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WEATHERING THE STORM

Insurance Coverage and Insolvency: *Maximizing Recovery In Bankruptcy*

As we count down the days until the New Year, we are reminded of the momentous year we will leave behind us on December 31. While memorable for many things, 2009 may long be remembered as a year of record corporate insolvency. In 2009, General Motors, CIT, Chrysler, and Thornburg Mortgage filed four of the ten largest corporate bankruptcies in U.S. history. Equally notable are the number of corporate filings made in 2009. With total fourth quarter filings yet to be reported, the number of businesses seeking bankruptcy protection during the first three quarters of 2009 alone has exceeded the annual filings in every year since 1997. See American Bankruptcy Institute, Quarterly Business Filings by Year (1994-2009), available at <http://www.abiworld.org>. Even by comparison to 2008 (also a record year for bankruptcies), 2009 stands out. While business filings topped 43,000 nationwide in 2008, the number of businesses filing for bankruptcy in 2009 may exceed 60,000—a nearly 38 percent increase over 2008.

As a result of the dramatic rise in corporate filings, an even greater number of companies have been exposed to the bankruptcy process as creditors anxious to collect from a host of now-insolvent debtors. In this environment, creditors and debtors alike are compelled to seek creative, alternative sources of payment, including insurance proceeds. Now more than ever, it is crucial that debtors, creditors, trustees, and, indeed, anyone with an interest in maximizing the financial resources on hand to satisfy debts, understand (1) what coverage may potentially be available; and (2) how to gain access to and maximize this important financial resource.

In particular, setting aside conventional general liability coverage for “bodily injury” and “property damage,” some policies frequently issued to corporate insureds cover risks or claims, which may not commonly be thought of as “insured.” For example, is a “breach of contract” an insured claim? Many errors and omissions (“E&O”) liability policies and directors’ and officers’ (“D&O”) liability policies provide coverage for damages the insured becomes legally obligated to pay because of “wrongful acts,” such as “breaches of duty,” including contractual breaches. Claims under liability policies, like E&O and D&O insurance, may be pursued by the trustee/debtor against third parties or by creditors against the debtor/insiders.

In addition to liability insurance, debtors (as well as creditors) may have “credit risk insurance” to offset losses caused by a default on insured contracts or loans. Mortgage guaranty insurance is one example. Other types of coverage may include crime/fidelity coverage, commercial property coverage, employment practices liability insurance coverage, and fiduciary liability coverage. Understanding what insurance coverage is available to help liquidate a claim in bankruptcy may mean the difference between a full recovery or no recovery at all for some creditors.

Just as important as knowing *what* is available is knowing *how* to benefit from and maximize insurance proceeds. Most insurance policies—and especially credit risk insurance policies—contain detailed conditions relating to notice and settlement of claims. Reconciling and abiding by these conditions in the procedural labyrinth of a bankruptcy proceeding is a complicated, albeit critically important task, requiring careful planning and analysis. Likewise, understanding basic insurance law principles can provide critical keys to increasing the value of the debtors’ or creditors’ claims. For example, under Texas law, insureds may be entitled to 18 percent interest on the amount of a claim for covered defense costs or other first-party benefits when the insurer fails to timely pay or respond to a covered claim. See, e.g., *Lamar Homes, Inc. v. Mid-Continent Cas. Co.*, 242 S.W.3d 1 (Tex. 2007).

In short, while the current escalation in bankruptcy filings has created new financial challenges for debtors and creditors alike, bankruptcy also provides, by necessity, opportunities to pursue a variety of insurance claims. Every creditor, debtor, or trustee pursuing insurance coverage in the context of bankruptcy should be familiar with the types of coverage potentially available and the legal principles that will ensure the greatest recovery possible.

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