

Professionals', Officers', and Directors' Liability

Emily R. Gifford

Although named after Charles Ponzi, the Ponzi scheme appeared long before Mr. Ponzi made it infamous in the 1920s. Charles Dickens included a ponziesque scheme in his serial novel *Little Dorrit*, in which the Dorrits lose their money after investing it in Mr. Merdle's bank.

Whether perpetuated by Mr. Merdle, Charles Ponzi, or the notorious Bernie Madoff, Ponzi schemes have far-reaching implications, including losses that trigger possible coverage of both first and third-party insurance policies. In this issue, the TIPS Professionals', Officers', and Directors' Liability Committee provides insight into these policies in the context of Ponzi schemes and examines approaches to corporate insolvency and directors' and officers' liability in non-U.S. jurisdictions.

Lisa Hall Johnson and Selena Linde describe steps policyholders who are victims of Ponzi schemes can take to maximize their insurance coverage. Richard Bale evaluates whether professionals who are associated with Ponzi schemes can look to a directors' and officers' policy, or other professional liability policy, for insurance coverage. Perry Granof and Shirley Spira take us on an international survey of directors' and officers' liability in the face of corporate insolvency or wrongful conduct when a company is in good standing.

Also in this issue, pick up technology tips from Howard Walthall about e-mail management and retention, and trial tips from Glen Olson on the attorney-client privilege and work product doctrine in high-stakes cases. "When I Was a New Lawyer" profiles the venerated Jim Bliss, and Madeline Meacham recaps the magic of the Midyear Meeting at Walt Disney World in Florida. Finally, enjoy the preview Joma Jones provides of San Francisco, site of the ABA Annual Meeting in August. ♦

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Initial Steps for Ponzi Scheme Victims to Maximize Coverage

Lisa Hall Johnson and Selena J. Linde

While the legal struggles for Bernie Madoff may have ended with his prison sentence, the legal hurdles for investors and others directly or indirectly involved with the fraud he perpetrated will span many years. Those individuals and corporate entities facing claims or potential claims in the Madoff fraud include investors, brokerage firms, investment managers and advisors, hedge funds, feeder funds, those who recommended Madoff, accounting firms that performed audits on funds that invested with Madoff, and, yes, even lawyers. These individuals and corporate entities may have insurance that could provide defense costs and financial reimbursement.

As is the case with all Ponzi schemes, the landscape will continue to change as factual details are revealed through the criminal cases. For example, one of Madoff's closest aides recently described how Madoff's firm created fake account statements and trading slips, and designed a fake computer stock-trading platform that used a random

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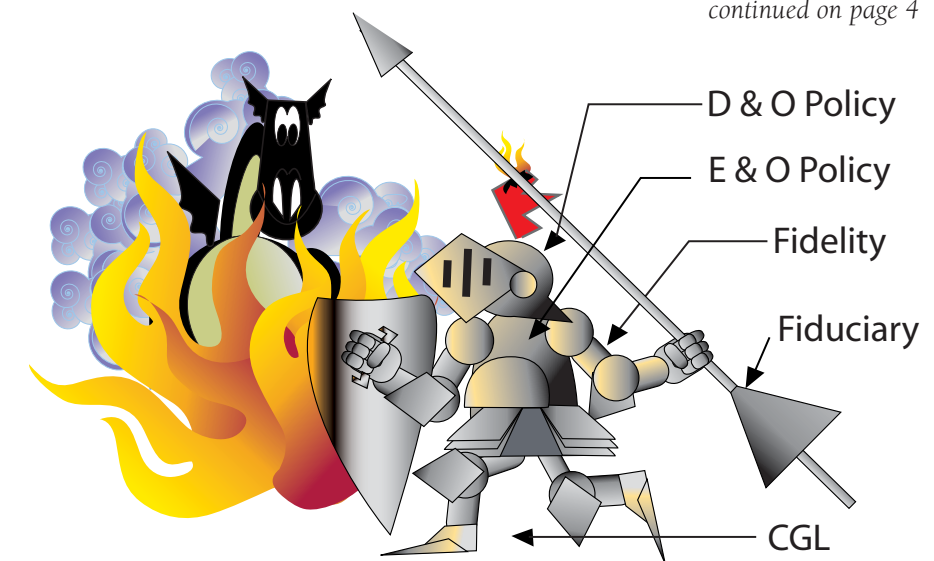
Reassessing Insurance Coverage: The Legacy of Recent Financial Fraud Schemes?

Richard W. Bale

When Charles Ponzi promoted the investment scam that bears his name in 1919 and 1920, he was not insured for wrongful acts. His scheme to arbitrage international reply coupons for postage stamps was exposed, he went to jail, and most of his victims went home without their money. The saga of Bernard Madoff and the other modern heirs to Ponzi's legacy will end differently, with years of litigation and new decisions on the insurance coverage available to defendants in the aftermath of Ponzi and financial fraud schemes.

Last year saw a record number of Ponzi schemes collapse and a multitude of lawsuits filed as victims sought to recoup their losses. According to an Associated Press analysis, about 150 Ponzi schemes were exposed in 2009, up from 40 in 2008, with estimated losses of more than \$16.5 billion. Curt Anderson, "Ponzi Schemes' Collapses Nearly Quadrupled in '09," www.law.com/jsp/article.

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Meeting Round-Up

Midyear Meeting in Orlando

Madeline Meacham

Winter raged in many parts of the country, but Orlando and Walt Disney World provided balmy temperatures and a fanciful setting for TIPS at the ABA Midyear Meeting, February 4–7, 2010. Even if you didn't hit the theme parks, the Swan Hotel was festooned with swans, seashells, and over-the-top architecture by Michael Graves, overlooking a lagoon between Epcot and Hollywood Studios. It was a Disney extravaganza.

The meeting opened on Wednesday with CLE programming cosponsored by TIPS, "Obtaining and Retaining a Diverse Judiciary." Other TIPS cosponsored CLE offerings included "Smart Soloing: Success Strategies for Diverse Lawyers" and—straight from the headlines generated by Justice Sonia Sotomayor's confirmation—"Diversity on the Bench: Is the 'Wise Latina' a Myth?"

CLE programs, committee meetings, TIPS Council, ABA House of Delegates, and other Midyear Meeting work made for a full schedule. However, we did manage to enjoy some extracurricular activities.

On Friday, TIPsters and their families joined local residents and children who braved stormy weather to enjoy a special performance: a mock trial called "B.B. Wolf vs. Curly Pig." Local actors in costume from the Orlando Repertory Theater and Orlando Shakespeare Theater made the trial come alive for kids and adults alike. Presiding on the bench was Orange County Judge Wilfredo Martinez, and TIPS's own Ginger Busby served as bailiff and master of ceremonies. Every child in the audience at the well-attended event had an opportunity to sit on a jury. The

trial used a familiar fairy tale to demonstrate that there are always two sides to a story. The children took their responsibilities as jurors very seriously, and their thoughtful deliberations resulted in two hung juries.

On Saturday, TIPS hosted a reception and dinner at the Atlantic Dance Hall on the Disney Boardwalk. The hall and the boardwalk evoke the golden age of beach resorts like Atlantic City. Victorian buildings and white sand beaches circle a lagoon, and the

Dance Hall's interior is decorated in grand art deco style. The Pursuit of Justice Award was presented to Samuel P. King of Orlando. The award recognizes lawyers and judges who have shown outstanding merit and who excel in providing access to justice for all. Congratulations were extended to the newly nominated slate of Section leaders, including TIPS Council nominees Sue Farina, Robert Redemann, James Riddle, Matthew Schiff, and Darcee Siegel. Nominated to office beginning in FY 2011 are Dick Semerdjian (vice-chair), John McMeekin (revenue officer-elect), Kim Hogrefe (financial officer-elect), and Tim Bouch (Section representative to ABA House of Delegates). Nominees will be officially elected at the 2010 Annual Meeting. After the formalities were concluded, the dance floor filled, the music rocked,

and the evening ended too soon. It was back to reality.

Section Chair John Tarpley, Midyear Arrangements Chair Pamela Beckham, TIPS's staff, sponsors, and countless others deserve our thanks for all their hard work on the meeting. The Disney World experience will be hard to top, but the TIPS Spring meeting in San Juan, Puerto Rico, may just pull it off. ❖

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TIPS Council nominees (l. to r.) Robert Redemann, Darcee Siegel, James Riddle, Sue Farina, and Matt Schiff celebrate at the Atlantic Dance Hall on Disney's Boardwalk. Photo by John Pavlou.



Trial Tip

Glen R. Olson

Attorney-Client Privilege and the Work Product Doctrine in Complex Litigation

As demonstrated by a few recent examples, financial crisis and other "high stakes" cases may create a strain on the attorney-client privilege and the work product doctrine. Attorneys involved in these cases need to keep abreast of circumstances when the privilege and doctrine, or exceptions to them, apply.

First, it is worth noting that the ABA has filed an amicus brief urging the United States Supreme Court to grant certiorari in *Textron v. United States*. *Textron* involves the issue of whether the work product doctrine applies when the relevant communications have a dual purpose, such as being prepared in anticipation of litigation and designed to comply with the Sarbanes-Oxley Act of 2002. (See the ABA announcement at www.abanet.org/abanet/media/release/news_release.cfm?releaseid=867.)

Second, in some instances, attorneys in complex litigation may have to urge waiver of the attorney-client privilege. See, e.g., *Qualcomm, Inc. v. Broadcom Corp.*, 2008 U.S. Dist. LEXIS 16897 (S.D. Cal. March 5, 2008). In *Qualcomm, Inc.*, Qualcomm's attorneys invoked the "self-defense exception" to the privilege, over the client's objection, to defend a request for sanctions related to the handling of e-discovery. The attorneys justified use of the exception based on the "accusatory adversity" between the client and counsel regarding responsibility for failure to comply with discovery orders. The court ruled that the attorneys had a due process

right to defend themselves under the totality of the circumstances presented in the sanctions hearing.

Third, there may be instances in which the client's adversary seeks to invade the attorney-client privilege, or at a minimum, narrow its scope. As illustrated in the recent California Supreme Court decision in *Costco Wholesale Corp. v. Superior Court*, 47 Cal.4th 725 (2009), courts may be reluctant to allow this to occur because of the policies underlying the privilege and the social consequences of allowing it to be narrowed.

In *Costco Wholesale*, employees in a class action claimed that Costco had misclassified some managers as "exempt" employees and failed to pay them overtime wages. The plaintiffs sought the production of an attorney opinion letter that addressed the "exempt" classification of such employees, arguing that at least the factual portions of the letter relating to the attorney's investigation were discoverable. Although the lower courts agreed with the plaintiffs, the California Supreme Court disagreed and reversed. The court held that the attorney-client privilege attached to the entire letter, irrespective of its content, and rejected the distinction between "legal" and "factual" materials contained in an attorney-client communication. 47 Cal.4th at 731-32. The court noted that the attorney-client privilege protects the transmission of information, and if the communication is privileged, it does not lose that protection simply because it contains materials that could be discovered through another source.

Complex litigation cases and financial crises will no doubt continue to test the boundaries of the attorney-client privilege and the attorney work product doctrine. Accordingly, attorneys should be vigilant in analyzing recent legal developments that may impact how the courts view privileges in various contexts. ❖

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Insolvency and D&O Liability around the World

Perry S. Granof and Shirley J. Spira

Corporate insolvencies pose complex and perilous legal problems for directors and officers (D&Os) worldwide. This article summarizes the approaches to insolvency and D&O liability in several non-U.S. jurisdictions. Their insolvency-related laws fall into two categories. The first emphasizes liability against D&Os for financially obligating a company when it is faced with possible insolvency. The second establishes liability for purported wrongful conduct while a company is in good standing. Countries in the first category include Australia, England, Germany, and India, whereas the second includes Canada, France, Italy, and the Netherlands. The two different approaches transcend the countries' common-law versus statutory legal systems. Below is a short summary of their respective insolvency provisions, based upon more extensive summaries by foreign lawyers published in the Spring 2009 and Winter 2010 issues of the *TIPS International Committee Newsletter*, www.abanet.org/tips/international/home.html. We gratefully acknowledge their contributions.

Australia: Insolvent Trading

Under Section 588G of the Corporations Act of 2001 and other key statutory provisions, a director of a company is under a duty to prevent the company from incurring debts when it is insolvent. Failure to do so will give rise to possible civil penalties and civil claims by liquidators against de jure directors as well as de facto or "shadow" directors and others who took part in the company's management. The liquidator is entitled to seek recovery on behalf of the creditors for the losses sustained when the company incurred debts while insolvent.

England: Wrongful Trading

Under Section 214 of the Insolvency Act of 1986 and other key statutory provisions, a liquidator may request that the court order directors to contribute toward the shortfall of the company's assets if they knew, or ought to have concluded, that there were "no reasonable prospect(s)" of a company avoiding insolvent liquidation yet continued to do business. Under Section 214, dishonest conduct is not required. If the directors are found liable, damages are paid to the liquidator for distribution among the company's creditors. Two defenses are available: Directors may prove that they did not know and could not have been expected to realize that there were no reasonable prospects of avoiding insolvency. If there was no reasonable prospect of avoiding liquidation, they may prove that they have taken every effort to minimize the potential loss to creditors.

Germany: Obstruction of Bankruptcy

Generally, only a company, and not its managing directors, can be liable for wrongful acts. However, in at least one case the managing directors of a corporation that was insolvent were found liable for granting loans without performing sufficient solvency and collateral checks. More commonly, under Section 15a of the German Insolvency Code, a managing director can be held personally liable in tort if he or she is proven to have delayed the filing of a corporate bankruptcy petition. The insolvent company or its creditors can claim damages for payments that were made by the managing directors when the company was in fact insolvent, preceding the filing of bankruptcy.

India: Criminal Liability of D&Os

The Companies Act of 1956 and subsequent amendments govern Indian companies faced with insolvency. The National Company Law Tribunal (NCLT) has the greatest power over an insolvent company. An insolvent company's board of directors may propose a plan of rehabilitation, and the NCLT may issue an order putting a "scheme" of rehabilitation in place. The Act specifies that a director of a company in liquidation must cooperate with the liquidator in realizing the assets of the company and distributing them

among the creditors, or face liability for fine and imprisonment.

The directors also have potential personal liability for any fraudulent activity that occurs when winding up a company. The Act holds the board accountable for failures of due diligence. The onus is on board members to prove the actions they had taken to discharge their fiduciary responsibility were fair and reasonable.

Canada: Oppression Remedy

Canadian law provides for an "oppression remedy," a civil remedy based on equitable principles. Under Section 241 of the Canada Business Corporations Act, the oppression remedy provides that where directors' business or affairs have been exercised in a manner that is prejudicial to or unfairly disregards the interests of any security holder or creditor, the court may issue a variety of equitable and legal orders of relief, including payment of the claimant's costs. The court need not find fault to provide an oppression remedy; it is sufficient that stakeholders' interests have been prejudiced.

In the Canadian Supreme Court's decision in *BCE, Inc. v. 1976 Debenture Holders*, (2008) 3 S.C.R. 560, two things are clear. First, in assessing whether oppression has occurred, a court will examine carefully the reasonableness of a complainant's expectations in light of all of the circumstances. Second, if the directors have properly considered the relevant factors and interests before taking action, a court will apply the business judgment rule and dismiss the case.

France: Liability to Pay for Insufficiency of Assets

Under Article L.651-2 of the Commercial Code Bylaw No. 2005-845 of July 26, 2005, where a corporation's assets prove insufficient to cover its outstanding liabilities, any de jure or de facto manager may be held personally liable to make up the shortfall based on a finding that management fault contributed to the insolvency.

A director may be held liable for the full amount of the insufficiency of assets even though he or she was only partially at fault. *Nasa Electronique*, Cass. com., Jan. 3, 1995, Bull. July 1995, § 84, at 266, decided by France's highest court, established that a permanent representative of a legal entity that held only 5 percent of the voting shares of a corporation could be held jointly and severally liable to pay for the entire insufficiency, despite his only causing a modest portion of the damages.

Italy: Liability for Not Preserving Remaining Value

Upon bankruptcy, a company's D&Os are automatically terminated from office. Liability stems from the violations of their responsibilities for actions carried out while the company was still in good standing. The bankruptcy receiver most frequently sues the company's former D&Os for their alleged violations of Sections 2485 and 2486 of the Italian Civil Code. These sections provide that whenever the company incurs losses that reduce its net equity to less than the minimum statutory level, the company is automatically placed in liquidation unless the shareholders provide the necessary capital injection. In liquidation, directors become solely responsible for preserving the value of the company's assets. D&Os often try to "save" the company by continuing its operations, but where the company ultimately declares bankruptcy, such actions constitute a per se violation of their duties to preserve the company's remaining value.

Netherlands: Liability for Deficit in Bankruptcy

Under Section 2:138 of the Dutch Civil Code for Public Companies, a trustee has the exclusive right to invoke personal liability of corporate directors of bankrupt corporations. Personal liability is established where directors have engaged in obvious mismanagement, defined as a grave mistake that exceeds an entrepreneurial risk. *Ceteco N.V.*, Dist. Ct., Utrecht, Dec. 12, 2007, JOR 2008/10, is a seminal Dutch case evaluating liability under the bankruptcy statutes. *Ceteco* filed bankruptcy and the trustee brought action against its former directors. The court ruled that a major cause of the bankruptcy was improper management. It found that management accelerated corporate growth by acquiring several other companies despite its knowledge that this risked overextending the corporation's resources. The directors were held personally liable for the "deficit in bankruptcy." The case is currently on appeal. The decision has been strongly criticized for failure to recognize the board's right to exercise its own business judgment. ❖

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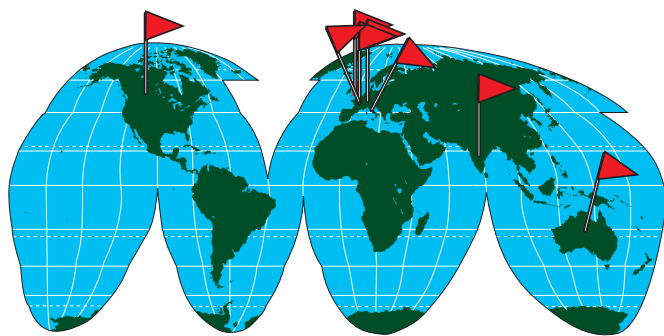


Illustration by Andrew O. Alcalá

Initial Steps for Ponzi Scheme Victims to Maximize Coverage

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number generator to prevent patterns from being detected. This information may offer new coverage avenues. In this article, we suggest initial steps all policyholders who find themselves victims of a Ponzi scheme should take to maximize their insurance coverage.

1. Gather and review potentially applicable insurance policies. The first step in determining whether insurance coverage is available is to gather and review all insurance policies. Ponzi scheme losses can trigger many types of coverage, in both first-party and third-party policies. First-party policies typically insure against loss of, or damage to, the policyholder's property. Fidelity policies (also known as crime policies), financial institution bonds, and homeowners policies are all first-party policies that may provide coverage for Ponzi scheme losses. Conversely, third-party policies provide for the policyholder's liability to third parties for damages. Hence, once a third-party has sued a company, these policies respond. Third-party policies that may apply in Ponzi scheme losses include:

- *Directors and officers policies.* These are implicated when a suit is brought against the directors and officers of a company, or against the company, alleging that they committed wrongful acts in their capacity as directors and officers. Such policies may also be implicated if a government entity initiates an investigation.
- *Errors and omissions policies.* These may apply when a claimant alleges that the policyholder was negligent in providing services.
- *Fiduciary policies.* These are implicated when a claimant alleges the company's pension fund has been mismanaged.

Other policies that may also apply include comprehensive general liability policies, Securities Investor Protection Corporation excess policies, and other specialty insurance policies.

Policies have different coverage terms, exclusions, and conditions. However, policyholders should not be discouraged because policy exclusions may appear at first blush

to preclude coverage. Case law differs greatly throughout the country, and while an insurance company may assert an exclusion, viable arguments and supporting case law may indicate that the exclusion does not apply. For example, many liability policies exclude damages sustained as a result of fraudulent conduct. However, the exclusion may *only* apply where there has been a final adjudication. If a case settles, there is no final adjudication. Even in cases that do not settle and end with a finding of fraudulent conduct, some policies require defense costs to be paid until the final adjudication.

2. Evaluate actual and potential claims. Policyholders must determine if the claims or potential claims they face are covered by their insurance policies. As discussed above, third-party policies provide coverage for the policyholder's liability to third parties for damages and thus generally require some type of

third-party "claim." However, a "claim" is not limited to a traditional lawsuit under the language of many of these policies. It can include a subpoena, government investigation, or a demand or notice of compliance.

Even if a policyholder is not currently facing a claim, the policyholder should evaluate the potential for future claims. Many policies require that the claim be made *and* reported to the insurance company during the policy period. These policies often require the policyholder to give notice of circumstances that could lead to future claims. If a policyholder was directly or indirectly involved in a Ponzi scheme, the potential for future claims is likely.

3. Provide prompt notice and cooperate with insurers. To ensure maximum coverage, policyholders must promptly give notice and provide the insurance company

with any appropriate information necessary to properly evaluate a claim for coverage. Notice requirements vary and need to be reviewed immediately after locating potentially applicable policies. Some policies require notice in as little as 30 days after the discovery of a loss. Some will require a notice of circumstances. If a policyholder fails to provide notice of circumstances that may give rise to future claims during the policy period when a wrongful act took place, the next policy may exclude coverage for those wrongful acts. Failure to abide by notice provisions may bar coverage in some jurisdictions.

Similarly, first-party policies are likely to contain strict proof of loss provisions that require a policyholder to provide details of the loss, including documentation within a specific period of time, often as little as 90 days.

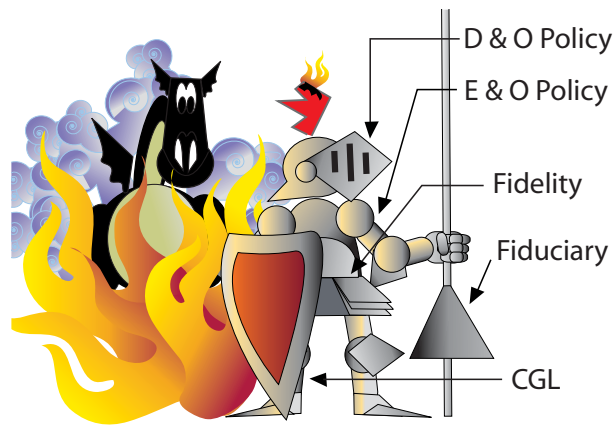
Cooperation clauses also are standard in policies. A prudent practice for policyholders is to keep a record of every communication made to a carrier and broker, in case questions are raised later.

4. Demand that insurers fulfill their coverage. Each policyholder must demand that its insurance company meet its contractual obligations. Do not accept denials as final. Insurance companies regularly deny covered claims. Review the policies and determine what steps need to be taken to file suit or to arbitrate. Some policies contain mandatory waiting periods and mediation or arbitration prior to bringing a coverage suit. Policyholders should know what the policy requires so they can maintain the pressure on the insurance company and, if necessary, initiate coverage litigation.

5. Stay informed of criminal developments. Policyholders should follow the underlying and related criminal cases. As cases unfold, details about the operations and mechanics of the fraud are often revealed through the presentation of evidence and the cooperation of coconspirators now working with the government. When new details emerge, new avenues of coverage may become available. Policyholders should repeat steps two through four above whenever new information is uncovered.

Victims of the Madoff scheme and other Ponzi schemes, and all the persons and companies directly or indirectly associated with such schemes, may recoup some losses through insurance coverage. Yet, all too often policyholders let their coverage wither on the vine by failing to follow the basic steps outlined above. Policyholders questioning the scope of their coverage or their rights should contact experienced coverage counsel. Above all, they must be diligent about seeking and maximizing their coverage. ♦

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Legislative Update

Robert M. Ferm and Leslie E. Miller

Health Care Reform Legislation . . . Yes or No?

The question remains . . . will Congress pass some version of health care reform in 2010? Below are some key points about the health care bills passed by the House and Senate in 2009 that were not reconciled in conference committee before year's end.

House Bill—Affordable Health Care for America Act (HR 3962)

- The total cost for this bill, which passed the House on November 7, 2009, is estimated at \$1.05 trillion over the next ten years.
- Revenue would be generated by new income taxes for individuals making more than \$500,000 and couples making more than \$1 million.
- The bill includes cuts to Medicare and Medicaid, fees on medical device makers, fines for individuals who do not have health insurance, and fines for employers who do not provide health insurance.
- The bill contains a government-run insurance plan. The Health and Human Services Department would negotiate rates with providers.
- Individuals would be required to obtain health insurance or face a tax penalty up to 2.5 percent of income.
- Employers would be required to provide insurance to their employees or pay a penalty of 8 percent of payroll.
- Medicare coverage would be extended to individuals under age 65 with incomes up to 150 percent of the federal poverty level.
- Individuals and families with annual incomes up to 400 percent of the poverty level, or \$88,200 for a family of four, would receive sliding scale subsidies to help purchase coverage.
- The bill contains a firewall between federal funding and abortion coverage.

Senate Bill—Patient Protection and Affordable Care Act (HR 3590)

- The total cost for this bill, which passed the Senate on December 24, 2009, is estimated at \$871.1 billion over the next ten years.
- Revenue would come from an excise tax on high premium insurance plans; cuts in Medicare and Medicaid; increased payroll taxes for Medicare on individuals earning \$200,000 or more and couples earning \$250,000 or more; fees on employers whose workers receive government subsidies; and fees on insurance companies, medical device manufacturers, and pharmaceutical manufacturers.
- The bill contains no public option, but the U.S. Office of Personnel Management would sponsor a new low-cost national health plan.
- Employers with 50 or more employees would be assessed a \$750 penalty for each worker who is not provided health insurance. Companies with more than 200 employees would be required to enroll employees in health insurance plans.
- Individuals would be required to have health insurance coverage or pay a penalty up to \$750 for an individual or \$2,250 for a family of four.
- Health insurance coverage would be extended to individuals with incomes up to 133% of the poverty level, or \$29,326 for a family of four.
- Tax credits would be available for individuals and families who make up to (estimated) 400 percent of the federal poverty level.
- The bill would allow federal funding for abortions.

Nina Owcharenko and Robert E. Moffit, "The House and Senate Health Care Bills: The Key Differences," *The Heritage Foundation Web Memo*, Dec. 22, 2009; Associated Press research and Kaiser Family Foundation, "Health-Care Overhaul Proposals," *Wall Street Journal*, Dec. 24, 2009, http://online.wsj.com/public/resources/documents/st_healthcareproposals_20090912.html; Donna Smith, "House, Senate Healthcare Bills Have Major Differences," *Insurance Journal*, Nov. 19, 2009, www.insurancejournal.com.

Election of Senator Scott Brown

Whether Scott Brown's come-from-behind victory in Massachusetts (in which he won the seat formerly occupied by Sen. Ted Kennedy) was a referendum on the government's health care debate will probably be decided in the 2010 mid-term elections. More importantly, Brown's victory stripped the Senate Democrats of the all-important 60th vote, which was needed to overcome any Republican filibuster.

In the aftermath of the Massachusetts race, House Speaker Nancy Pelosi said, "I don't think it is possible to pass the Senate bill in the House." The House members specifically oppose the provision in the Senate bill that earmarked certain benefits for Nebraska's Medicaid recipients (which would eliminate Medicaid cost increases for that state). In addition, many House Democrats oppose as insufficient the federal subsidy portion of the Senate plan. Another major point of contention is the federally funded abortion provisions contained in the Senate bill. Shailagh Murray and Paul Kane, "Pelosi: House Won't Pass Senate Bill to Save Health-Care Reform," *Washington Post*, Jan. 22, 2010; Janet Adamy and Greg Hitt, "Health Care Bill Faces Hurdles in House," *Wall Street Journal*, Feb. 24, 2010.

President Obama's Plan

Although Democratic leadership in both the House and the Senate are still optimistic that a deal can be reached, it seems that President Obama has taken it upon himself to resolve the health reform quagmire. Just days before the Health Care Reform Summit on February 25, 2010, the president unveiled his own plan based on the Senate bill. The cost of the plan is estimated at \$950 billion. The main tenants of the president's plan are as follows:

- A board, which includes the Secretary of Health and Human Services, would review premium rate hikes.
- Insurance subsidies would be provided to families of four making up to \$88,000 annually, or 400 percent of the federal poverty level.
- A 40 percent tax on certain plans would be imposed on insurance companies providing high premium insurance plans.
- The federal government would pay 100 percent of the cost of expanded Medicaid coverage through 2017.
- Individuals without insurance would face fines up to \$695 or 2.5 percent of their income, whichever is greater.
- Companies with more than 50 employees would be required to pay a fee of \$2,000 per worker if the company does not provide coverage and any of the company's workers receives federal health subsidies.
- States could choose whether or not to ban abortion coverage.

The President's Proposal, Feb. 22, 2010, www.whitehouse.gov/sites/default/files/summary-presidents-proposal.pdf; "White House Unveils Compromise Health Bill," Feb. 22, 2010, www.cnn.com; "Obama unveils revised \$1 trillion health plan," Feb. 22, 2010, www.msnbc.com.

Health Care Reform Summit

In the absence of a bipartisan agreement on any issue arising from the president's Health Care Reform Summit on February 25, Democrats seemed willing to go forward with health care reform regardless of Republican support. The strategy as this issue of *TortSource* went to press seemed to be to attempt to unify Democrats behind President Obama's compromise health care plan. "In Advance of White House Summit, Renewed Hope for Passage of Healthcare Reform," *Political Bulletin*, Feb. 24, 2010, <http://politicalbulletin.bulletinnews.com/usnb/default.aspx>. The president's plan could then be used as a part of procedure known as budget reconciliation, where provisions related to health care reform would be tacked on to budget legislation. This procedure would allow the Senate to simply adopt the budget based on a majority vote, thereby thwarting any Republican filibuster. Laura Meckler, "Obama Health Plan Costs \$950 Billion over 10 Years," *Wall Street Journal*, Feb. 22, 2010. What remains to be seen is whether or not House Democrats in this election year are willing to go along with this new strategy. Janet Adamy and Greg Hitt, "Health Bill Faces Hurdles in House," *Wall Street Journal*, Feb. 24, 2010. ❖

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Reassessing Insurance Coverage: The Legacy of Recent Financial Fraud Schemes?

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jsp?id=1202437299784. The Madoff investor and feeder fund litigation includes at least 19 federal securities class actions, over 50 lawsuits filed in state court, and eight insurance coverage cases, according to a list maintained by Kevin LaCroix's D&O Diary Web site, www.dandodiary.com.

Directors and Officers Liability Policy Issues

The coverage litigation involving directors and officers (D&O) policies is already breaking new ground. The \$7 billion fraud allegedly perpetrated at Sanford Financial Group involving certificates of deposit (CDs) resulted in a Securities and Exchange Commission (SEC) enforcement proceeding against the company's chief executive officer, R. Allen Stanford, and its former chief financial officer, Laura Pendergest-Holt, both of whom have denied any wrongdoing. When Pendergest-Holt sought defense cost reimbursement under a Lloyd's of London D&O policy, the court-appointed receiver objected, claiming that policy proceeds were receiver-ship assets and that reimbursement of defense costs would deplete the available limits and violate the court's asset freeze order.

This issue is raised frequently by bankruptcy trustees but not court-appointed receivers. The argument is based on the fact that some D&O policies provide coverage for the individual directors and officers and also directly to the corporation for its own liabilities. Any payments deplete the limits available to all insureds. See, e.g., *In re Metropolitan Mortgage & Securities Co.*, 325 B.R. 851, 855-56 (Bankr. E.D. Wash. 2005). The court overseeing the Stanford SEC proceedings eventually allowed the payments. See Order dated October 9, 2009, *SEC v. Stanford International Bank, Ltd.*, Civ. Action No. 3:03-CV-298-N (N.D. Tex.). However, the battle among Ponzi scheme defendants over their priority to D&O policy benefits is far from over. Too few policies have "priority of payments" clauses that attempt to provide guidance on the insureds' priorities to the policy benefits.

Pendergest-Holt's victory over the receiver was short lived. About a month later, Lloyd's cut off defense cost payments for all insureds based on the D&O policy's exclusions for fraud and money laundering. Stanford, Pendergest-Holt, and other insureds filed suit against Lloyd's in a Texas federal court, seeking the resumption of payments. This dispute illustrates another important issue in coverage litigation arising from Ponzi schemes and financial frauds: whether exclusions relating to the insured's conduct require an adjudication. The fraud exclusion in the Stanford D&O policy required a final adjudication, but the money laundering exclusion did not.

D&O policies sometimes require a final judgment or adjudication before the exclusions based on the insured's conduct—i.e., illegal acts, fraud, etc.—can be used to deny benefits. This makes sense because D&O policies afford coverage for wrongful acts, and the underlying allegations against D&O insureds typically run the gamut from negligence to intentional conduct, so limiting the enforcement of conduct exclusions to final adjudications adds some certainty to the coverage. This is a significant feature of many D&O policies and one reason they could play a pivotal role in responding to financial fraud claims.

Insurer payouts on these financial fraud claims may be huge. An early 2009 estimate by Aon Benfield's Actuarial and Enterprise Risk Management practice predicted \$1.8 billion in direct insurance payouts on behalf of feeder funds, banks, and other investment firms for Madoff-related liabilities. In addition to D&O policies, financial and other institutions targeted by Ponzi scheme victims have been looking to professional liability or errors and omissions (E&O) policies.

Professional Liability Policy Claims

Professional liability and E&O policies apply to claims arising out of "professional services." The more entangled a defendant is in the perpetration of a Ponzi scheme, the more difficult it will be to show that the claims arise out of professional services. The Stanford scheme was allegedly promoted in part with "safety and security" letters issued by the insurance brokerage firm of Bowen Miclette & Britt. The



letters, which were used for marketing the CDs, allegedly asserted incorrectly that the Stanford bank issuing the CDs had passed stringent risk management reviews by an outside auditing firm. Facing numerous lawsuits, Bowen Miclette & Britt sought coverage under its professional liability policy. The insurer contended that the claims did not arise out of professional services. Notwithstanding the tangential connection between the letters and brokering insurance policies, the district court found that the brokerage was entitled to the reimbursement of defense costs under the policy. *Endurance American Specialty Insurance Co. v. Brown, Miclette & Britt, Inc.*, Civ. Action No. H-09-2307, slip op. at 4-9 (S.D. Tex. Jan. 4, 2010).

The exclusions in professional liability and E&O policies also will play a role in these cases. One common exclusion applies to claims alleging violations of state or federal securities laws. If the allegations can be separated into negligent acts and conduct violating securities laws, then the court may find in favor of coverage for defense costs. This was the result when Bowen Miclette & Britt sought coverage under its professional liability policy. *Id.* at 6-9. However, in some situations the negligent conduct is too intertwined with the securities law violations to avoid the exclusion. See, e.g., *Hiscox Dedicated Corporate Member Ltd. v. Partners Commercial Realty, L.P.*, 2009 WL 1794997, at *8 (S.D. Tex. June 23, 2009).

The other exclusion that individual investment agents or representatives may need to examine closely precludes coverage for claims arising out of the sale of "unapproved" financial instruments. The Third Circuit Court of Appeals recently looked at this exclusion as it applied to claims relating to a Ponzi scheme allegedly run by a financial planner doing business as an agent and registered representative of the broker-dealer Honor, Townsend & Kent. The court ruled that since that company did not approve the investments, coverage was excluded. *Smith v. Continental Casualty Co.*, 2009 WL 3214234, at *2 (3d Cir. Oct. 8, 2009).

Litigation arising out of Ponzi schemes will certainly encourage defendants to take a new look at old coverages, and this may be one of the legacies of today's schemes. ❖

Richard Bale is a partner at Larson King, LLP, in St. Paul, Minnesota, where he represents policyholders and insurance companies in coverage litigation. He can be reached at rbale@larsonking.com.



InMotion

Mary Alexander of Mary Alexander & Associates, a leading San Francisco personal injury law firm, led a team from her firm in securing a \$5.5 million settlement in Alameda County Superior Court for a long haul trucker who was struck by another trucker in 2005. The victim, hit while he was outside the cab of his rig inspecting his load, suffered permanent brain damage and other injuries.

Charles J. Faruki and **D. Jeffrey Ireland**, partners of Faruki Ireland & Cox P.L.L. of Dayton, Ohio, have been recognized in the Ohio edition of *Super Lawyers* magazine. Faruki, a trial lawyer who focuses on business litigation, was selected as one of the Top Ten attorneys in Ohio, and Ireland, whose practice includes antitrust and advertising and trademarks, was named as one of the Top 100 attorneys in the state.

Robert P. Bartlett Jr. and **Robert "Eli" W. Kiefaber** of the firm were selected as a Super Lawyer and a Rising Star, respectively.

Jeff Kichaven, an independent mediator with a nationwide practice, received the Award for Excellence in Mediation from the Asian Pacific American Dispute Resolution Center in Los Angeles on April 1 for his commitment to diversity and his national leadership in mediation. Kichaven is a past chair of the TIPS Alternative Dispute Resolution Committee and a vice chair of the TIPS Insurance Coverage Litigation Committee.

Dennis J. Wall, principal of Dennis J. Wall, Attorney at Law, PA, in Winter Springs and Orlando, Florida, was named a 2010 Super Lawyer by the publishers of the Florida edition of *Super Lawyers* magazine. His firm focuses on counsel and expert witness services in the areas of insurance coverage, insurance good faith, and fair dealing. ❖



“When I Was a New Lawyer”

**James I. Bliss
Bliss McKnight, Inc.
Bradenton, Florida**

What is your background, and what inspired you to become a lawyer?

I was raised in Florida and later in central Illinois farm country. I was lucky and was admitted to University High School at Illinois State University. For someone raised in a corn field, this was a major opportunity. But I pretty much had to become a lawyer. Both my father and grandfather had tried and failed in that regard. My grandfather read for the law. When he came to Chicago for the bar exam, a taxi in which he was traveling was involved in an accident that resulted in the death of another person. He was so upset that he couldn't take the exam. On the way back home, he met a man on the train who offered him a job with an insurance company—where he worked for the rest of his career. Years later, while my father was enrolled at the University of Illinois College of Law, I contracted a very bad case of childhood asthma. So, on doctors' orders, my family moved to the Florida coast, ending my father's legal studies. Instead, he became a spec builder and later an underwriter for the Chubb Group of Insurance Companies.



Jim Bliss with wife Rose at the 2005 Annual Meeting (above) and demonstrating his musical talents at a TIPS social event (at right). Photos by John Pavlou.

Where did you go to law school, and what did you do right after that?

The University of Illinois College of Law. Thereafter, I worked for Spray, Price, Hough & Cushman, a large corporate law firm in Chicago. The firm later became Keck, Mahin & Cate.

Do you have any young lawyer experiences that particularly stand out in your memory? If so, what have you learned from them and how have they helped you to become so successful?

I was asked to work on a complex tax issue. After substantial work, there was still one question that I couldn't answer, so I went to the tax partner and asked him the question. His response was “that's the wrong question.” I learned humility from that.

Whom do you most admire?

My grandfather. He was raised in a log cabin—literally—near St. Francisville, Illinois. He had to attend the eighth grade twice because the school had no ninth grade. He then went to University High School at Illinois State University for a year. Following that, he attended Illinois State for a couple of years and graduated from that institution. He rose quite a bit.

What is your greatest source of professional pride?

Organizing the insurer called Governmental Interinsurance Exchange.

What got you started with ABA involvement?

My initiative. In the late 1980s, some committees were effectively closed unless you knew someone. I didn't, but I got permission to create a national institute program on risk pools for local governments and then an annual meeting program on ethics in representing local governments. However, my big break came in 1995 when the Section's fall meeting was held in Jackson Hole, Wyoming. I was the only TIPS member for many miles, so Walter Beckham appointed me to cochair the meeting with John Pavlou. That meeting was a great success, after which Mitch Orpett gave me the opportunity to work on *The Brief* editorial board. And the rest is history.

What was the worst professional advice you ever received?

Don't spend your time writing the book chapter on municipal insurance for the Illinois Institute for Continuing Legal Education. (I didn't take the advice.)

What was the best professional advice you ever received?

A colleague advised me to do what I thought was right involving the manufacture of PCBs (polychlorinated biphenyls) by Monsanto Company (my employer at that time). I advised the corporation's board in no uncertain terms what I thought they should do. They stopped producing PCBs immediately.

What personality trait has served you best over the years?

Creativity and hard work.

What challenges you the most?

Keeping all the balls in the air when drafting or reviewing a complex insurance policy or contract.



What is the one thing you cannot stand (regarding the law or lawyers)?

Lawyers who are intentionally nasty or unkind.

What is your favorite type of legal work?

Something that combines business and law.

What are your future ambitions?

To slowly retire and to do more charity work for Neighbor to Family, Inc., a not-for-profit child care and services organization on whose board I serve. And, I'd like to do some traveling and fishing.

What can the ABA do to be a good home to young lawyers?

Create and implement ways to bring young lawyers into active participation in the Sections and reduce the cost of ABA membership. ❖

James I. Bliss's Advice for New Lawyers:

- Integrity is everything.
- Always be professional.
- All you can do is all you can do, and all you can do is enough. ❖



Mark Your Calendar

TIPS/ABOTA National Trial Academy
April 17–21, 2009, Reno, NV
(312-988-5656)

Property Insurance Law Committee Spring Meeting
April 29–May 1, 2010,
Half Moon Bay, CA
(312-988-5672)

Fidelity & Surety Law Committee Spring Meeting
May 6–7, 2010, New Orleans, LA
(312-988-5708)

Windstorm Insurance Network Texas Symposium
May 11, 2010, Dallas, TX
(813-988-0737)

TIPS Spring Leadership Meeting
May 12–16, 2010, San Juan, PR
(312-988-5672)

ABA Annual Meeting
August 5–10, 2010, San Francisco, CA
(312-988-5672)

TIPS Fall Leadership Meeting
October 12–17, 2010, Dallas, TX
(312-988-5672)

