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**NCIGF/IAIR Joint Conference**  
**Tipping Points: Exploring the Insolvency Decision Process**  
**Perspectives on Managing Troubled Companies**

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November 7, 2008

# Lessons Learned--Trouble Companies

1. Establish a relationship with the Guaranty Funds.
  - Helpful source of historic perspective and lessons learned
  - Source for experts that can be helpful in the process
2. Take Action Early.
  - Aggressively act on information and gut
  - Focus on corporate governance (Key in assessing risk)
  - Focus on controls and internal documents (Board Reports, Internal Audits, Audit Committee Reports, etc)
  - Force the company to “prove it”
  - Take the steps listed below
3. Engage All Necessary Experienced Experts and Counsel early in the Process.
  - Insurance department staff do not have extensive experience
  - Necessary work requires a different skill set--monitoring role versus forensic and transactional
  - Identify the work that needs to be done early
  - Essential to obtaining an accurate and complete story and possible solutions

# Lessons Learned--Trouble Companies (Cont'd)

## 4. Focus on Project Management.

- Plan
- Communicate
- Coordinate
- Assess Information
- Revise Plan (work the problems)

## 5. Know the right questions to ask and items to explore.

- Reinsurance
- Reserves
- Accounting treatment of material items
- Rate adequacy
- Value of company in the market

## 6. Aggressively assess management's competence, plan and execution.

- Assess the plan--obtain views from outside experts and sources
- Assess value proposition by obtaining feedback from potential suitors and other sources

# Lessons Learned--Trouble Companies (Cont'd)

7. Inform and engage the Board.
  - Question the Board regarding “what they have been told”
  - Demand a plan of action
  - Be clear about what regulators are and will be doing
  - Continually follow-up
8. Assess risks of allowing the company to remain in business versus opportunity to minimize loss.
  - Has all the damage already been done?
  - Materiality of future harm?
  - Economic impact and impact on employees?
9. Take action.
10. Situation is usually worse than initial assessment.

# Enron's Failure and Final Results - Background

- Enron officers knowingly abused positions of authority, power and trust in order to secure huge personal profits.
- They were knowingly and intentionally aided by employees at some of the world's largest and most influential financial institutions.
- Together, they crafted structured finance transactions that manipulated and engineered Enron's financial statements past recognition.
- In nearly every case, the transactions were complex for only one reason: to disguise Enron's true financial condition.
- Transactions usually boiled down to a loan to Enron, often involving offshore conduit entities specially created for the transaction involved.

## Enron's Failure and Final Results (Cont'd)

- These transactions never appeared as loans or debt on Enron's financial statements.
- In less than five years, the financial institutions collectively collected almost \$750 million in fees from Enron.
- Enron insiders extracted well more than \$100 million dollars.
- Because the scheme removed real checks and balances on business operations, Enron's business became filled with novel and extraordinarily expensive failures, causing the need to borrow even more money.
- When the fraud was discovered, the money ran out and Enron collapsed into bankruptcy.

# Enron's Failure and Final Results (Cont'd)

## ■ Result

- The most complex Chapter 11 cases in US history (Enron Corp. and more than 300 affiliates)
- Four lengthy and extraordinarily important reports by the Examiner
- Commencement by Enron of the so-called “Mega Claim Lawsuit” in 2003 against 14 major financial institutions and related affiliates seeking billions of dollars in damages
- Over 1500 deposition days in an 18 month period
- Tens of millions of pages of documents were produced and analyzed
- Multitudes of experts provided reports and were deposed.
- Consolidated landmark decision on the issue of equitable subordination of claims held by transferees of the alleged wrong doers
- Settlements providing in excess of \$3.4 billion in cash payments to Enron's estate and in excess of \$1.6 billion of claims were subordinated

# Enron Lessons Learned

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## 1. Assemble the right team from the start.

- Volume and complexity required this.
- Multi-disciplinary approach contributed greatly.
- In addition to litigation and restructuring attorneys, we engaged our corporate, structured finance and tax lawyers at the inception.
- We created “structure” teams cutting across all relevant legal disciplines.
- Similar team approach was taken as to each financial institution.
- These teams played a critical role both during the investigation and discovery phases, as well as the latter stages of motion practice and trial preparation.

# Enron Lessons Learned (Cont'd)

## 2. Prioritize the investigation.

- Limited time, cost constraints, and likelihood of collection suggest that looking under every rock is not a wise investment.
- Aiming high and wide to bring every conceivable party and claim may dilute an opportunity to successfully settle or litigate the claims that really have value.
- List of factors to help analyze the likelihood putative defendants would be held liable (low hanging fruit). For example:
  1. The role played by the party in the transaction (i.e., did the party structure the transaction or simply participate in it),
  2. The number of transactions in which the party participated,
  3. The type of transaction (garden variety loan or unusual structured finance transaction),
  4. The amount of fees paid to the party,
  5. The relationships between the party and others in the transaction.

# Enron Lessons Learned (Cont'd)

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## 3. Role of the examiner.

- Nearly \$100 million in fees paid to the Examiner and his professionals.
- Importance of the Examiner in the fact gathering exercise was critical.
- Examiner was able to obtain the cooperation of virtually every deponent.
- Deponents responded to the Examiner's requests at a level not ordinarily seen.
- Based on the markedly different approach to discovery taken by many of the same parties after the commencement of the Mega Claim Litigation, it is apparent that the Examiner was able to develop a factual record that might not have been achieved in his absence.
- Examiner was very open to receiving input from various parties during his investigation, including putative defendants.

# Enron Lessons Learned (Cont'd)

## 4. Take what you are given.

- Exploit any available sources of information (e.g., Senate subcommittee investigations, state attorney general enforcement proceedings, etc).
- Information obtained included key event time lines, criminal proceeding summaries, and investigatory notes, with supporting accounting analysis and legal submissions, that advanced our own investigatory efforts.
- Nurture relationships with counsel involved in parallel proceedings (the “enemy of my enemy is my friend”).
- Enron and Creditors Committee encouraged us to advance a cooperative “MDL like” joint discovery processes--assuring us that lead deposition responsibility, as well as document review and the attendant cost were broadly allocated among the parties having like interests.

# Enron Lessons Learned (Cont'd)

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## 5. Anticipate likely outcome of litigation.

- Tremendous amount of care was taken by Enron in drafting the Mega Complaint (sounds ordinary course, but).
- Enron team anticipated (correctly in hindsight) that the Mega Claim Litigation would most likely be settled.
- Potential grounds for a motion to dismiss were considered when drafting the complaint in an effort to limit the grounds on which a motion to dismiss could be based.
- Specifically, the 800 pound gorilla was an anticipated--in pari dilecto as basis for dismissal.
- Complaint carefully navigated the in pari dilecto minefield and, in fact, no motion to dismiss was filed on that basis.

# Enron Lessons Learned (Cont'd)

## 6. Selecting Experts in Mega Case.

- Dilemma in any “mega fraud” case is how to select experts--two basic choices.
  1. Select a single expert for each particular issue, or
  2. Select a single expert who is an “assembler” (or a “conspiratologist”).
- Every case is different, but Enron cried out for an expert who could weave the entire story.
- This is an unusual approach and not often employed--was not employed in Enron.

## 7. Its all about the paper.

- Despite the hundreds of depositions and dozens of experts, in the end it was the mountains of paper, including devastating emails that established their culpability.
- Witnesses who were generally geniuses at their jobs have sudden bouts of amnesia about the most basic terms of transactions in which they were intimately involved.

# Enron Lessons Learned (Cont'd)

## 7. Its all about the paper (Cont'd)

### ■ Examples of incriminating memoranda and emails include:

- “The transaction provides favorable accounting treatment for the customer. Although the deal is effectively a loan, the form of the transaction would allow the customer to reflect it as ‘liabilities from price risk management activity’ on their balance sheet and also provide a favourable [sic] impact on reported cash flow from operations;”
- “Enron’s motivation in the deal now appears to be writing up the asset in question from a basis of about \$100MM to as high as \$250MM, thereby creating earnings;
- “. . . also want to get your confirmation that (apart from the fact we put deals together for Enron which we knew confused the ratings agencies) there is no skellington in the closet.” [A pun referring to Enron CEO Jeffrey Skilling];
- “Sounds like we made a lot of exceptions to our standard policies, I am sure we have gone out of our way to let them know we are bending over backwards for them...let’s remember to collect this iou when it really counts;” and
- “I think what we’re trying to gauge is how, how aggressive they are to pay for this stuff now, which is discreetly get, you know, several hundred million dollars and have no market knowledge of what’s going on . . .”.

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