



# Insurance Bad Faith

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## Expert Analysis

### Maximizing Insurance Recovery On Madoff-Related Losses

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Even in a year marked by one shocking financial catastrophe after another, the massive losses suffered by those who had investments with Bernard Madoff's hedge fund have left the investing community around the world slack-jawed.

Although it might be several weeks or months before many key questions (Who? How? How much? Why?) are answered, those affected should take immediate steps to minimize their losses.

This article provides an overview of the key details to consider in developing a plan to maximize the insurance recovery associated with losses and liability claims arising from these events.

The liabilities and losses of the key figures in this saga generally are so large that they will far outstrip policy limits. At the same time, D&O, E&O and other forms of third-party insurance should in many cases cover some if not all policyholders' defense costs and possibly much or perhaps even all the policyholder's liabilities — meaning some investors stand to recover much of what otherwise is thought to have been lost.

There are several steps that policyholders and investors should consider in order to maximize their potential recoveries via available insurance.

#### *Understand the Available Insurance*

Depending on the claims asserted, the following types of insurance may be called upon to respond to Madoff-related losses.

#### *Third-Party Insurance*

##### D&O Insurance

Directors and officers insurance covers losses arising from errors, omissions, misstatements and other missteps that are broadly defined as “wrongful acts” under such policies. Such policies provide coverage when the policyholder's

directors and officers are responsible for such wrongful acts, but many policies also cover liability against the policyholder itself or against non-director employees.

Typically, D&O insurance is provided on a “claims made” basis, which means the insurance is triggered only by claims (often defined as written demands seeking relief or payment from the policyholder) made during the policy period.

Because any insurance company underwriting renewal D&O coverage for likely defendants involved in the Madoff matter almost certainly will include exclusions for Madoff-related claims, it is important to pursue coverage for D&O claims immediately, in order to minimize the risk that such claims will fall under next year’s D&O insurance policy.

D&O claims continue to lead to coverage disputes — often when insurers balk at advancing defense costs on grounds that the policy was obtained under false pretences. Policyholders should resist such defenses.

In 2008 Anderson Kill obtained two key rulings for policyholders whose insurers resisted advancing defense costs. The Delaware Superior Court rejected an attempt by D&O insurance companies to “allocate” defense costs and instead required full advancement of defense costs. *HLTH Corp. v. Agric. Excess & Surplus Ins. Co.*, 2008 WL 3413327 (Del. Super. Ct. Jul. 31, 2008). The court also rejected the recent unfavorable analysis in *Qualcomm Inc. v. Certain Underwriters at Lloyd’s, London*, 2008 WL 763483 (Cal. Ct. App., 4th Dist. 2008), and *Comerica Inc. v. Zurich American Insurance Co.*, 498 F. Supp. 2d 1019 (E.D. Mich. 2007), and found that excess policies can be triggered when the policyholder has spent to the limit of underlying insurance.

In the second decision, the New York Court of Appeals upheld a ruling by the New York Supreme Court and the Appellate Division’s 1st Department on the broad obligation of a D&O insurance company to pay defense costs on a current basis. The court entered judgment on the full amount of the policy limits plus pre- and post-judgment interest. It rejected insured-vs.-insured arguments as well as the assertion of a so-called “equitable sub-limit.” *Trustees of Princeton Univ. v. Nat’l Union*, No. 650 202/06 (N.Y. Nov. 25, 2008).

#### E&O Insurance

Claims for professional negligence (such as accounting malpractice) generally are covered under professional

liability errors and omissions policies. Like D&O policies, E&O coverage typically is written on a “claims made” basis. E&O policies also include many of the same types of exclusions that are found in D&O policy forms.

#### Other Types

Although the D&O and E&O will be the main sources of coverage for Madoff-related third-party liabilities, it is a good idea to check all insurance policies for potential coverage. Many financial institutions carry *general partners liability* insurance that provides coverage for many of the claims likely to surface in the coming months.

Moreover, although *commercial general liability* insurance generally requires liability to arise out of property damage or bodily injury, such policies sometimes include endorsements that may compel those policies to respond to Madoff-related claims.

#### First-Party Insurance

The following types of insurance may provide some coverage for the policyholder’s own loss.

#### Crime Insurance and Fidelity Bonds

Crime insurance policies (aka fidelity bonds) generally provide a company with coverage for losses incurred due to intentional theft or other criminal conduct by employees (and sometimes by third parties) acting for their own benefit and not the benefit of the company.

#### Homeowners

Some blue-chip homeowners insurance policies, such as Chubb’s “masterpiece” policy, include limited coverage for losses like those arising from investments with Madoff’s hedge funds.

#### Consider Both ‘Named’ Insurance and ‘Additional’ Insurance

Be aware that many liability policies provide coverage not only to the party that buys the insurance, but also to “additional insureds,” typically other entities with whom the “named insured” does business. Accordingly, in planning a strategy for minimizing exposure to Madoff-related losses, be sure to consider the insurance purchased by others involved in the investment transactions at issue.

### *Consider Where/How to Pursue Claims*

The exact strategy for minimizing losses will depend on your particular circumstances, but there are a few strategic options/choices that generally are worth considering.

#### Negotiation/Mediation

Because time may be of the essence in gaining access to finite resources, those pursuing claims should consider whether alternative means of dispute resolution are more advantageous than litigation, which can be time-consuming.

#### Litigation in Your Home State or Country

Foreign entities should consider whether the laws of their home country are more or less favorable than U.S. law in securing a complete recovery for the losses at issue. Similarly, consideration should be given to the question of jurisdiction abroad over American targets and the extent to which those targets have assets abroad to satisfy any judgment obtained in another country.

#### Assignment of Insurance Claims

Finally, especially in instances where a defendant has no personal assets to satisfy claims, an assignment of the rights to insurance proceeds may allow for a mutually beneficial settlement.

This step minimizes the risk that the insurance dollars needed to pay losses will be spent defending against liability claims. It also would accelerate the process of

getting to the point of payment in cases where the insurance company is fighting the claim for insurance coverage.

The aim is to avoid a scenario in which the claimant and policyholder are faced with two sets of litigation before the insurance company would have to pay — one to establish the target's liability and another to establish the right to coverage for such liability.

An effective strategy for minimizing the losses at hand should take into consideration the concepts discussed above, but can only be assessed based on the particular facts of each situation. Whatever the opportunity for recovery of such losses, a prompt, thorough assessment of the options available is key to maximizing one's recovery at this difficult time.

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