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TO THE HONORABLE COURT:

Defendant Laura Pendergest-Holt (“Defendant”) files this Motion for Clarification that the Receivership Order Does Not Apply to D&O Policy Proceeds, or, Alternatively, for Authorization of Disbursement of D&O Policy Proceeds. In support thereof, Defendant respectfully shows as follows:

INTRODUCTION

On the eve of the Underwriters’ first payment of defense costs for Defendant Laura Pendergest-Holt, the Receiver for the first time has claimed an interest in the D&O policies, threatening the Underwriters with a contempt action for merely following through on their contractual obligation to advance defense costs. Notwithstanding the Receiver’s belated threats, however, the Receiver has no recognized interest in the policy proceeds under applicable Fifth Circuit law, which provides that an insured’s contractual right to reimbursement for third-party claims is not an estate asset. Moreover, even in other jurisdictions that treat D&O policies as an estate asset, courts routinely authorize the disbursement of defense costs to counsel for directors and officers.

As set forth below, Defendant seeks resolution of this motion on an expedited basis to help ameliorate the prejudice caused by the Receiver’s belated attempt to prevent Defendant from mounting a vigorous defense in this case. Defendant further seeks an oral argument on this motion.

RELEVANT FACTS¹

1. Lloyd's of London has issued the following insurance policies relevant to this case: (1) Lloyd's D&O and Company Indemnity Policy, reference number 576/MNK558900; (2) Lloyd's Financial Institutions Crime and Professional Indemnity Policy, reference number 576/MNA85300; and (3) Lloyd's Excess Blended "Wrap" Policy, reference number 576/MNA831400.² (App. 1-153). For purposes of this motion, "D&O Policies" shall mean the above policies and any applicable excess policies, excluding sections one and two of the Lloyd's Financial Institutions Crime and Professional Indemnity Policy, reference number 576/MNA85300.³

2. The D&O Policies provide indemnity coverage for the Stanford entities and their officers and directors, including Defendant. (App. 55-97). Underwriters agreed in the D&O policies to advance defense costs and expenses and to "pay . . . on behalf of the Directors and Officer" and "on behalf of the Company" for "Loss resulting from any Claim first made during the Policy Period for a Wrongful Act." (App. 6-8, 102-03). A "Claim" means a "written demand for monetary or non-monetary damages," or a "judicial or administrative proceeding initiated against any of the Directors and Officers or the Company in which they may be subjected to a

¹ Citations to the Appendix in Support of Defendant Laura Pendergest-Holt's Expedited Motion for Clarification that the Receivership Order Does not Apply to D&O Policy Proceeds, or, Alternatively, for Authorization of Disbursement of D&O Policy Proceeds are in the form of "App.____."

² Sections one and two of the Lloyd's Financial Institutions Crime and Professional Indemnity Policy provide coverage to the Stanford entities for financial institutions crime and electronic and computer crime. (App. 55-97) Because these sections have separate policy limits and require the payment of a separate premium, the granting of this motion would have no effect on such coverage. (App. 56-57).

³ Defendant has been informed that there are certain excess insurance policies issued by other underwriters. The Receiver has not provided the excess policies to Defendant or confirmed the details of such excess policies. Nonetheless, because it is customary for excess policies to follow the coverage provisions of the primary policy, this motion requests the same relief as to any and all applicable excess insurance policies.

binding adjudication of liability for damages or other relief.” (App. 7, 102). The D&O Policies therefore provide only for the payment of amounts owed to third-parties, not for the payment of amounts that may be owed directly to the Stanford entities.

3. Defendant has asserted a claim for coverage under the D&O Policies as to both this action and the criminal case against her (as well as several other cases). The Underwriters have advised Defendant that they will advance defense costs to her for both the SEC and the criminal case, with the first payment scheduled for July 1, 2009. (App. 154-164).

4. On June 25, 2009, counsel for Underwriters wrote that they “learned for the first time [on June 24, 2009]” that the Receiver “now takes the position that all proceeds under the policies . . . are ‘Receivership Assets’ as defined by the Court’s February 17, 2009 order.” (App. 165). Underwriters further advised that “the Receiver has taken the position that his right to the proceeds ‘supersedes’ the right of the insureds.” (*Id.*) Because the Receiver has threatened to pursue contempt charges, Underwriters advised that no payments will be made absent a ruling from this Court. (App. 165-66).

ARGUMENT

I. Defendant’s Motion Should be Decided on an Expedited Basis (Unopposed by Receiver).

Since February 2009, Defendant has had the unenviable task of trying to defend herself against a criminal indictment and the SEC’s claims without any money to pay for her defense. As this Court is well aware, all of Defendant’s assets were frozen, leaving her with no assets to fund a defense. Defendant has been able to retain counsel only because of the prospect that such counsel will get paid from the proceeds of the D&O Policies. Given that counsel for Defendant

have already been working without compensation for months, a further delay in payment would jeopardize Defendant's ability to mount an effective defense to the criminal case and this case.

The fact that Defendant was seeking her defense costs under the D&O Policies was no surprise to the Receiver. Counsel for Defendant raised the issue of insurance coverage in its very first communications with the Receiver. The Receiver was also no doubt aware that Defendant sued the Underwriters for coverage in state court in March 2009 in the matter of *Laura Pendergest-Holt v. Lloyd's of London Underwriting Members, et al.*; Cause No. 09-03133 pending in the 101st Judicial District Court of Dallas County, Texas. Because the Receiver has known for months that Defendant was seeking coverage under the D&O Policies, the Receiver should have asserted its purported claim to the D&O Policies long ago. Instead, the Receiver ignored the state court case and waited until Defendant's attorneys were only a few days away from receiving their first payment under the D&O Policies. Moreover, before asserting his claim to the D&O Policies, the Receiver never bothered to consult with Defendant's counsel in any way. Indeed, the Receiver did not even copy Defendant's counsel on the Receiver's correspondence with the Underwriters.

To address the prejudice caused by the Receiver's actions, Defendant requests that the Court order that any response to this motion be filed within five (5) days from the date on which this motion was filed, and that any reply in support thereof be filed within five (5) days of such response. The Receiver has agreed to the request for expedited consideration. Defendant further requests that the Court hold an oral hearing on this matter.

II. The Proceeds of the D&O Policies Are Not Property of the Receivership Estate.

Defendant respectfully requests that the Court rule that Defendant's contractual right to defense costs under the D&O Policies is not a receivership asset, not subject to the Receiver's control, and is not otherwise subject to the Court's order freezing Defendant's assets. Such a ruling is not only supported by common sense, but it is also supported by Fifth Circuit precedent in the closely analogous context of determining whether insurance policy proceeds are part of a bankruptcy estate. In that context, the Fifth Circuit identified the relevant question as "not who owns the policies, but who owns the liability proceeds." *In re Louisiana World Exposition, Inc.*, 832 F.2d 1391, 1399 (5th Cir. 1987). Under Fifth Circuit law, even if the bankrupt entity owns the insurance policies at issue, the proceeds of those policies are not part of the bankruptcy estate if the bankrupt entity has no claim or entitlement to receive the proceeds of those policies. *Id.*

The Fifth Circuit articulated the following test for determining whether insurance policy proceeds are the property of a bankruptcy estate:

The overriding question when determining whether insurance proceeds are property of the estate is whether the debtor would have a right to receive and keep those proceeds when the insurer paid on a claim. When a payment by the insurer cannot inure to the debtor's pecuniary benefit, then that payment should neither enhance nor decrease the bankruptcy estate. ***In other words, when the debtor has no legally cognizable claim to the insurance proceeds, those proceeds are not property of the estate.***

In re Edgeworth, 993 F.2d 51, 55-56 (5th Cir. 1993) (emphasis added).⁴ The court in *Edgeworth*

⁴ In 1995, a Fifth Circuit panel questioned the distinction between ownership of the policy and the policy proceeds, while noting that the "precedential – or even merely instructional – value of this opinion to future Chapter 11 cases should probably be 'little or none.'" *In re Vitek, Inc.*, 51 F.3d 530, 533 n. 3 (5th Cir. 1995). Subsequent Fifth Circuit cases have continued to cite to the policy/proceeds test set forth in *Edgeworth*. See *In re Babcock & Wilcox Co.*, 69 F. App'x 659 (5th Cir. May 30, 2003); *In re Border Steel Rolling Mills, Inc.*, 54 F. App'x 591 (5th Cir. Nov. 20, 2002); *Matter of Zale Corp.*, 62 F.3d 746, 757-58 & n.33 (5th Cir. 1995). Similarly, lower court cases have either ignored this language in *In re Vitek* (see *Executive Risk Indemnity, Inc. v. Integral Equity, L.P.*, 2004 WL

identified casualty, collision, life and fire insurance policies that name the debtor as a beneficiary as examples of policy proceeds that would be property of a bankruptcy estate. *Id.* at 56. Because such policy proceeds would be made payable to the debtor – instead of a third party creditor – the proceeds would inure to the benefit of all bankruptcy creditors. *Id.* By contrast, the court noted that “under the typical liability policy, the debtor will not have a cognizable interest in the proceeds of the policy” because “[t]hose proceeds will normally be payable only for the benefit of those harmed by the debtor under the terms of the insurance contract.” *Id.* In that circumstance, the court therefore held that the proceeds of a debtor physician’s liability policy were not the property of his bankruptcy estate. *Id.*

These bankruptcy principles apply with equal force in a receivership setting. *See Executive Risk Indemnity, Inc. v. Integral Equity, L.P.*, 2004 WL 438936, at *13 (N.D. Tex. March 10, 2004). In his summary judgment opinion in *Executive Risk Indemnity*, in deciding whether advancement of defense expenses was consistent with a receivership order and applicable law, Judge Fish expressly noted that “there is clear Fifth Circuit precedent on a closely related issue – the treatment of liability insurance proceeds in the context of bankruptcy.”⁵ *Id.* This Court should similarly look to bankruptcy precedent in resolving this motion.

In *Executive Risk Indemnity*, Judge Fish identified the key issue as “whether proceeds of a liability insurance policy that covers two groups of coinsureds – one group in receivership, and

438936 at *13 (N.D. Tex. March 10, 2004)) or declined to follow it. *See In re Sfuzzi, Inc.*, 191 B.R. 664, 667-668 (Bankr. N.D. Tex. 1996).

⁵ Indeed, in this case, the Receiver has argued that his role is “very similar to the trustee’s role in bankruptcy.” Receiver’s Response to Examiner’s Response to Examiner’s Report and Recommendation No. 1 [Docket No. 441] at 2 n. 1.

one not – may be distributed to the insureds that are not in receivership without violating receivership law.” *Executive Risk Indemnity, Inc.*, 2004 WL 438936 at *13. After examining the policy language and relying on the Fifth Circuit opinion in *Edgeworth*, Judge Fish reached the conclusion that “any proceeds from the Policy – whether they are first paid to the Insured or not – are owed not to the Insured but to successful third-party claimants against the Insured, as well as to the Insured’s attorneys defending against those claims.” *Id.* at *14. Judge Fish further held that the two insured entities in receivership also had no cognizable interest, in and of themselves, in the proceeds of the insurance policy at issue. *Id.* On that basis, Judge Fish held that the payment of defense costs to the parties requesting such “will not violate the Receivership Order or applicable law.”⁶ *Id.*

Similarly, the payment of defense costs to Defendant’s counsel in this case would not violate this Court’s receivership order. The D&O Policies provide only for a defense and for indemnification of losses incurred in connection with third-party claims. (App. 1-153). For example, the coverage under the D&O Policies must be triggered by a “Claim,” which requires a “written demand for monetary or non-monetary damages,” or a “judicial or administrative proceeding initiated against any of the Directors and Officers or the Company in which they may be subjected to a binding adjudication of liability for damages or other relief.” (App. 7, 102). Further, unlike certain types of insurance where the insured has a direct entitlement to payment,

⁶ Admittedly, in *Executive Risk Indemnity*, only the non-receivership insureds sought advancement of defense costs, while in this case Defendant has been placed under receivership individually. *Id.* at *13-14. That fact, however, should not be controlling. Judge Fish’s reasoning applies equally to receivership entities seeking advancement of defense costs: because the policy proceeds inure to the benefit of third parties, as well as to the lawyers defending the third-party claims, these proceeds are not part of the receivership estate and should not be subject to the control of the receiver. *Id.*

the D&O Policies provide only for payment to be made to a third-party “on behalf of the Directors and Officers” or “on behalf of the Company.” (App. 6-8, 102-03).

Thus, just as the policy in *Edgeworth* was not part of the bankruptcy estate, the D&O Policies here are triggered only by payments that are required to be made to third-parties or to the lawyers defending the third-party claims; and the policy proceeds therefore are not part of the receivership estate. Moreover, the payment of defense costs will be made to counsel for Defendant, none of whom are parties to the receivership or subject to the receivership order. Defendant therefore requests that the Court follow Judge Fish’s reasoning in *Executive Indemnity Risk* and confirm that the Underwriters’ payment of defense costs for Defendant Pendergest-Holt will not violate the receivership order, any other receivership law, or the Court’s order freezing assets in this case.

III. Alternatively, if the Court were to find that the Proceeds of the D&O Policies are Receivership Assets, the Court Should Authorize Payment of Defense Costs to Defendant.

By showing that the proceeds of the D&O Policies are not property of the receivership estate, Defendant has established that her counsel should be paid from the proceeds of the D&O Policies under their applicable terms and conditions. No further inquiry is necessary. This point is illustrated by case law surrounding the demise of Adelphia Communications, a high-profile case with John Rigas and his family that involved an alleged fraudulent scheme causing losses in the billions of dollars. There, the bankruptcy court accepted the argument of the bankruptcy trustee and creditors that an excessive drain on the company’s D&O policies might harm the debtor’s reorganization efforts, which prompted the court to regulate the disbursement of the policy proceeds by allocating an initial amount to each defendant, with defendants having the

right to request additional disbursements in the future. *In re Adelpia Communications Corp.*, 285 B.R. 580, 592-93, 597-600 (Bankr. S.D.N.Y. 2002). The district court reversed the bankruptcy court's order, finding that "[n]o cognizable equitable and legal interest in the proceeds has arisen here," and that "Adelpia's estate cannot be ascribed to hold a property interest in those proceeds." *In re Adelpia Communications Corp.*, 298 B.R. 49, 54 (S.D.N.Y. 2003).

If this Court nonetheless believes that it should exercise its authority over the D&O Policies, Defendant's counsel should still receive payment from the proceeds of the D&O Policies. Unlike the Fifth Circuit, certain other jurisdictions either treat D&O policy proceeds as property of the estate, or have not specifically addressed the issue. As a result, several courts have grappled with competing claims to policy proceeds by directors and officers and a debtor company. Such courts have consistently recognized the right of directors and officers to receive the advancement of defense costs to fund their defense. *See, e.g., In re Allied Digital Technologies Corp.*, 306 B.R. 505, 513-514 (Bankr. D. Del. 2004) (holding that, even if the proceeds of the D&O policy were property of the estate, the automatic stay should be lifted to authorize advancement of defense costs in accordance with the policy terms); *In re Laminate Kingdom LLC*, 2008 WL 1766637, at *5 (Bankr. S.D. Fla. March 13, 2008) (lifting automatic stay to extent applicable "to permit [insurer] to reimburse the reasonable and necessary Costs of Defense incurred by the Directors and Officers"); *In re Cybermedica, Inc.*, 280 B.R. 12, 19 (Bankr. D. Mass. 2002) (holding that "the Underwriters are allowed to make the defense costs disbursements in accordance to their contractual obligation contained within the D&O Policy").

The rationale for advancing defense costs to directors and officers is particularly strong when a debtor company has only a theoretical claim to direct coverage. Indeed, claims against a debtor entity are typically discharged in bankruptcy. See *In re CHS Electronics, Inc.*, 261 B.R. 538, 543 (Bankr. S.D. Fla. 2001). When the debtor entity is discharged from liability, the real concern of a bankruptcy trustee is that the payment of defense costs may impact the trustee's right as a plaintiff to recover from a D&O policy, instead of impacting the ability of the bankrupt entity to defend itself. See *In re Allied Digital Technologies Corp.*, 306 B.R. at 513. In *Allied Digital Technologies*, the court rejected a trustee's attempt to regulate the payment of defense costs, explaining as follows:

The bottom line is that the Trustee seeks to protect the amount he may receive in his suit against the directors and officers while limiting coverage for the defense costs of the directors and officers. This is not what the directors and officers bargained for. In bringing the action against the directors and officers, the Trustee knew that the proceeds could be depleted by legal fees and he took that chance. The law does not support the Trustee's request to regulate defense costs.

Id. at 513.

The reasoning of *Allied Digital Technologies* applies with equal force to this case. This Court has stayed all actions against the Stanford entities and the Receiver, and the final judgment in this case presumably will provide for a complete discharge from liability. At most, the Receiver has an interest in any potential recovery that the SEC may obtain in its actions against the directors and officers. The D&O Policies were intended to provide a defense to Defendant, and the Receiver should not be allowed to interfere with Defendant's contractual right to a defense. Thus, to the extent that the Court finds that the proceeds of the D&O Policies are an asset of the receivership estate, Defendant requests that the Court specifically authorize payment

of the proceeds of the D&O Policies to Defendant's counsel, with such payments being limited only by the terms and conditions of the D&O Policies.

CONCLUSION

WHEREFORE, Defendant Pendergest-Holt respectfully requests that the Court: (1) order an expedited briefing schedule that will provide that any response be filed within five (5) days from the date on which this motion was filed, and that any reply in support thereof be filed within five (5) days of such response; (2) clarify that the proceeds of the D&O Policies are not property of the receivership estate, and that Underwriters may pay defense costs and expenses incurred by Defendant without violating this Court's receivership order, any other order of this Court, or applicable receivership law; (3) alternatively, in the event the Court determines that the proceeds of the D&O Policies are property of the receivership estate, that the Court authorize the payment of defense costs to Defendant's counsel in accordance with the terms and conditions of the D&O Policies; (4) that the Court hold an oral argument on this matter; and (5) that the Court grant Defendant such other and further relief to which she may be justly entitled.

DATED this 30th day of June, 2009.

Respectfully submitted,

/s/ Jeffrey M. Tillotson, P.C.

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CERTIFICATE OF CONFERENCE

On June 29, 2009, the Undersigned counsel held a conference about the substance of this motion with Tim Durst, counsel for Receiver. The Receiver agreed to the request for expedited consideration, but an agreement could not be reached on the substance of the motion because the Receiver opposes the relief requested in this motion. The motion is therefore submitted to the Court for determination.

/s/ Jeffrey M. Tillotson, P.C.

Jeffrey M. Tillotson, P.C.

CERTIFICATE OF SERVICE

The undersigned hereby certifies that a true and correct copy of the above and foregoing document has been served *via ECF* on counsel of record on this the 30th day of June, 2009:

/s/ Jeffrey M. Tillotson, P.C.

Jeffrey M. Tillotson, P.C.