

**UNITED STATES BANKRUPTCY COURT
DISTRICT OF MINNESOTA**

In re:

**Jointly Administered under
Case No. 08-45257**

Petters Company, Inc., et al.,

Court File No. 08-45257

Debtors.

Court Files No.'s:

(includes:

Petters Group Worldwide, LLC;

08-45258 (GFK)

PC Funding, LLC;

08-45326 (GFK)

Thousand Lakes, LLC;

08-45327 (GFK)

SPF Funding, LLC;

08-45328 (GFK)

PL Ltd., Inc.;

08-45329 (GFK)

Edge One LLC;

08-45330 (GFK)

MGC Finance, Inc.;

08-45331 (GFK)

PAC Funding, LLC;

08-45371 (GFK)

Palm Beach Finance Holdings, Inc.)

08-45392 (GFK)

Chapter 11 Cases
Judge Gregory F. Kishel

**TRUSTEE'S RESPONSE TO GREENWICH INSURANCE COMPANY'S AND XL
SPECIALTY INSURANCE COMPANY'S MOTION FOR RELIEF FROM
AUTOMATIC STAY, IF APPLICABLE, TO ALLOW PAYMENT OF CERTAIN
DEFENSE EXPENSES AND SUPPLEMENTAL MOTION FOR RELIEF FROM STAY**

Douglas A. Kelley, as Trustee of Petters Group Worldwide, LLC ("PGW") and Petters Company, Inc. ("PCI"), ("Trustee") submits this response to Greenwich Insurance Company's and XL Specialty Insurance Company's Motion for Relief from Automatic Stay, if Applicable, to Allow Payment of Certain Defense Expenses and their Supplemental Motion for Relief From Stay.

INTRODUCTION

Greenwich Insurance Company ("Greenwich") and XL Specialty Insurance Company ("XL") owe substantial defense costs to PGW and PCI in connection with ongoing criminal and

civil actions. It is not clear that the automatic stay is an impediment to their payment. However, to the extent relief from the stay is necessary for such payment, the Trustee does not oppose the insurers' motion for relief from the automatic stay in connection with reimbursement for and advancement of Defense Expenses and requests payment of the \$2,125,110.42 approved Defense Expenses incurred by Insureds to date.¹

With respect to the Supplemental Motion for Relief to assert counterclaims against PGW and PCI in the recently filed declaratory judgment action, the Trustee does not have information sufficient to ascertain whether such relief is necessary or appropriate. To the extent the insurers seek a declaration of non-coverage, the declaratory judgment action filed by PGW and PCI will determine the issues. If the insurers intend to bring any other counterclaims, the Trustee opposes the requested relief.

FACTS

A. The Underlying Actions

PGW, PCI, and certain officers, directors, managers and employees of PCI and PGW, including sole owner and former Chairman and Chief Executive Officer Thomas Petters, became the subject of a federal investigation in September 2008. On or about September 27, 2008, the government informed PGW and PCI that the companies were targets of a pending grand jury investigation. The result of the investigation was a complaint filed in the United States District Court for the District of Minnesota, *United States of America v. Petters, et al*, Civ. No. 08-SC-5348 ("Government Action") on October 2, 2008 alleging an investment fraud scheme, false representations, and false statements and omissions. Individuals specifically named in the Government Action include, but are not limited to, Thomas Joseph Petters, Deanna Coleman aka

¹ Capitalized terms not defined herein are terms defined by the relevant XL and Greenwich insurance policies.

Deanna Munson, Robert White, James Wehmhoff, Larry Reynolds, Michael Catain, and Frank E. Vennes, Jr. In conjunction, the District Court subsequently froze the defendants' assets and appointed a Receiver for the companies.

On or about December 1, 2008, the United States indicted Thomas Petters, PCI and PGW, alleging mail fraud, wire fraud, conspiracy to commit mail and wire fraud, money laundering, and conspiracy to commit money laundering.

In addition to the ongoing criminal action, at least eight civil lawsuits naming PGW, PCI and various directors, officers, managers, and employees were filed shortly after the government's investigation was made public. These actions assert violations of RICO, the Minnesota Consumer Fraud Act, Minnesota's Unlawful Trade Practices Act, Minnesota's Deceptive Trade Practices Act, Securities and Exchange Act of 1934, and Minnesota Securities Act. There are also allegations of fraudulent inducement, common-law fraud, conversion, unjust enrichment, conspiracy, rescission, and breach of contract.

Because of the Government Action, indictment and various civil lawsuits, all of which allege Wrongful Acts by PCI, PGW and its officers, directors, managers and employees, certain directors, officers, managers, and employees of PGW and PCI have retained legal representation and incurred Defense Expenses as a result of having been named or mentioned in lawsuits, subpoenaed as potential targets, subpoenaed to testify, or questioned by government agencies.

B. The Insurance Policies

Greenwich issued to PGW Private Company Reimbursement Insurance Policy No. ELU105480-08 for the June 25, 2008 to June 25, 2009 policy period ("PGW Policy"). The limit of liability under the Management & Company Liability Coverage Part is \$10,000,000. *See*

Declaration of Kristine Tejano Rickard (“Rickard Decl.”), Ex. 1.² XL issued to PCI liability insurance Policy No. ELU105060-08 for the June 1, 2008 to June 1, 2009 policy period (“PCI Policy”). The limit of liability under the Management & Company Liability Coverage Part is \$5,000,000. See Rickard Decl., Ex. 2. The PCI Policy and PGW Policy contain a Tie In Limits Endorsement, limiting the combined liability under the policies to \$10,000,000. *See* Rickard Decl., Ex. 1, Ex. 2.

The PGW Policy and PCI Policy generally provide coverage for Loss incurred in connection with a Claim first made against an Insured during the Policy Period for a Wrongful Act. Loss, Claim, Insured, Policy Period, and Wrongful Act are all terms defined by the policies. See Rickard Decl., Ex. 1, Ex. 2. A Wrongful Act includes an alleged act, error, omission, misstatement, misleading statement or breach of a duty by an Insured. *See* Rickard Decl., Ex. 1, Ex. 2. In addition to PCI and PGW, persons insured under both policies include past, present or future directors, officers, members, managers and employees. *See* Rickard Decl., Ex. 1, Ex. 2.

PGW and PCI provided notice of and tendered to the insurers the Government Action, the indictment and the various civil lawsuits between October 10, 2008 and December 5, 2008. *See* Affidavit of Paul A. Banker (“Banker Aff.”) at 2-6. Additionally, on February 23, 2009, the insurers were notified that as a result of both the Government Action, indictment and various civil lawsuits, certain directors, officers, managers, and employees have retained legal representation and incurred Defense Expenses because they have been named or mentioned in lawsuits, subpoenaed as potential targets, subpoenaed to testify, or questioned by government agencies. *See* Banker Aff. at 8.

² The Declaration of Kristine Tejano Rickard was filed in support of Greenwich’s and XL’s Motion in Support of Relief from Automatic Stay, if Applicable, to Allow Payment of Certain Defense Expenses. Dock. No. 167.

Importantly, Greenwich and XL issued a joint coverage position letter on December 19, 2008, both reserving their rights and issuing a partial denial of coverage, in response to each of the above-mentioned tenders. *See* Banker Aff. at 7, Ex. F. In the position letter, the insurers did not indicate that they would pay Defense Expenses nor have the insurers offered to make such payments. *See* Banker Aff. at 7, Ex. F. Neither Greenwich nor XL have recognized coverage for Defense Expenses or indemnification under the policies issued to PCI and PGW. *See* Banker Aff. at 7, Ex. F.

As a result, PCI and PGW initiated a declaratory-judgment and breach-of-contract action in the District Court, *Petters Group Worldwide, LLC et al. v. Greenwich Insurance Company et al.*, Case No. 0:09-cv-603 (D. Minn.) seeking a determination of coverage for Defense Expenses and indemnification under the policies in relation to the underlying claims.³ Greenwich and XL now seek this Court's relief from the automatic stay in order to assert counterclaims against PGW and PCI related to the relevant insurance policies, though it is unclear from their request which counterclaims they seek to assert. With PGW and PCI's declaratory judgment complaint pending, the issues regarding coverage under the policies will be determined without additional claims against PGW and PCI. To the extent Greenwich and XL intend to assert claims for declaratory relief, the claims are unnecessary. To the extent the insurers intend to bring other claims against the Insureds, the Trustee opposes the requested relief.

C. Unreimbursed Defense Expenses Incurred By Insureds

Douglas A. Kelley, as Receiver, moved the District Court on December 17, 2008 for approval to make payments of \$1,181,624.89 in Receiver and Attorney fees. *See United States*

³ Nothing in this brief regarding relief from the stay shall be construed as altering the scope of the declaratory judgment action against Greenwich and XL. For example, this brief does not address the insurers' obligations to pay Loss for judgments or settlements in connection with the underlying claims.

of America v. Thomas Joseph Petters et al., Case No. 08-5348, Dock. No. 152-154. The District Court granted that motion without reduction on December 23, 2008, specifically directing the Receiver “to seek reimbursement of the foregoing sums to the extent possible under applicable insurance policies, including directors and officers liability policies maintained by Petters Company Inc., Petters Group Worldwide, LLC or any other related entity.” *See Banker Aff. at 9, Ex. H.*

In relation to Defense Expenses to be reimbursed under the PGW and PCI policies, the Court approved a \$62,361.26 payment to Greene Espel, P.L.L.P. (“Greene”), which represents James Wehmhoff in ongoing civil and criminal proceedings. *See Banker Aff. at 9, Ex. H.* The Court approved payment of \$247,905.35 to Felhaber, Larson, Fenlon & Vogt (“Felhaber”), which represents Thomas Petters in ongoing civil and criminal proceedings. *Id.* The Court also approved payment of \$39,607.50 to Kelley & Wolter, P.A. (“Kelley”) and \$607,050.78 to Lindquist & Vennum P.L.L.P. (“Lindquist”) for work done by or on behalf of the Receiver. *Id.*

On February 17, 2009, the Receiver made a second motion in the Government Action to approve payments for the Receiver and Attorney’s fees. In its second motion, the Receiver sought approval for payment of \$1,280,429.85 in incurred Receiver and Attorney fees. *See Case No. 08-5348, Dock. No. 191-193.* On March 16, 2009, the Court approved the request, in part, authorizing payment to Kelley for \$368,428.25 and to Lindquist for \$312,038.93. *See Banker Aff. at 10, Ex. I.* The Court again directed the Receiver to seek reimbursement under applicable insurance policies, including the Greenwich and XL directors and officers liability policies. *Id.*

The Court issued a supplemental Order on March 20, 2009, approving payment of certain other fees. *See Banker Aff. at 10, Ex. J.* Specifically in relation to Defense Expenses to be reimbursed under the PGW and PCI policies, the Court approved payment to and payment to

Pretzel & Stouffer, Chartered for \$3,695.50, Neal, Gerber & Eisenberg, LLP for \$38,412.27, Peter B. Wold, P.A. for \$17,188, James E. Ostgar for \$6,800, Birrell & Newmark, Ltd. for \$19,237.50, Best & Flanagan for \$18,163.02, and Sands & Moskowitz, P.A. for \$5,000. *Id.* Once again, the Court directed the Receiver to seek reimbursement under available directors and officers liability policies maintained by PCI, PGW and related entities. *Id.* On March 25, 2009, the Court approved payments of \$332,910.20 to Felhaber and \$46,311.86 to Greene. *See Banker Aff.* at 10, Ex. K.

Although Defense Expenses continue to be incurred, the Insureds have incurred not less than \$2,125,110.42 in approved Defense Expenses reimbursable under the policy upon this Court's determination regarding the application of, or relief from, the automatic stay.

II. LEGAL AUTHORITY

A. Obligation to Reimburse and Advance All Defense Expenses.

Greenwich and XL are obligated under the terms of their policies to pay Defense Expenses incurred in connection with a Claim first made against an Insured during the Policy Period for a Wrongful Act. PGW, PCI and its officers, directors, manager and employees currently are facing criminal and civil Claims for which Defense Expenses are being incurred and for which they are entitled to reimbursement under the Greenwich and XL policies.

Under Minnesota law, an insurer's contractual obligation to pay defense expenses is broader than its duty to indemnify. *Wooddale Builders, Inc. v. Maryland Cas. Co.*, 722 N.W.2d 283, 302 (Minn. 2006); *St. Paul Fire & Marine Ins. Co. v. Lenzmeier*, 309 Minn. 134, 139, 243 N.W.2d 153, 156 (1976). An insurer is obligated to pay defense expenses for those claims that arguably fall within the scope of the policy. *Meadowbrook, Inc. v. Tower Ins. Co., Inc.*, 559 N.W.2d 411, 415 (Minn. 1997); *Inland Const. Corp. v. Continental Cas. Co.*, 258 N.W.2d 881, 884 (Minn. 1977), *citing Christian v. Royal Ins. Co.*, 185 Minn. 180, 240 N.W. 365 (Minn.

1932). Defense expenses include those costs to investigate and determine liability. *Westling Mfg. Co. v. W. Nat'l Mut. Ins. Co.*, 581 N.W.2d 39, 47 (Minn. Ct. App. 1998), *review denied* (Minn. Sept. 22, 1998).

Furthermore, under the director's and officer's liability policies issued to PGW and PCI, the insurers are required to immediately pay all legal bills incurred in defending the underlying action. *See, i.e., Julio & Sons Co. v. Travelers Casualty & Surety Co.*, 591 F. Supp. 2d 651 (S.D.N.Y. 2009) (holding that insurers must immediately pay the legal bills officers and directors incur in defending against all the charges in an underlying action, not just the covered claims).

Under the terms of the Greenwich and XL policies, the insurers are obligated to advance or reimburse Defense Expenses for any Insured Person, which includes PCI, PGW past, present or future directors, officers, members, managers and employees. Along with PCI and PGW, certain directors, officers, members, managers and employees Defense Expenses have been incurred in defending or otherwise responding to Claims for Wrongful Acts against Insured Persons. As such, Greenwich and XL are contractually obligated to immediately reimburse the Debtor Entities for those amounts.

B. The Trustee Takes No Position on Whether the Proceeds of the Policies Are the Property of the Estate.

Like Greenwich and XL, the Trustee does not take a position at this time on whether or not the insurance proceeds are property of the estate. However, the Trustee notes that, although the Eighth Circuit has not ruled on the specific issue, several courts have determined that while the insurance policies were considered property of the estate, the proceeds from such policies typically are not included in the property of the estate as the debtor has no interest in that interest unless terms were satisfied. *See, i.e., Marchfirst, Inc. v. Megliola*, 288 B.R. 526, 529-530 (N.D.

Ill. 2002); *In re Louisiana World Exposition*, 832 F.2d 1391 (5th Cir. 1987); *In re CHA Electronics, Inc.*, 261 B.R. 538 (Bankr. S.D. Fla. 2001); *In re Daisy Systems Sec. Litig.*, 132 B.R. 752 (N.D. Cal. 1991); *Pintlar Corp. v. Fidelity & Casualty Co.*, 124 F.3d 1310, 1313 (9th Cir. 1997). As the *Marchfirst* court explained, the “filing of a bankruptcy petition does not expand or change a debtor’s interest in an asset . . . whatever rights a debtor has in property at the commencement of the case continue in bankruptcy – no more, no less.” *Marchfirst*, 288 B.R. at 530. Thus, several jurisdictions suggest that the insurance proceeds are not property of the estate.

Because it is unclear that the automatic stay precludes payment of the Defense Expenses under these circumstances and because the District Court already has ordered that the Receiver may properly seek reimbursement under the relevant insurance policies, the Trustee takes no position regarding whether or not the insurance proceeds are the property of the estate.

III. CONCLUSION

Based on the foregoing, the Trustee does not oppose the motion for relief from the automatic stay to the extent necessary to reimburse the \$2,125,110.42 in Defense Expenses incurred thus far by Insureds in connection with the ongoing criminal and civil actions and for the insurers to continue to reimburse Defense Expenses as they are incurred on an ongoing basis. However, because PGW and PCI already have filed a declaratory judgment complaint that will determine the coverage issues under the XL and Greenwich policies, the Trustee opposes the insurer’s request for relief from the stay to bring counterclaims against them.

DATE: April 2, 2009

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