization and (4) that a judgment against the non-debtor could create collateral estoppel concerns for the debtor.



Bankruptcy and D&O Insurance

The Bankruptcy Court's Automatic Stay



The analysis in the bankruptcy courts begins with determining whether the policy and its proceeds are property of the estate. Property of the estate is defined broadly under Section 541(a)(1) of the Bankruptcy Code to include "all legal and equitable interests of the debtor in property as of the commencement of the case."

If the D&O policy is property of the estate, the automatic stay under the Bankruptcy Code would prevent anyone, including a creditor or a D&O, from accessing the policy and its proceeds. In addition, because property of the estate may not be used outside the ordinary course of business without court approval, the company would not be able to pay claims against its D&O's or reimburse them for their defense costs associated with any pending litigation against them without court approval.



Bankruptcy and D&O Insurance

The Bankruptcy Court's Automatic Stay



The courts have had to grapple with the competing rights of the debtor corporation and its D&O's to policy proceeds where both are insureds under the policy following bankruptcy. The solution to this issue is to make sure the policy is endorsed with a specific allocation of the proceeds in the event of bankruptcy.

Insurance companies are willing to add a provision called "**Priority of Payments,**" or "**Order of Payments.**" These provisions dictate that when a claim involves both the individual D&O's along with the corporate entity, the payments are first made on behalf of the individuals. This helps prevent the exhaustion of the policy proceeds by the entity, leaving no recoverable funds for the individuals.

Where the policy proceeds are dedicated first to the D&O's, a bankruptcy filing by the corporate entity should not prevent the D&O's from accessing the policy proceeds for covered claims.



Bankruptcy and D&O Insurance

Order or Priority of Payments



- If a Company becomes subject to a bankruptcy proceeding, the Company will likely be unable to fund its D&O indemnification obligation.
 - **The D&O Side A policy is structured to deal with this issue if properly structured. The policy should have what is termed an “Order or Priority of Payments Endorsements” that automatically converts the coverage to Side A in the event of Bankruptcy.**
- It has been stated: If the D&O policy also provides entity coverage (Side C), it is considered by the courts to be an asset of the bankruptcy estate.
 - **Again, if the policy contains what is termed an “Order or Priority of Payments Endorsements”, the policy automatically converts the coverage to Side A, and the courts have acknowledged this.**



Bankruptcy and D&O Insurance

Order or Priority of Payments



Order or Priority of Payments Provisions:

- The provisions clarify if there is a single limit of liability and claims are brought that trigger coverage provided to both the corporate entity and to its D&O's, payments to or on behalf of D&O's are given priority over payments to or on behalf of the bankrupt company.
- A bankruptcy trustee or creditor will argue that since the D&O policy provides entity coverage in addition to coverage for the individual D&O's, the policy and its proceeds should be considered an asset of the bankruptcy estate and, as a result, the policy proceeds cannot be used to pay costs of D&O's. A priority of payments provision that specifies that the D&O's have first claim to the policy proceeds provides a basis for the bankruptcy court to allow the D&O's access to the proceeds of the policy to pay for defense expenses and potential liabilities.



Bankruptcy and D&O Insurance

Order or Priority of Payments



ENRON CASE:

The Enron bankruptcy court addressed this issue. Although Enron's D&O policies provided entity coverage to the corporation as well as direct coverage to its directors and officers, the Enron court allowed former directors and officers access to D&O policy proceeds. Enron's policies contained an “**order of payments**” provision, which granted the directors and officers priority to the proceeds over the corporation and, thus, presented the bankruptcy court with an easy case.

Source: Insurance Law Bulletin No. 8 – John H. Mathias, Jr., & Timothy W. Burns.



Bankruptcy and D&O Insurance

Order or Priority of Payments



ADELPHIA CASE

In *In re Adelfhia Communications Corp.*, Case No. 02-41729 (REG) (Bankr. S.D.N.Y. Nov. 15, 2002), the bankruptcy court was presented with a much more difficult case. There, the D&O policies provided entity coverage to the corporation and direct coverage to the directors and officers, **but contained no “order of payments” provision.** Faced with motions by directors and officers to lift the bankruptcy stay to allow them access to the proceeds, the bankruptcy court candidly admitted that the case presented a peculiar set of circumstances. According to the court, one of the co-corporate debtors (1) stood a very real chance of paying all creditor claims in full and thus eventually could be in a position to pay securities claims covered under its entity coverage and (2) had made a showing that it would be difficult to retain directors and officers if the D&O policies’ proceeds were depleted. Based on these circumstances, the court held (1) that the D&O policies’ proceeds were estate assets and (2) the court nevertheless would lift the stay to allow the directors and officers some access to the proceeds. Notably, the court also held that the peculiar circumstances of that case required it to maintain strict control over the disbursement of the proceeds.

Source: *In re Adelfhia communications Corp.*, Case No. 02-41729 (REG) (Bankr.S.D.N.Y. Nov. 15, 2002)



Bankruptcy and D&O Insurance

Order or Priority of Payments



ADELPHIA CASE

The *Adelphia* decision is uncommon in its rigorous analysis of the myriad issues involved in its holding. Dissecting those issues, the court made a number of statements that may prove useful to directors and officers in other cases in which they seek to obtain D&O policy proceeds. Most significantly, the court noted that it was the rare case in which entity coverage would require a bankruptcy court to hold D&O policy proceeds to be an asset of the estate. According to the court, “[t]hat coverage is rarely meaningful in bankruptcy cases (even in Chapter 11 cases), because under section 510(b) of the [Bankruptcy] Code, claims for securities fraud claims arising from rescission of a purchase or sale of a security or for damages arising from such are subordinated to claims that are senior or equal in priority, and since there are rarely enough assets to pay all creditors in full, debtors rarely are in a position (and do not have a need) to make distributions on more junior claims.”



Bankruptcy and D&O Insurance

Change of Control



D&O policies typically contain a “Change in Control” provision.

A bankruptcy filing may trigger a change in control, causing the policy to convert to run-off automatically.

Examples:

Some D&O policies specifically state that the appointment of a receiver, conservator, liquidator, trustee, rehabilitator or any comparable authority shall constitute a Change of Control. Other typical provisions read: If, during the Policy Period, there is a Change in Control, the coverage provided under this Policy shall continue to apply, but only with respect to a Claim against an Insured for a Wrongful Act committed or allegedly committed up to the time of the Change in Control; and

- (a) coverage will cease with respect to any Claim for a Wrongful Act committed subsequent to the Change in Control; and
- (b) The entire premium for the Policy will be deemed to be fully earned immediately upon the consummation of a Change in Control.
- (c) Change in Control” means . . . “the appointment of a Receiver, Conservator, Liquidator, Trustee, Rehabilitator, or any comparable authority, with respect to the Parent Company.”



Bankruptcy and D&O Insurance

Change of Control

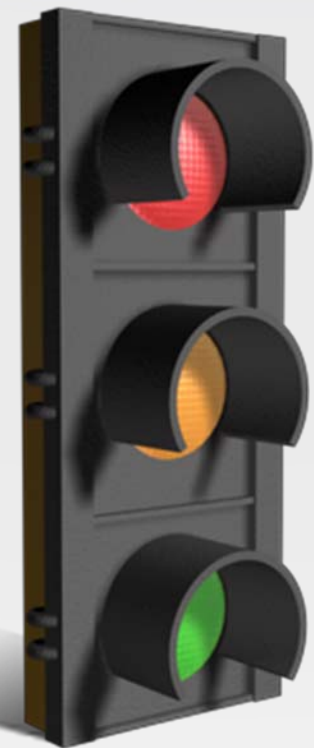


The implications for Insureds in the event the policy change of control is invoked are:

- Policy goes into run-off for remainder of policy term
- No coverage for acts after effective date of transaction
- Premium is fully earned

The options that need to be considered are:

- During policy renewal, request removal of bankruptcy event as triggering change in control provision
- If event occurs during the policy period with a bankruptcy trigger, seek waiver of the change in control
- Secure new D&O coverage as necessary for post-filing “wrongful acts”



Bankruptcy and D&O Insurance

Insured v Insured



The “Insured v. Insured” exclusion can pose a problem.

- The terms of the I v. I (“I v. I”) exclusion vary. Generally, the I v. I exclusion bars coverage for claims “brought by” or claims “brought by or on behalf of” one insured against another insured.
- The main issue in the bankruptcy context is whether a bankruptcy trustee, creditors committee or assignee of the debtors’ or creditors’ rights constitutes an “Insured” under the policy such that claims brought by them against the debtor’s D&O’s trigger the I v. I exclusion.
- D&O policies do not cover claims brought by the bankruptcy trustee against the D&O’s unless specifically endorsed. Special Note: A debtor-in-possession is considered a separate legal entity from the company. As such, it does not meet the definition of insured under the policy unless there is specific wording.



Bankruptcy and D&O Insurance

Insured v Insured



The “Insured v. Insured” exclusion can pose a problem (continued).

- Insurers argue that because a bankruptcy trustee stands in the debtor’s shoes for purposes of asserting claims against its D&O’s, the I v. I exclusion bars coverage for the trustee’s claims just as it would bar coverage for claims brought in the name of or by the debtor itself.
- Trustees and creditors committee’s (and D&O’s) argue, however, that the debtor and the trustee are legally separate entities and that the purpose of the I v. I exclusion is not implicated in the bankruptcy context because the actions by trustees or creditor’s committees are not collusive.



Bankruptcy and D&O Insurance *Insured v Insured*



The “Insured v. Insured” exclusion can pose a problem (continued).

The options that need to be considered are:

1. Secure a carve back to the “I v. I” exclusion for claims brought by the trustee;
2. The exclusion applies unless the claim is brought by the Bankruptcy Trustee or Examiner of the Company or any assignee of such Trustee or Examiner; or any Receiver, Conservator, Rehabilitator, Liquidator, Custodian, or comparable authority of the Company.



Bankruptcy and D&O Insurance

Insured v Insured



In summary, whenever possible, try to limit application of the I v. I exclusion to claims brought directly by the company. At a minimum, make certain that your policy includes the available market exceptions to the Iv.I exclusion, which carve back coverage for:

- derivative claims;
- claims brought with the assistance or participation of corporate whistleblowers;
- certain claims brought on behalf of a company while in bankruptcy;
- employment practices claims asserted against individual Ds and Os;
- claims for contribution or indemnity between defendants in otherwise covered claims;
- claims brought entirely in a foreign jurisdiction; and
- claims asserted by former Ds and Os of more than four years.



Bankruptcy and D&O Insurance

Personal Conduct/Fraud/Profit Exclusion



All conduct exclusions contain a “trigger” by which the insurer may invoke the exclusion. Some policies, for example, require a judgment or “**final adjudication**” adverse to the insured in the underlying action before the exclusion is triggered. With such wording, insurers should not be able to deny coverage in the absence of a final adjudication of fraud or illegal profit in the underlying lawsuit. This should also at least afford the insured coverage for defense costs, assuming other exclusions do not bar coverage. Other policies require only that the requisite conduct occurred “**in fact.**” Under such policies, the insurer may be able to rely on evidence of misconduct to deny coverage outright or otherwise leverage a greater insured contribution to settlement. Certain newer policy forms further trigger the exclusion where the conduct occurs “in fact,” as evidenced by an insured’s written statements, documents, or admissions. Under some variations of this wording, insurers may point to testimony or admissions of *any insured to deny coverage as to other insureds*. The key issue here is whether the fraud or illegal profit attributable to one individual D or O can be imputed by the insurer to other individual Ds and Os or to the company.



Bankruptcy and D&O Insurance

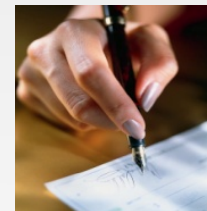
Waiver of Automatic Stay Provision



- **Waiver of Automatic Stay Provision**

- Typical language: If a liquidation or reorganization is commenced by the Parent Company under Title 11 of the United States Code, then with respect to a covered Claim, the insured organization hereby:
 - (a) waive and release any automatic stay or injunction to the extent it may apply in such proceeding to the proceeds of this Policy under such Bankruptcy Law; and
 - (b) agree not to oppose or object to any efforts by the Insurer or any Insureds to obtain relief from any stay or Injunction applicable to the proceeds of this Policy as a result of the commencement of such liquidation or reorganization proceeding.
- Benefit: Insurer should be able to cover D&O's despite the bankruptcy of the company. Enforceability of provision has not been tested yet in any reported decisions.

Prepetition stay relief agreements involve complex issues. As with most bankruptcy questions, owners and lenders should get advice from bankruptcy counsel on their specific situation when considering whether to include such a waiver of the automatic stay.



Bankruptcy and D&O Insurance

Advancement of Defense Costs



- **Advancement of Defense Costs**

- The D&O policy should have a provision stating that the insurer will pay covered Defense Costs on an as-incurred basis. If the D&O policy does not specify that an insurer must pay defense costs as they are incurred, then the D&O's may find themselves in a situation where they are obligated to pay millions of dollars of defense costs out of their own pockets until a claim is finally resolved and the insurer is obligated to pay the covered defense costs and the damages.
- A typical D&O policy that has an advancement of defense costs provision will also provide that if it is finally determined that any defense costs paid by the Insurer are not covered under this Policy, the Insureds agree to repay those non-covered Defense Costs to the Insurer. Many carriers will agree to delete this latter requirement.



Side A Coverage



Benefits (Typical):

- No “presumptive indemnification;”
- Specifically non rescindable;
- Full severability of the application and conduct exclusions;
- Policy drops down as primary in the event of insolvency of the underlying carrier;
- Less restrictive fraud exclusion;
- Less restrictive I v. I exclusion;
- Covers D&O’s where company refuses to indemnify; and
- Covers where primary policy has been deemed an asset of the debtor’s estate in bankruptcy.

Special Notes:

- Coverage only comes into play when the covered entity cannot or declines to fund a claim and/or the law will not allow funding;
- Coverage is excess over indemnification by the company and any other insurance.
- The Side A policy value is enhanced if a firm files bankruptcy during the policy year.



Side A Coverage



There is a lot of information pertaining to Side A, much of which is promoting its purchase. It is important to factor in all the facts when considering the purchase of Side A coverage. Highlighted below are a number of facts that are not noted and/or elaborated upon in many of the articles discussing Side A.

- Side A sits excess of **indemnification (corporate assets)** and **other insurance**, and is triggered only after a firm cannot, refuses and/or the law will not allow it to fund a claim.
- Conventional D&O policies contain what is termed “presumptive indemnification” clauses which make it difficult for a firm to refuse its indemnification obligations.
- Most D&O policies today have an “order or priority of payments” provisions that convert the policy to Side A in the event of bankruptcy or insolvency. This provision has been upheld numerous times and eliminates the issue of who owns the policy rights in the event of bankruptcy.
- Conventional D&O policies have Side A coverage.
- Many of the cases cited regarding the issue of who has rights to the policy in the event of bankruptcy fail to reference the date of the case, circumstances and final outcome.
- A number of the articles fail to bring forth the impact the organization will sustain in the event it forgoes balance sheet protection.
- Side A contracts are one year policy forms.



Bankruptcy - Program Options



When a firm contemplates the filing of bankruptcy, it needs to review its D&O policy and coverage options. Highlighted below are a **few** issues and options that may be available:

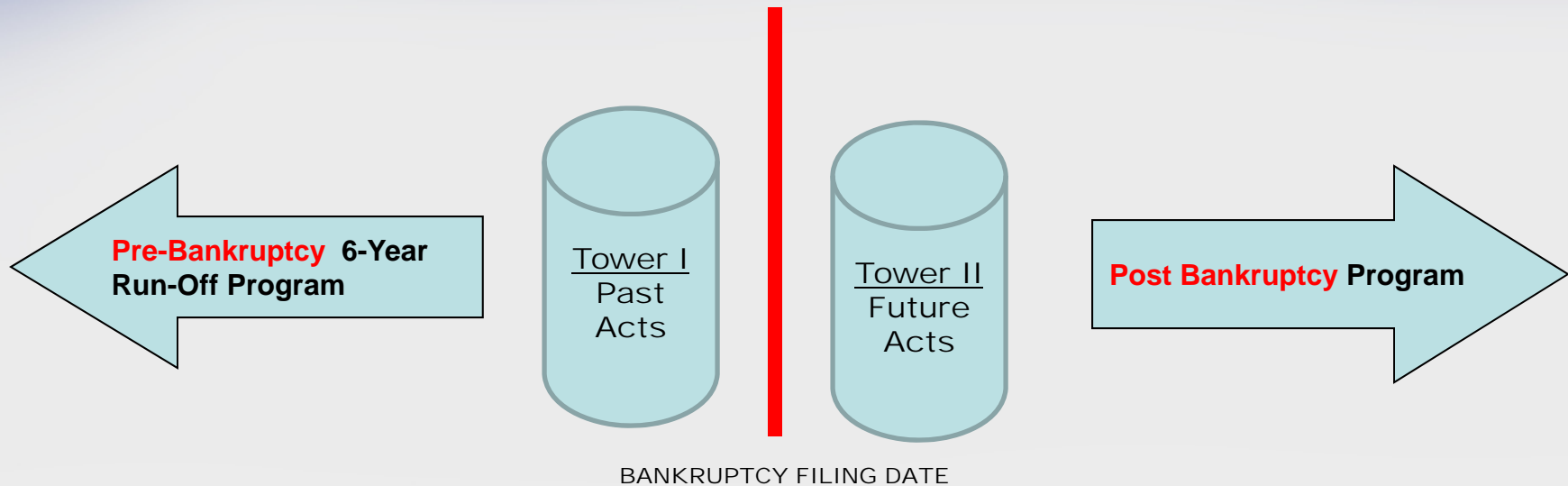
1. Determine if bankruptcy triggers Change of Control.
2. Report all claims and/or material situations that could give rise to a claim (including the act of bankruptcy) to the carrier, and let the policy fall into its standard runoff term until its expiration date.
3. Exercise the runoff provisions as highlighted in the policy.
4. Secure alternative runoff provisions from both the incumbent and new carrier(s).
5. Generate options utilizing a combination of all of the above.



Bankruptcy - Program Options



Stand alone pre-bankruptcy run-off program plus stand alone post-bankruptcy program.



Features

- Separate dedicated run-off limits for incumbent D&Os.
- Non-cancelable term assures run-off period to cover contingent liability and statute of limitations imposed by Sarbanes-Oxley (SOX).
- Future Acts Program provides a fresh new limit to cover post bankruptcy exposures a company faces when it emerges from bankruptcy.

Bankruptcy - Program Options



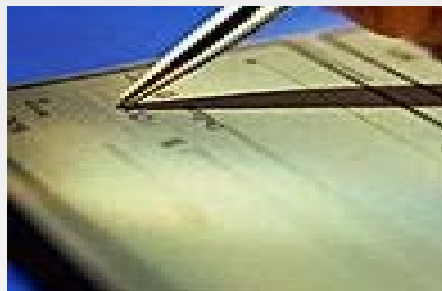
- Incumbent markets **may not** be the market of choice for a runoff program
 - Built in runoff term factors may be cost prohibitive
 - May be unwilling to post a fresh new aggregate limit
 - Reported claims and/or circumstances leading to a claim may erode the limit in place prior to bankruptcy
 - Policy form may be restrictive
- New markets may provide much more favorable **run-off and carry forward** terms, conditions and provisions if past issues are buried.
- Consideration needs to be given to the Notice Provision prior to the filing of bankruptcy.
- Competitive quotes from both the incumbent and non-incumbent markets need to be secured.



Bankruptcy - Program Options



- Review proposed bankruptcy date in relation to policy expiration date
- Study D&O policy provisions relating to bankruptcy
- Generate conceptual alternative runoff program structures utilizing incumbent and new markets
- Establish an underwriting submission
- Confirm lines of coverage and limits desired for both pre & post bankruptcy coverage
- Request run-off quotes from existing and new carriers
 - Take into consideration the unearned premium to be applied to run-off premium
 - Set target range for acceptable runoff factors
- Arrange for underwriting conference calls, if needed
- Determine the proper date for funding – should take place prior to the filing of bankruptcy



QUESTIONS/ANSWERS



**The entire
Blais Team
operates as a
combined unit to
answer questions
and handle
accounts.**



QUESTIONS/ANSWERS



What is the typical runoff term?	6 years – SOX states that the statute of limitations is 5 years.
Are underwriters willing to amend the insurance form on the brink of filing of bankruptcy?	For the most part the answer to that question is no. Therefore it is important to secure the proper policy wording well in advance.
How often are alternative carriers utilized in the placement of runoff coverage?	In the past carriers would not quote runoff unless they were the incumbent. In light of the fact many of the programs are impaired with claims prior to bankruptcy and the incumbent carriers will not post fresh limits – new carriers are stepping in with a great degree of frequency.
When is Side A triggered?	When an corporation cannot, will not or the law will not allow it to fund a claim.
How is Side A priced in comparison to ABC?	In today's market if the insured has no real potential for bankruptcy in the next three years they can secure Side A coverage at a 60% to 65% of the cost of ABC coverage.



CONCLUSION



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PAST WEBINARS

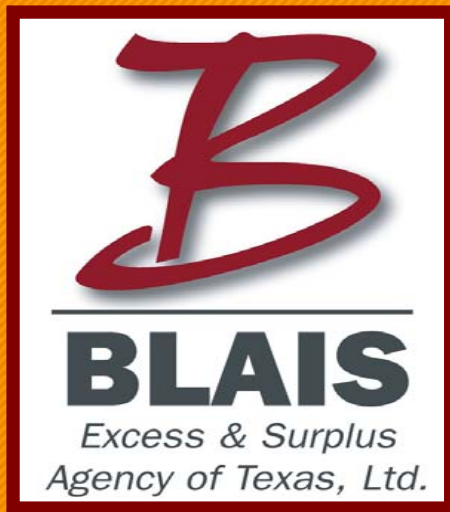
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