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Maximizing the Recovery of Madoff-Related Losses

By Marshall Gilinsky

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. Insurance undoubtedly will play a significant role in helping those involved in minimizing their Madoff-related 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 out these events.

1. Understand the Available Insurance

Depending on the claims asserted, there are three main types of insurance that are likely to be called upon to pay for the financial losses at hand.

A. D&O Insurance

Directors and Officers ("D&O") 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 that the insurance is only triggered 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.

B. E&O Insurance

Claims for professional negligence (such as accounting malpractice) generally are covered under professional liability errors and omissions ("E&O") 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.

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C. Crime Insurance and Fidelity Bonds

Crime insurance policies (a/k/a 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. Unlike the "third party" coverage provided under D&O and E&O polices (so-called because the claimant is a third party to the relationship between the policyholder and the insurance company), crime polices are a type of "first party" insurance (because the loss occurs directly to the policyholder).

D. Other Types of Insurance May Apply

Although the three categories of insurance discussed above will be the main sources of coverage for Madoff-related losses and liabilities, it is a good idea to check all of your insurance policies for potential coverage. For example, many financial institutions carry General Partners Liability ("GPL") insurance that provides coverage for many of the claims that are likely to surface in the coming months. Moreover, although Commercial General Liability ("CGL") insurance generally requires liability to arise out of property damage or bodily injury, such policies sometimes include endorsements that may compel those polices to respond to Madoff-related claims. Indeed, even Homeowners insurance policies like Chubb's "Masterpiece" policy usually include limited coverage for losses like those arising out of investments with Madoff's hedge funds.

It will be very important to understand the full scope and limits of all potential insurance in devising the best strategy for maximizing any recovery through insurance. Because the coverages identified above might include exclusions that could be implicated by certain allegations against potential targets, insurance professionals such as your insurance broker or an insurance attorney should be consulted in developing your recovery strategy.

2. 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 "additional insureds" — typically other entities with whom the "named insured" does business. Accordingly, in planning a strategy for minimizing your exposure to Madoff-related losses, be sure to consider the insurance

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purchased by others involved in the investment transactions at issue.

3. Focus on Likely Sources of Recovery

Although it is common for litigants to adopt a "sue everybody" strategy, given the magnitude of the losses at hand and the possibility that certain of the resources/insurance policy limits available to pay claims may be finite, it is a good idea to focus on those that are most likely to be available and relatively undiluted, so as to avoid losing time in what may well turn out to be a "race" to secure the funds available to cover the losses at hand.

4. 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:

A. 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.

B. Litigation in Your Home State/Home 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.

C. 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 would minimize 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 such that the claimant and policyholder are faced with two sets of litigation before the insurance company would have to pay — one to establish the policyholder'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 and thorough assessment of the options available is key to maximizing one's recovery at this difficult time. ▲