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Protecting Lender Interest in Borrower Insurance Proceeds

Navigating Insurance and Bankruptcy Issues in Commercial Lending

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Today's faculty features:

Michael L. Weissman, Of Counsel, **Levin Ginsburg**, Chicago

Frederic J. Giordano, Partner, **K&L Gates**, Newark, N.J.

Gary M. Zimmerman, Senior Vice President and Chief Underwriting Counsel,
Fidelity National Financial, Chicago

John Eggum, Attorney, **Butler Pappas**, Chicago

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INSURANCE ISSUES IN COMMERCIAL LOAN DOCUMENTATION

Michael L. Weissman, Esq.
Levin Ginsburg
180 North LaSalle Street
Suite 3200
Chicago, IL 60601-2800
Phone: (312) 368-0100
Fax: (312) 368-0111

E-mail: mweissman@lgattorneys.com

Insurance Issues in Commercial Loan Documentation

- What kinds of Insurance Affect a Lender's Collateral
 - Hazard or Casualty Insurance
 - Flood Insurance
 - Business Interruption, Loss of Income and Rental Interruption Insurance
 - Product and Public Liability Insurance
 - Workmen's Compensation Insurance
 - Builder's Risk Insurance

Insuring Collateral – General Matters

1. Does the Lender Have an Insurable Interest?
2. Who Has the Duty to Insure Collateral?
3. Binders: What Form Must They Take?
4. Coinsurance: How Does it Affect Loss Recoveries?
5. Insurance is Outside the Uniform Commercial Code.
6. Insurance as “Proceeds”.
7. Notice to the Insurer – The Loss Payee Endorsement.
8. What Happens to Insurance Proceeds if the Borrower Goes Into Bankruptcy?

Insuring Collateral – Key Requirements

1. Loss Payee Clauses

- a. Open Loss Payee Clause.
- b. Standard Loss Payable Clause.
- c. Lender's Loss Payable Endorsement.

2. Certificate of Insurance vs Evidence of Insurance

- ACORD 2S-S (Certificate of Insurance);
- ACORD 28 (Evidence of Property Insurance).

ACORD 25-S

“This certificate is issued as a matter of information only and confers no rights upon the certificate holder. This certificate does not amend, extend or alter the coverage afforded by the policies below.”

ACORD 28

“This is evidence that insurance as identified below has been issued, is in force, and conveys all the rights and privileges afforded under the policy.”

Borrower's Duty to Maintain Property and Casualty

- Insurance. Borrower shall: Keep the Collateral properly housed and insured for the full insurable value thereof against loss or damage by fire, theft, explosion, sprinklers, collision (in the case of motor vehicles) and such other risks as are customarily insured against by Persons engaged in businesses similar to that of Borrower, with such companies, in such amounts, with such deductibles and under policies in such form as shall be satisfactory to Lender. Original (or certified) copies of such policies of insurance have been or shall be, within ninety (90) days of the date hereof, delivered to Lender, together with evidence of payment of all premiums therefore, and shall contain an endorsement, in form and substance acceptable to Lender, showing loss under such insurance policies payable to Lender. Such endorsement, or an independent instrument furnished to Lender, shall provide that the insurance company shall give Lender at least thirty (30) days' written notice before any such policy of insurance is altered or canceled and that no act, whether willful or negligent, or default of Borrower or any other Person shall affect the right of Lender to recover under such policy of insurance in case of loss or damage. In addition, Borrower shall cause to be executed and delivered to Lender an assignment of proceeds of its business interruption insurance policies. Borrower hereby directs all insurers under all policies of insurance to pay all proceeds payable thereunder directly to Lender.

Borrower's Duty to Maintain Other Insurance

- Maintain, at its expense, such public liability and third-party property damage insurance as is customary for Persons engaged in businesses similar to that of Borrower with such companies and in such amounts with such deductibles and under policies in such form as shall be satisfactory to Lender and original (or certified) copies of such policies have been or shall be, within ninety (90) days after the date hereof, delivered to Lender, together with evidence of payment of all premiums therefore; each such policy shall contain an endorsement showing Lender as additional insured thereunder and providing that the insurance company shall give Lender at least thirty (30) days' written notice before any such policy shall be altered or canceled.

Borrower's Failure to Maintain Insurance

- If Borrower at any time or times hereafter shall fail to obtain or maintain any of the policies of insurance required above or to pay any premium relating thereto, then Lender, without waiving or releasing any obligation or default by Borrower hereunder, may (but shall be under no obligation to) obtain and maintain such policies of insurance and pay such premiums and take such other actions with respect thereto as Lender deems advisable. Such insurance, if obtained by Lender, may, but need not, protect Borrower's interests or pay any claim made by or against Borrower with respect to the Collateral. Such insurance may be more expensive than the cost of insurance Borrower may be able to obtain on its own and may be cancelled only upon Borrower providing evidence that it has obtained the insurance as required above. All sums disbursed by Lender in connection with any such actions, including, without limitation, court costs, expenses, other charges relating thereto and reasonable attorneys' fees, shall constitute Loans hereunder, shall be payable on demand by Borrower to Lender and, until paid, shall bear interest at the highest rate then applicable to Loans hereunder.

Illinois Statute

- **Collateral Protection Act.** Pursuant to the requirements of the Illinois Collateral Protection Act, the Borrower is hereby notified as follows: Unless the Borrower provides the Lender with evidence of the insurance coverage required by this Loan and Security Agreement or any of the other Loan Documents, Lender may purchase insurance at the Borrower's expense to protect Lender's interests in the Collateral for the Liabilities. This insurance may, but need not protect the Borrower's interests. The coverage the Lender purchases may not pay any claim that the Borrower makes or any claim that is made against the Borrower in connection with the Collateral or any other collateral for the Liabilities. The Borrower may later cancel any insurance purchased by Lender but only after providing Lender with evidence that the Borrower has obtained insurance as required by this Loan and Security Agreement or any other Loan Documents. If Lender purchases insurance for the Collateral for the Liabilities, the Borrower will be responsible for the costs of that insurance, including interest and any other charges that Lender may lawfully impose in connection with the placement of the insurance, until the effective date of the cancellation or expiration of the insurance. The costs of the insurance may be added to the total outstanding Liabilities. The costs of the insurance obtained by Lender may be more than the cost of insurance that the Borrower may be able to obtain on its own.

Lender's Power of Attorney

- Borrower irrevocably makes, constitutes and appoints Lender (and all officers, employees or agents designated by Lender) as Borrower's true and lawful attorney (and agent-in-fact) for the purpose of making, settling and adjusting claims under such policies of insurance, endorsing the name of Borrower on any check, draft, instrument or other item of payment for the proceeds of such policies of insurance and making all determinations and decisions with respect to such policies of insurance, provided however, that if no Event of Default shall have occurred and is continuing, Borrower may make, settle and adjust claims involving less than \$50,000.00 in the aggregate without Lender's consent.

Life Insurance as Original Collateral

- In the case of certain borrowers, there may be one individual whose presence is considered essential for the successful operation of the borrower and the repayment of the loan. If this individual were not alive, the borrower could encounter substantial difficulty in remaining in business. In such cases, it is considered good practice for the “key man” to procure life insurance coverage and then to assign the proceeds of the policy due upon his death to the lender.

The Collateral Assignment

1. The collateral assignment of life insurance is designed to give the lender-assignee the sole right to collect the proceeds due upon death of the insured, the sole right to surrender the policy and receive the cash surrender value thereof, and the right to obtain loans under the policies.
2. In return, the lender agrees that subject to the rights obtained under the assignment, the insured retains the right to designate and change the residual beneficiary under the policy and the right to elect any optional mode of settlement permitted by the policy.
3. The lender, as assignee, also agrees that if it collects any monies due as a result of the death of the insured, to the extent there are proceeds in excess of the amount of the indebtedness due, the excess proceeds will be paid to the persons entitled thereto under the terms of the beneficiary designation.
4. The lender also agrees not to surrender the policy or obtain policy loans from the insurance company, unless the borrower has defaulted or has failed to pay premiums when due, and the lender has first given notice of its intention to exercise such rights to the insured.
5. The collateral assignment further provides that although the lender is under no obligation to pay premiums or principal or interest on any policy loans, it may do so, and if it does so, such amounts shall become part of the indebtedness due from the borrower.



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Legal Trends and Developments Affecting Insurance Requirements and Documentation

Commercial Loan Documentation and Insurance Issues
Strafford Publications

Frederic J. Giordano

K&L Gates LLP

One Newark Center, Tenth Floor, Newark, NJ 07102

973.848.4035 frederic.giordano@klgates.com

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Insurance Requirements

- Lenders seek to protect their interest in collateral and against potential third party liability
- Require borrowers to obtain insurance coverage
- Often, but not limited to, property and commercial general liability (CGL) insurance
 - **Property:** insures the policyholder's losses to its property – such as buildings, fixtures, equipment, inventory – against covered perils
 - **CGL:** insures against liability to others and usually covers bodily injury, property damage and personal injury

Property Policy Issues

- Coverage Grants
 - All Risks or Difference-in-Condition
 - Named Perils
- Key Exclusions
 - Vacant Buildings
 - Correction of faulty workmanship, construction, design
- Key Conditions
 - Timely Notice
 - Cooperation and Examinations Under Oath
 - Sworn Proof of Loss
 - Suit Limitations Clauses

CGL Policy Issues

- Coverage Grants
- Duty to Defend
- Key Exclusions
 - Owned property
 - Pollution
 - Product recall and damage to own product or work
 - Employer's liability
- Key Conditions
 - Timely Notice
 - No Voluntary Payments

Protection for Lenders

- Beyond requiring insurance, have policies endorsed to protect Lender's collateral and/or against claims from others
- “Additional interest” on property policies
- “Additional insured” on liability policies
 - Subject to terms of additional insured endorsement
- Subject to policy's other terms, conditions and exclusions
- All coverage is not the same – read the policies

Additional Interest on Property Policies

- Loss payable or “ordinary” mortgage clause
 - Mortgagee can recover to the extent of the mortgagee’s interest
 - Subject to defenses insurer could raise against mortgagee (e.g., fraud, arson)
 - Can collect only if named insured complied with policy conditions
- “Standard” mortgage clause
 - Construed as an independent contract between insurer and lender
 - Affords additional protection – typically loss caused by named insured’s neglect or actions will not invalidate coverage
 - Independent of whether named insured complied with policy conditions

Additional Insured on Liability Policies

- Different additional insured endorsements provide different coverage
 - Specific endorsements
 - Blanket endorsements
 - ISO forms, such as CG 20 10 and CG 20 33
 - Custom forms
 - Ongoing/completed operations
 - Additional insured's negligence
 - Vicarious liability

Issues with Additional Insured Coverage

- Primary vs. excess
 - Competing “other insurance” clauses
 - Contract provisions and state law
 - Deductibles and self-insured retentions do not constitute “other insurance” in many states. See, e.g., *Guercio v. Hertz Corp.*, 40 N.Y.2d 680 (1976); *American Cas. of Reading, PA v. St. Charles Hosp. and Rehabilitation*, 21 A.D.3d 914 (2d Dep’t. 2005)

Contracting

- Specify types of coverage, entities to be covered, duration of coverage, etc.
 - Subsidiaries and affiliates if appropriate
- Communicate clearly to insurance broker contractual insurance requirements
- Consider having counsel review contractual insurance requirements to ensure that the contract effectuates the parties' intent

Verifying Coverage

- All too often, required coverage is not placed
- Do not rely on Certificates of Liability Insurance or Evidence of Property Insurance
 - Generally do not constitute proof of coverage
 - Usually informational only
 - Do not describe coverage fully
 - See *Glynn v. United House of Prayer for All People*, 292 A.D.2d 319, 322 (1st Dep't. 2002) (Certificate of Insurance naming party as an additional insured does not, by itself, raise a factual issue as to the existence of coverage, particularly where policy makes no provision for such coverage)
 - Most jurisdictions concur

Verifying Coverage (Cont.)

- Better to review additional insured endorsement itself, but best to review entire policy for scope of coverage
 - Reserve right in contract to review entire policy
 - Confirm again at renewals
 - Uncover other potential hidden pitfalls
 - Employee Exclusions
 - Self-insured retentions that only the named insured can pay. See Forecast Homes, Inc. v. Steadfast Ins. Co., 105 Cal. Rptr. 3d 200 (Cal. Ct. App. 2010).

Verifying Coverage (Cont.)

- Practically speaking, a company may not have the time or resources to review every policy providing it with additional insured coverage
 - Perhaps review for significant or riskier exposures
 - Consider outside legal review
 - Cost/benefit analysis

Interplay with Contractual Indemnification

- Contractual indemnification often constitutes another part of risk transfer
- Be aware of issues of state law and limitations on indemnification for the indemnified parties' negligence
- Where enforceable, may be another way to get an insurer to cover lender's liability even if lender is not an additional insured
 - "Insured Contract" exception to contractual liability exclusion

Other Tips

- Identify potential sources of insurance coverage
- Always provide insurers with prompt, written notice of claim
 - Law requires prompt notice and some jurisdictions are strict. See, e.g., Granite State Ins. Co. v. Nord Bitumi U.S., Inc., 422 S.E. 2d 191 (Ga. 1992)
 - Many jurisdictions require prejudice before an insurer can deny coverage on late notice grounds.
 - Most jurisdictions do not require insurers to pay defense costs incurred before the insured notifies the carrier. See, e.g., SL Indus., Inc. v. American Motorists Ins. Co., 128 N.J. 188 (1992)



NEWARK OFFICE

Partner

973.848.4035

frederic.giordano@kgates.com

Frederic J. Giordano

Frederic J. Giordano is a partner in the firm's Newark office. He focuses his practice on complex civil and commercial litigation. Mr. Giordano counsels clients on and litigates matters involving various types of insurance coverage. His experience includes advising policyholders on insurance coverage claims involving construction defects and construction-related bodily injury, mold, building products, consumer products, directors' and officers' liability, fiduciary liability, employers' liability, bankers' professional liability, workers' compensation and environmental impairment. He also evaluates insurance policies and programs and advises corporate clients regarding the scope of their existing coverage.

Shift Risk on Personal Property like you do on
Real Property

UCC Insurance

The Basics of UCC Insurance
A New Title Insurance Product

By

Gary M. Zimmerman

Senior Vice President and Chief Underwriting Counsel

(312) 223-2441

gary.zimmerman@fnf.com



UCC Insurance Overview

- Offered by Fidelity National Title, Chicago Title, First American and Stewart Title
- Policy Developed about 10 years ago as a response to Lender's inquiries
- A Title Insurance Product
- Multiple Forms
- Centrally Underwritten
- A National Product

UCC Insurance

Standard Insuring Provisions

- A Lenders Policy of Insurance
- Policy Insures Attachment, Perfection, and Priority of the Lien on the Pledged Assets
- Insures for Validity and Enforceability
- Insures against Fraud and Forgery
- Provides for Defense Costs and Indemnity

Typical Policy Jacket Insuring Provisions

INSURING CLAUSES

SUBJECT TO THE EXCLUSIONS FROM COVERAGE, THE EXCEPTIONS TO COVERAGE CONTAINED IN SCHEDULE B, AND THE CONDITIONS AND STIPULATIONS, TITLE INSURANCE COMPANY, herein called the Company, insures, as of Date of Policy shown in Schedule A for those coverages included in Category I, and after Date of Policy for those coverages set forth in Category II, against Loss or Damage, not exceeding the amount of insurance stated in Schedule A, sustained or incurred by the Insured by reason of any of the following:

Category I

- The Insured Security Interest has not Attached to all of the Collateral;
- The Insured Security Interest has not been Perfected as to all of the Collateral;
- The Insured Security Interest does not have Priority over any Lien or other Security Interest in all of the Collateral;
- Any assignment shown in Schedule A has not transferred the Insured Security Interest to the Insured free of any Security Interest of any other person or entity that has Priority over the Insured Security Interest in all of the Collateral;

Category II

- With respect to any advance made subsequent to Date of Policy pursuant to Commitment under the Debtor Security Agreement, failure of the Insured Security Interest, at the time the advance is made and as security for that advance, (a) to Attach to, and to be Perfected as to all of the Collateral and (b) to enjoy Priority over any Lien or other Security Interest in all of the Collateral, provided the advance is made prior to the time the Debtor becomes a debtor in a federal bankruptcy proceeding, state insolvency or similar proceeding.
- Any Purchaser of all or any portion of the Collateral whose interest in the Collateral is acquired after Date of Policy obtaining Priority over the Insured Security Interest or taking the Collateral, or any portion thereof, free of the Insured Security Interest, but only if the Purchaser acquires its interest prior to the time the Debtor becomes the subject of a federal bankruptcy, state insolvency or similar proceeding.

Broad Categories of Article 8/9 UCC Insurance Coverage

UCC Insurance Policy

Covers:

- Accounts
- Chattel Paper
- Promissory Notes
- Inventory
- Instruments
- Certificated and Uncertificated Securities
- Equipment
- Fixtures
- Deposit Accounts
- Securities Accounts
- Letter of Credit Rights
- General Intangibles
- Payment Intangibles
- Even Commercial Tort Claims!

Types of Transactions in which UCC Insurance protection has been used

- Mezzanine Loans
- Solar/Wind loans
- Sales of Notes
- Hotel Construction/
Refinance
- Project Finance/
Heavy Equipment
- Asset Based Loans
- Hospital /Medical
Facility Loans
- All-Asset Loans
- Any Interest in
Personal Property
Covered By Article 9

UCC Insurance Insuring Provisions-Continued

- Attachment-(9-203 of the UCC)
- Debtor has either ownership rights or “rights in collateral” sufficient to transfer it to the lender/secured party.
- The lender has given value (loaned \$ or committed to lend \$)
- The debtor has “authenticated” (signed) a security agreement or evidenced its intent to grant a security interest in the collateral

UCC Insurance Insuring Provisions-Continued

- Perfection-(9-308-9-316 of the UCC) Lender has taken steps that will protect it from:
 - creditors of the debtor
 - the trustee/representatives of creditor in a debtor's bankruptcy proceedings
 - Being properly secured protects the Lender from the Bankruptcy atomic bomb:secured vs. unsecured

UCC Insurance Insuring Provisions-Continued

- Coverage is Similar to Real Property Title Insurance
 - Case Law is unforgiving:
 - LLC vs L.L.C.
 - Inc. vs No Inc.
 - Individual's names

UCC Insurance Insuring Provisions-Continued

- Perfection can be more complex than real property law.
- Article 9 recognizes multiple ways to perfect which can affect priority.
- Four different ways to perfect:
 - Filing a Financing Statement
 - Possession
 - Control
 - Automatically
- UCC Insurance Coverage covers all 4 Article 9 means of perfection

UCC Insurance Insuring Provisions-Benefits of Coverage

- Searching and Filing is Complex and Detailed
- Search Office Errors and Omissions
- Indexing Inconsistencies
- Financing Statement Inaccuracies
- UCC Insurance Coverage shifts risk and eliminates exposure to all of the foregoing risks

UCC Insurance Insuring Provisions-Continued

- Priority-(9-317 to 9-342 of the UCC) i.e. the Lender's security interest is in first place
- A Complication: Article 9 recognizes multiple means of perfection which have differing degrees of priority
- Example: Chattel Paper
- Experienced UCC underwriters will always recommend best means of Perfection to achieve highest Priority notwithstanding exclusion

UCC Insurance Exclusions

- Matters created, suffered, assumed by Insured
- Matters known and not disclosed
- General Bankruptcy Exclusion
- Incorrectness of "Schedule A" information
- Perfection by a method not authorized by Article 9
- Article 9 Code provided exclusions: Example-Buyer in the Ordinary Course

UCC Insurance Underwriting

- Comprehensive review of loan documentation
- Comprehensive review of organizational documentation
- Knowledgeable about UCC Searching procedures
- Knowledgeable about UCC Filing Requirements and Procedures
- Knowledgeable about closing transactions

UCC Insurance Policy Conditions- Summary

- Provides for Defense Costs and Indemnification
- Insures Capacity/Authorization of Borrower
- Insures over Fraud and Forgery
- Provides "Gap" Coverage
- Does not contain any limitation relating to the laws of a specific jurisdiction

Benefits To You and Your Client

- A second set of eyes equals a happy lender whose risk of loss is reduced.
- Provides full perfection and priority coverage obviating the need for the Borrower's counsel opinion to do so
- Reducing the Borrower's firm's exposure from giving the legal opinion
- Reduces the Borrower's cost for the legal opinion

Impact of Bankruptcy on Insurance Proceeds

Commercial Loan Documentation and Insurance Issues

April 12, 2011



John Eggum

Butler Pappas Weihmuller Katz Craig LLP

115 S. LaSalle Street, Suite 3200

Chicago, IL 60603

312-456-0900

jeggum@butlerpappas.com

Bankruptcy Fundamentals

- The “Estate” – 11 U.S.C. § 541
- Chapters 7, 11, and 13
 - Chapter 7 – Liquidation-type Bankruptcy
 - Chapter 11 – Reorganization-type Bankruptcy
 - Can be used for liquidation purposes
 - Chapter 13 – Repayment Plans (Individuals Only)
- “Executory” Contracts

Fundamentals: The Estate

- Section 541(a) creates the bankruptcy estate. It provides:

The commencement of a case . . . creates an estate. Such estate is comprised of all the following property, wherever located and by whomever held . . . (1) all legal or equitable interests of the debtor in property as of the commencement of the case.

11 U.S.C. § 541.

- The Trustee has broad powers to reach property of the estate – he can file lawsuits to force a third-party to turn over property of the estate and under certain circumstances, he can claw-back payments and other transfers made to third parties. *See* 11 U.S.C. §§ 542, 546, 547, 548

Fundamentals: Who's in Charge?

- Chapter 7 Cases (Liquidations)
 - The purpose of a chapter 7 case is to equitably distribute the property of the estate to creditors.
 - A Trustee is appointed to administer the estate. One of the primary jobs of the Trustee, as set out in section 704 of the Code, is to “collect and reduce to money the property of the estate for which such trustee serves.” 11 U.S.C. § 704(a)(1).
 - The Trustee’s fiduciary duty is to the creditor body as a whole and his compensation is tied to the amount of money he recovers.
- Chapter 11 Cases (Reorganization and occasionally liquidations)
 - Chapter 11 lets the Debtor stay in charge – no Trustee is appointed and the Debtor gets to exercise all of the powers that the Trustee would otherwise have (“Debtor-in-Possession” or “DIP”). 11 U.S.C. §§ 1106, 1107.
 - To reorganize, a Debtor has to file a “Plan” that meets numerous requirements. 11 U.S.C. §§ 1123, 1129.
 - Until “Confirmation” occurs, the Debtor is usually interested in amicably resolving controversies.
 - Post-Confirmation, especially if a “Liquidating Trust” is formed, these cases function more like chapter 7 cases.

Fundamentals: Executory Contracts

- In bankruptcy cases, contracts to which a Debtor is a party are divided into two groups – executory and non-executory.
- Contracts are executory if both parties owe performance.
 - An executory contract is a contract under which the obligation of both the bankrupt and the other party to the contract are so far underperformed that the failure of either to complete performance would constitute a material breach excusing the performance of the other. *In re Gen. DataComm Indus., Inc.*, 407 F.3d 616, 623 (3d Cir. 2005); *see also N.L.R.B. v. Bildisco and Bildisco*, 465 U.S. 513, 522 n.6 (1984).
- If a contract is executory, a Debtor has a choice – it may assume the benefits and obligations of the contract (if certain requirements are met), or it may reject the contract, leaving the counter-party with just an unsecured claim in the bankruptcy case. *See L.R.S.C. Co. v. Rickel Home Centers, Inc. (In re Rickel Home Centers, Inc.)*, 209 F.3d 291, 298-99 (3d Cir. 2000).
- If a contract is not executory, there is no choice for the Debtor to make – the contract simply represents a binding obligation that rides-through the bankruptcy case. *See Hays & Co. v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 885 F.2d 1149, 1153 (3d Cir.1989); *see also In re Exide Techs.*, 378 B.R. 762, 765 (Bankr. D. Del. 2007).
 - Similarly, contracts that are expired – like insurance policies that have a term that ended prior to the filing of bankruptcy – may not be modified. *Counties Contracting and Const. Co. v. Const. Life Ins. Co.*, 855 F.2d 1054, 1061 (3d Cir. 1988) (citing 2 Collier on Bankruptcy ¶ 365.04)); *see also In re Balco Equities Ltd., Inc.*, 312 B.R. 734, 750 (Bankr. S.D.N.Y. 2004); *see Stumpf v. McGee (In re O’Connor)*, 258 F.3d 392, 405 (5th Cir. 2001) (“[T]here is no difference between a contract that . . . cannot be assumed, and one which is neither assumed nor rejected. . . . Each is simply unaffected by the bankruptcy proceedings.”).

Policy/Proceeds Distinction

- Policy = Property of the Estate
 - It is axiomatic that a Debtor’s insurance policy becomes “property of the estate” – the rights of the Debtor as the “insured” under the policy are property rights that come into the estate. *See Houston v. Edgeworth (In re Edgeworth)*, 993 F.2d 51, 55 (5th Cir. 1993).
- Proceeds = Maybe Property of the Estate, Maybe Not
 - Inquiry – Outside of bankruptcy, would the Debtor have a right to the proceeds?
 - First Party Insurance – Payment to Debtor for Loss
 - First-party policies reimburse the *insured* for direct losses – E.g., fire, water, and other similar losses, as well as theft and breaches of fiduciary duties.
 - Third Party Insurance – Payment to Others
 - Third-party policies pay amounts that the insured becomes legally obligated to pay. These payments are made directly to the third-party; the insured has no interest in the proceeds.

Except...

- Although the proceeds/policy distinction is generally accepted, courts occasionally find cause to bring proceeds that weren't payable to the Debtor-Insured into the estate.
 - *See In re Doug Baity Trucking*, 2005 WL 1288018, No. 04-13537 (Bankr. M.D.N.C., April 21, 2005); *see also Homsy v. Floyd (In re Vitek)*, 51 F.3d 530.

Particular Applications

- Loss Payee Issues
 - If lender is named as the loss-payee (as generally required by loan agreements), lender will be entitled to proceeds.
 - *In re Huff*, 332 B.R. 661 (Bankr. M.D. Ga. 2005).
 - *In re Stevens*, 130 F.3d 1027 (11th Cir. 1997).
 - *In re Hardin*, 375 B.R. 506 (Bankr. E.D. Wis. 2007).
 - Failure to list the lender as loss payee may result in proceeds being payable solely to the estate.
 - *In re Coker*, 216 B.R. 843 (Bankr. N.D. Ala. 1997).

Particular Applications

- Assignment of Policies
 - Although bankruptcy law is federal, the Bankruptcy Code looks to state law to determine property rights. *Butner v. United States*, 440 U.S. 48, 54 (1979).
 - If assignment of policy was ineffective under state law, lender may end up grouped with general unsecured creditors.
 - Example – Lender attempted to take assignment of all of Debtor-Insured's assets to collateralize a loan, but assignment turned out to be ineffective under state law. Proceeds from key-man insurance policy, in the absence of a valid assignment, were payable to the estate, as successor to the insured. Pro-rata distribution, rather than full payment to lender, followed. *Tucker v. Illinois Life & Health Ins. Guar. Assoc. (In re MEG Manu.)*, 1996 WL 33406617, No. 92-6906 (Bankr. S.D. Ind., Feb. 22, 1996).

Particular Applications

- Strong Arm Powers – 11 U.S.C. § 544
 - If a security interest is unperfected as of the date of the Debtor-Insured's bankruptcy filing, the Trustee may be able to avoid the security interest and obtain rights greater than the secured party.
 - If the secured party is properly perfected, their right to full payment will be recognized by the bankruptcy court. *See, e.g., In re Jll Liquidating, Inc.*, 344 B.R. 875 (Bankr. N.D. Ill. 2006).

Particular Applications

- Preference Payments – 11 U.S.C. § 547
 - One of the avoiding powers of a Trustee is the ability to claw-back “preferential payments”
 - Payments are not preferential if the transferee would have received the full amount of the payment under the Code’s distribution scheme
 - If a lender has a perfected security interest, it is entitled to receive the full amount of the transfer. *See, e.g., Gilber v. Assoc. Fin. Servs. Corp. (In re Ridgway)*, 22 B.R. 737 (Bankr. S.D. Ohio 1982).

Particular Applications

- “We assumed all those policies”
 - In chapter 11 cases, Debtors frequently purport to “assume” all of the pre-petition insurance policies.
 - However:
 - Policies that have expired cannot be assumed.
 - The rights and obligations under a policy cannot be modified, whether executory or non-executory.
 - Lenders need to ensure that the Plan adequately provides for what will happen to insured claims.

Other Issues: Drop Down

- In bankruptcy, although excess liability insurers are not relieved of their obligations above retained amounts, they do not have to “drop down” to provide coverage on account of the insolvency of an underlying carrier (including an insured, where a retention exists).
 - *See, e.g., Missouri Pacific Railroad Co. supra.; Home Insur. Co. of Illinois v. Hooper, 691 N.E.2d 65 (1 Dist. 1998); Hartford Accident & Indemnity Co. v. Chicago Housing Authority, 12 F.3d 92 (7th Cir. 1993); Zurich Ins. Co. v. Heil Co., 815 F.2d 1122, 1125 (7th Cir. 1987).* The retention is not an amount that the debtor owes the excess carrier, it is the “threshold” of the excess carrier’s liability to the insured. *In re OES Environmental, Inc., 219 B.R. 266 (M.D. Fla. 2005).*

#Winning: Being the Trustee

[Why you need to pay attention to what's happening in the bankruptcy court]

- Whenever insurance policy proceeds are potentially available, there is a risk that a Trustee will seek to drag those proceeds into the estate, regardless of to whom the proceeds are payable.
 - Chapter 7 trustees are compensated by the percentage of recovery they achieve for the estate. 11 U.S.C. § 326.
 - » A \$1M policy is potentially worth \$53,250 in fees for the Trustee.
 - Courts are extremely deferential to the Trustee's "business judgment."
 - The administrative role of chapter 7 trustees is essential to the fundamental operation of the bankruptcy system, and courts are inclined to be deferential for this independent reason.