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April 10, 2000

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Re: Trustee Compensation Order

Gentlemen:

I previously circulated a form of order on the Court's January 14, 2000 approval of the Compensation Committee's recommendation. Hugh wrote me to point out that the draft did not include certain aspects of the Committee's report and I revised the order, incorporating the text mentioned in Hugh's letter. However, Colbert noted that the second draft still did not include all of the issues addressed in the Committee's Report and asked that I include them as well. Principal among these issues is the Committee's recommendation concerning insurance coverage procured at the expense of the Estate.

Upon closer reading of the Committee's text concerning insurance coverage, I am concerned that it could be construed to preclude the Estate from acquiring coverage that it reasonably would want to obtain. I assume that the Committee intended that the Trustees should not be protected at Estate expense against their own criminal acts and breaches of duty, but that the Committee did not object to the Estate obtaining coverage against any losses it may suffer because of such wrongdoing.

It is not clear to me how such coverage would work, however. The existing policy covers "wrongful acts", which are defined to include errors, omissions and neglects of duty. Some of these covered acts may be deemed "*intentional acts which are in dereliction of a Trustee's duty*" (the Committee's phrase). In the absence of insurance, the Estate likely will have no practical recourse and may suffer losses because of Trustee misconduct. But, if coverage is obtained, it probably has the effect of insuring the Trustees as well.

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Insurers do not cover fines, criminal penalties and investment fluctuations, but do cover losses arising from misconduct such as embezzlement, fraud, defalcation, etc. In the absence of insurance, the Estate's only recovery for such losses may be either against the Trustees themselves (and they may be judgment-proof) or against their bonds, for which the Estate pays the premiums. In combination, the insurance and the bonds may provide the only fund from which the Estate realistically may expect to recover for what otherwise would be the Trustees' personal obligations to the Estate. In such cases, the bonding company might have the right to pursue the defaulting Trustees. The insurer probably would not, because the Trustees are named insureds and there generally is no subrogation against an insured.

Another variety of claim is where a third party alleges misconduct on the part of a Trustee (wrongful discharge, defamation, wrongful eviction, trespass) that may be either a proper act in the discharge of fiduciary duties or an abusive act in excess of duties. In either event, the Estate must defend against the third party claim because modern law increasingly allows direct suit against the trust estate, and the Estate may have to pay on any judgment, whether or not it can recover from the Trustee.

I have discussed this matter with Louanne Kam, senior counsel in the Estate's Litigation & Risk Management Division. Louanne and I have not identified a means by which the Estate might obtain the benefit of such coverage without covering the Trustees. This is because of the nature of the Estate's insurance program: it is a form of association insurance in favor of the officers and agents of an unincorporated entity.

I suggest that we discuss this issue and determine the most appropriate course of action. There is an outstanding oral order that should be reduced to a formal order. While the Court itself did not address the insurance issue at the hearing, its approval of the Committee's Report is without exception.

Very truly yours,

ASHFORD & WRISTON


By Robert Bruce Graham, Jr.

cc: Colleen I. Wong, Esq.
Louanne K. L. Kam, Esq.