UNITED STATES DISTRICT COURT
EASTERN DISTRICT OF MISSOURI
EASTERN DIVISION

SECURITIES AND EXCHANGE COMMISSION,	)	
	)	
Plaintiff,	)	
v.	)	**CASE NO. 4:12-CV-00080-CEJ**
	)	
BURTON DOUGLAS MORRISS,	)	
ACARTHA GROUP, LLC,	)	
MIC VII, LLC,	)	
ACARTHA TECHNOLOGY PARTNERS, LP, and	)	
GRYPHON INVESTMENTS III, LLC	)	
	)	
Defendants, and	)	
	)	
MORRISS HOLDINGS, LLC,	)	
	)	
Relief Defendant.	)	
_____	)	

REPLY MEMORANDUM OF LAW IN FURTHER SUPPORT OF DEFENDANT BURTON DOUGLAS MORRISS'S MOTION FOR ENTRY OF AN ORDER CONFIRMING THAT INSUREDS ARE ENTITLED TO ADVANCEMENT OF DEFENSE EXPENSES UNDER INSURANCE POLICY NOTWITHSTANDING ASSET FREEZE ORDER

Defendant Burton Douglas Morriss ("Mr. Morriss") respectfully submits this Reply Memorandum of Law in further support of his Motion for entry of an order confirming that Federal Insurance Company ("Federal") may advance defense costs on behalf of Mr. Morriss as an insured under an insurance policy purchased by Acartha Group, LLC ("Acartha"). Doc. # 72, # 73. This Memorandum is submitted in reply to the Plaintiff's Memorandum in Opposition. Doc. # 91.

INTRODUCTION

The SEC asks this Court to give it a plaintiff's dream-come-true: to render the defendant completely defenseless at the very start of the case. In an eight-count, 21-page Complaint, the SEC has set out 74 paragraphs of accusations that span six years and refer to scores of complex business transactions. Yet, this most powerful Plaintiff asks for an Order that would require Mr. Morriss to face this onslaught pro se, without expert witnesses and with no ability to conduct meaningful

discovery. Ignoring that the insurance policy plainly provides that Mr. Morriss is entitled to defense costs, the SEC further asks this Court to set aside the insurance carrier's coverage letter stating that its own insurance contract entitles Mr. Morriss such defense costs. Instead, the SEC invites this Court to hand down a ruling that will shake the foundation on which all directors and officers ("D&O") policies rest. In support of its arguments, the SEC presents a long list of cases that have nothing whatsoever to do with D&O insurance and which do not even remotely involve the issue that faces this Court. The SEC ran headlong into the same wall that the Receiver faced: no supporting cases. Instead, perhaps inadvertently, the SEC even commends to this Court a case that strongly *supports* Mr. Morriss's Motion.

In the absence of supporting authority, the SEC turns instead to the "believe me, my opponent is a bad guy" argument. It has dumped its most incendiary allegations against Mr. Morriss into its Response and then added some additional hot sauce in the apparent hope that if it breathes enough fiery, unproven allegations, this Court will somehow determine that Mr. Morriss is culpable right now. The SEC, like the Receiver, has things profoundly out of order. Just because the Plaintiff is the SEC does not excuse it from having to first prove its allegations. An allegation is just that, an allegation. Mr. Morriss stands no chance of defending himself against the SEC with its near-unlimited resources without counsel, experts, or the ability to conduct meaningful discovery. Yet, the SEC would have this Court conclude that Mr. Morriss is already culpable and does not deserve even a chance to defend himself. Due process will not bear it.

The Court will find a crucial omission in both the SEC's and the Receiver's briefings: no mention of the dramatic impact their arguments, if successful, would have on the marketplace for D&O insurance in the United States. If this Court holds that the Receiver can deny Mr. Morriss coverage, D&O policies all over the country would be rendered useless for the officers and directors for whom they were purchased. Who would agree to manage or direct a company under financial duress if he or she knew that a receiver would later be able to withhold coverage of defense costs

under a D&O policy? Further, what company would even bother to purchase a D&O policy for its officers and directors if its coverage could be withheld on the basis of mere accusations in a civil complaint? The SEC and the Receiver have taken an extreme position that would have a grievous impact not only on Mr. Morriss, but also on the willingness of people to serve as officers and directors and on the marketplace for D&O insurance. Courts have uniformly affirmed the crucial role of D&O coverage in the economy and have rejected efforts by receivers to deprive directors and officers accused of malfeasance of the D&O coverage purchased on their behalf.

ARGUMENT

I. The Insurance Proceeds Are Not Property of the Investment Entities Subject to the Asset Freeze

The SEC obscures in its briefing what the law makes clear: although a D&O policy is an asset of the receivership estate, the proceeds for defense of an officer or director are not a part of the estate where the policy, as here, subordinates entity coverage to coverage for the individual insureds. By its plain, unambiguous terms, the Policy here provides that losses covered under the individual insureds' coverage – including defense costs – are paid "first" before other claims, and that other claims are paid "then, and only to the extent of the remaining Limit of Liability available, if any, after payment" of individual insureds' claims.[1] Perhaps the SEC's confusion on this issue is the

[1] The Priority of Payments provision states in relevant part:

> (1) In the event of Loss for which payment is due under Insuring Clause 1 and Loss for which payment is due under any other Insuring Clause in the Policy, [the insurer] shall, upon written request of any Insured Person:
>
> i. first pay all Loss for which coverage is provided by Insuring Clause 1; and
>
> ii. then, and only to the extent of the remaining Limit of Liability available, if any, after payment under i. above, pay such other Loss for which coverage is provided under any other Insuring Clause under this Policy.
>
> (2) Except as otherwise provided in this Endorsement, [the insurer] may pay Loss as it becomes due without regard to the potential for other future payment obligations under this Policy.

reason it has featured a case that squashes the SEC's argument and supports Mr. Morriss's Motion. The Plaintiff cites case law holding that where a policy covers the corporate entity, its proceeds are part of the bankruptcy estate. Doc. # 91 pp.7-8. However, none of the cases cited for this proposition involved the situation this Court faces, *where the policy itself makes entity coverage subordinate to coverage for individual insureds.*[2]

The Plaintiff quotes a Fifth Circuit decision in which the court states: "Faced with the typical situation in which a debtor corporation's liability policies provide the debtor and thus the estate with direct coverage against third party claims, virtually every court to have considered the issue has concluded that the policies-and clearly the proceeds of those policies-are part of debtor's bankruptcy estate, irrespective of whether those policies also provide *liability* coverage for the debtor's directors and officers" *Matter of Vitek, Inc.*, 51 F.3d 530, 534 & n.18 (5th Cir. 1995) (emphasis added) (citing *In re Louisiana World Exposition, Inc*., 832 F.2d 1391, 1399-1400 (5th Cir. 1987)), *cited in* Doc. # 91 p.7. Although the snippet of the case to which the SEC refers seems to support its arguments, a careful reading of this precedent shows that it supports Mr. Morriss's, and not the SEC's, position in this case.[3]

Doc. # 73-1, Policy Endorsement No. 11.

[2] The SEC also asserts that the Policy "likely excludes Morriss' claims for coverage," citing these exclusions. Doc. # 91 pp.6-7. However, whether or not the Policy provides coverage is not for the SEC to decide. The insurance company, which has obligations to Mr. Morriss under the Policy, has already determined that it will advance defense costs on Mr. Morriss's behalf, subject to a reservation of rights. *See* Doc. # 73-2, at p.2 ("Federal has accepted this matter as a Claim and will reimburse Defense Costs incurred on behalf of Mr. Morriss[.]"). Federal has thus complied with its obligation to Mr. Morriss to cover his defense costs, subject to the possibility that it may later be determined that the claim at issue falls within an exclusion to the Policy's coverage. *See id.* at p.7 (noting that SEC's claims are unsubstantiated at this time); *id.* at pp.11-12 (reserving its right to deny claim under policy's fraud exclusion if it is later determined that an insured engaged in excluded conduct).

[3] *Vitek* itself is not relevant to the issues in this case; it did not involve D&O insurance, but rather a general liability policy. The issue before the court involved whether the trustee for the bankrupt corporation could exhaust the full policy limits in a settlement with the insurer, thereby leaving the individual insureds without the duty to defend (and liability coverage) otherwise owed by the insurer. *See* 51 F.3d at 531.

In *Louisiana World Exposition*, a creditors' committee was suing, on behalf of the bankrupt corporation ("LWE"), several directors and officers for mismanagement and malfeasance. The committee also sought to prohibit the debtor's D&O insurer from providing coverage for the defense of these individual insureds. 832 F.2d at 1393-94. The court noted that in many bankruptcy cases, the courts had indeed held that liability insurance *policies* belonged to the bankrupt's estate. *Id.* at 1399. The court added, however, that these decisions were not controlling because "[t]he question is not who owns the policies, but who owns the liability proceeds." *Id.* Where the policies provided coverage to the bankrupt corporation itself, the court explained that "[i]n such cases, the estate owns not only the policies, but also the proceeds *designated* to cover corporate losses or liability." *Id.* at 1400 (emphasis added). In the case before it, however, the policy covered only the directors and officers, and therefore it was those individual insureds and not the corporation "who have the property interest in such proceeds for bankruptcy purposes." *Id.* The court stressed that an estate's interests in property "'rise no higher than those of the debtor.'" *Id.* at 1399. In the case before it, therefore, the debtor "had no ownership interest whatever in the proceeds from the liability coverage." *Id.* The fact that the creditors' committee had claims against the directors and officers for malfeasance did not change this result. As the court explained: "One having a pending, unadjudicated tort claim against another does not—whether or not the claimant is bankrupt—thereby have a property interest in liability insurance proceeds payable to the [insured] defendant; but the defendant does have a property interest, recognized in bankruptcy, in such proceeds. The fact that LWE purchased the policies does not change the outcome." *Id.* Acknowledging that the corporate debtor did have indemnification coverage under the policies, the court nevertheless emphasized that the Committee's claim was not related to that coverage but, rather, to the liability coverage afforded to the officers and directors directly. The committee claimed that this coverage, "which [debtor] LWE could reach if successful in its suit . . . against [the directors and officers], will be diminished by the payment of [the directors' and officers'] legal fees and hence there will be less of such liability

coverage against which LWE, as plaintiff in that suit, might effect any recovery it may ultimately be awarded therein." *Id.* at 1400. The court rejected this reasoning, relying on the principle that an estate's interest in property "rises no higher" than that of the debtor, and thus "a solvent LWE would never have owned the only proceeds at issue here." *Id*. at 1401.

As the *LWE* court pointed out, when a policy provides coverage to the bankrupt corporation itself, "the estate owns not only the policies, but also the proceeds *designated* to cover corporate losses or liability." *Id.* at 1400 (emphasis added). In this case, as the SEC notes, the D&O policy does cover the receivership entities as well as individual directors and officers. Doc. # 91 p.7. The SEC then jumps to the conclusion that the policy proceeds are assets of the entities. However, the SEC ignores a critical step in the analysis – the receivership estate's interest in the proceeds rises only as high as the entities' interests. While the estate would therefore own the "proceeds *designated* to cover corporate losses or liability," *LWE*, 832 F.2d at 1400, no entity claims have been made by the Receiver against such proceeds to date in this case. The entities' interests – and thus the estate's interests – in the policy proceeds are limited by the terms of the policy, including the priority of payments clause. Every case found involving such a clause supports Mr. Morriss's claim that he is entitled to coverage of his defense costs.

The other cases cited by the SEC do not support its position because they do not address the effect of a priority of payments provision. *See* Doc. # 91 pp.7-8 (citing *In re Allied Digital Tech. Corp.*, 306 B.R. 505 (Bankr. D. Del. 2004); *In re Sacred Heart Hosp. of Norristown*, 182 B.R. 413, 420 (Bankr. E.D. Pa. 1995)). Indeed, in *Allied Digital*, the court explained that while a liability policy is generally property of the bankruptcy estate, whether or not policy *proceeds* are part of the estate is "controlled by the language and scope of the policy at issue not by broad, general statements." 306 B.R. at 509. In that case, the trustee of the corporate debtor had sued officers and directors, who in turn sought coverage for their defense costs under the debtor's D&O policy. The court explained that if a suit is brought on behalf of the debtor against officers and directors, "the

courts generally hold that the debtor is merely an indirect insured and the proceeds are not property of the estate." *Id.* at 512 (citing *In re First Cent. Financial Corp.*, 238 B.R. 9, 18 (Bankr. E.D.N.Y. 1999), in which "the court was unwilling to divest the directors and officers of liability protection and payments of legal fees because the policy was for their protection"). In *Allied Digital*, the court therefore held that the directors and officers *were* entitled to coverage under the policy:

> Here, the Trustee brought the action against the directors and officers. The policy in question provides direct coverage to the directors and officers for claims and defense costs (which are real), and indemnification coverage to the company for amounts paid to the directors and officers (which is hypothetical). The Trustee has made no credible showing that the direct coverage of Allied Digital under Clause B(i) for securities claims has any continuing vitality. The Trustee's real concern is that payment of defense costs may affect his rights as a plaintiff seeking to *recover from* the D & O Policy rather than as a potential defendant seeking to be *protected by* the D & O Policy. In this way, Trustee is no different than any third party plaintiff suing defendants covered by a wasting policy. No one has suggested that such a plaintiff would be entitled to an order limiting the covered defendants' rights to reimbursement of their defense costs.

Id. at 512-13 (emphasis in original). The SEC attempts to ignore the governing legal principles and contractual language involved in this case in favor of the "equities" as it sees them. However, like the directors and officers in *Allied Digital*, Mr. Morriss stands accused of malfeasance and is entitled to coverage of his defense funds under the policy. The court in *Allied Digital* further held that even if the policy proceeds were property of the bankruptcy estate, the automatic stay should be lifted to permit payment of defense costs. *Id.* at 513. As the court in that case explained: "Without funding, the Individual Defendants will be prevented from conducting a meaningful defense to the Trustee's claims and may suffer substantial and irreparable harm. The directors and officers bargained for this coverage." *Id.* at 514. The same reasoning applies here.

II. The Court Should Hold that the Policy Proceeds Are Not Part of the Receivership Estate Subject to the Asset Freeze Order

The cases cited by the Plaintiff regarding asset freeze modifications are all distinguishable. *See* Doc. # 91 pp.8-10. Indeed, the SEC cites a long list of cases that do not even involve D&O insurance, let alone a D&O policy with a priority of payments provision. None of them involve the

instant situation, where a corporate officer seeks defense costs coverage under a policy procured by an entity whose assets are frozen. Moreover, Mr. Morriss is seeking access to insurance funds that are not part of the receivership estate. Thus, the rationale for the authorities cited by the Plaintiff does not exist here. Instead, most of the cases the SEC cites simply hold that under the particular circumstances, frozen cash assets of the defendant would not be released to the defendant to cover legal expenses. *See also S.E.C. v. Comcoa Ltd.*, 887 F. Supp. 1521 (S.D. Fla. 1995) (cash transferred to the defendant's attorneys was subject to an order freezing his assets); *S.E.C. v. Quinn*, 997 F.2d 287 (7th Cir. 1993) (defendant not entitled to release of frozen cash assets to hire counsel); *S.E.C. v. Lauer*, 445 F. Supp. 2d 1362 (S.D. Fla. 2006) (same); *S.E.C. v. Roor*, 1999 WL 553823 (S.D.N.Y. July 29, 1999) (same); *S.E.C. v. Coates*, 1994 WL 455558 (S.D.N.Y. Aug. 23, 1994) (same).

The Plaintiff claims that in one case, the court refused to allow a defendant access to insurance proceeds to pay attorney fees. Doc. # 91 p.10 (citing *S.E.C. v. Credit Bancorp Ltd.*, 2010 WL 768944 (S.D.N.Y. Mar. 8, 2010)). However, the *Credit Bancorp* case is wholly inapplicable. In that case, the defendant's personal assets had been frozen, in addition to his former employer's assets, in connection with a securities fraud case. In fact, the court had previously permitted the employee coverage for his legal fees "pursuant to the applicable insurance policies," holding that this was permitted by the asset freeze order. *Id.* at *1. What the court refused to do, however, was to release frozen funds (cash, stock and a 401k account) to pay attorney fees. *Id.* at *3. The court also rejected the defendant's bizarre argument that he was entitled to the proceeds of a settlement between the insurer, his former employer, and the receiver under the terms of that settlement agreement. *See id.* at *5 (rejecting defendant's contention that settlement agreement entitled him to the settlement proceeds, explaining that even if the defendant had settled with the SEC, which he had not, "at most the Insurer Settlement Agreement would have permitted a portion of the insurers' settlement payment to serve as a credit against any disgorgement obligation that Rittweger agreed to as part of a

settlement with the SEC"). None of the cases cited by the Plaintiff involve an insurance policy provision covering an insured's defense costs, as is the precise issue before this Court.

The Plaintiff argues that courts will release frozen funds to a defendant only when "the frozen assets exceed possible disgorgement, and in many cases penalties[.]" Doc. # 91 p.8. This may be true in cases where defendants are seeking to use cash or other estate assets to pay legal expenses. However, here Mr. Morriss seeks insurance proceeds which are (1) not part of the receivership estate and (2) likely not available to pay any penalties or disgorgement.[4] Mr. Morriss has cited to numerous cases to support his contention that insurance proceeds payable to a corporate officer for defense costs are not property of the corporate entity, especially where, as here, there is a priority of payments clause. Moreover, there is no evidence that the policy proceeds at issue would be available to pay any penalties or disgorgement.[5]

Thus, the Plaintiff's argument that modifying the asset freeze order would harm defrauded investors by denying them access to policy proceeds for disgorgement is not tenable. If the policy proceeds cannot be used to cover these losses, then the SEC has no argument that the policy must be preserved to pay these losses. What the Plaintiff really seeks to do here is deprive Mr. Morriss of coverage for defense costs – which Federal has already agreed to advance – so that he will be unable to defend himself against the Plaintiff's claims. In effect, the SEC is asking the Court to render its

[4] The SEC mistakenly claims that the Policy is one of the "few assets" available to compensate investors. *See, e.g.*, Doc. # 91 p.1. However, this ignores the fact that, according to the SEC, approximately $53 million was invested in portfolio companies as of 2011. Doc. # 1, Complaint ¶ 18. Compared to the $9 million the SEC alleges was improperly transferred, *id.* ¶ 1, it is simply not true that the Policy is the only asset available to compensate investors. Indeed, assuming the Receiver adequately manages the investments, there are more than sufficient assets to repay the amounts involved.

[5] Indeed, the Plaintiff itself argues that the policy does not provide coverage for disgorgement or penalties. *See* Doc. # 91 pp.11-12; Doc. # 73-1, Policy § 32, as amended by Endorsement 10 (defining loss to exclude penalties), § 8(H), as amended by Endorsement 13 (fraud exclusion). *See also, e.g., In re TransTexas Gas Corp.*, 597 F.3d 298, 309-10 (5th Cir. 2010) (restitution or disgorgement not "loss" covered under liability policy); *Millennium Partners, L.P. v. Select Ins. Co.*, 882 N.Y.S.2d 849, 853 (N.Y. Sup. Ct. 2009) (same)

opponent powerless to defend against its claims. Given the terms of the policy, a direct effect of a finding that the Defendants committed fraud would be to render any losses uninsured – in other words, investors would be precluded from ever accessing policy proceeds, something the SEC purportedly wants to avoid.

Plaintiff argues that the policy should not be used to cover Mr. Morriss's defense costs because the other insureds (the Investment Entities) "may very well be the subject of claims by others" and thus may need insurance coverage for their defense costs. Doc. # 91 p.12. As Mr. Morriss has extensively argued to the Court, the mere possibility of other claims against a policy does not justify refusing coverage for claims that already exist. In the words of other courts on this exact issue, Mr. Morriss's claim under the policy for his defense costs is "real and immediate." Doc. # 73-3, *S.E.C. v. Stanford Int'l Bank, Ltd.*, No. 3:09-cv-298, 2009 U.S. Dist. Lexis 124377, at *21 (N.D. Tex. Oct. 9, 2009). *See also Groshong v. Sapp (In re Mila, Inc.)*, 423 B.R. 537, 545 (B.A.P. 9th Cir. 2010 (individual insured's "defense losses were clear, immediate, and ongoing, while Trustee could only show hypothetical or speculative indemnification claims").[6]

Moreover, the Plaintiff does not explain the logical inconsistency as to why the Investment Entities would be entitled to defense costs under the policy while Mr. Morriss would not be. The Plaintiff argues that Mr. Morriss is not entitled to coverage for his defense costs because, among other things, the Court's asset freeze order has found a *prima facie* case of securities laws violations.

[6] The SEC also suggests that the Investment Entities or the Receiver could sue other insureds, claiming that Endorsement 9 of the policy permits the Receiver to sue individual insureds. Doc. # 91 p.13. However, the provision cited permits only bankruptcy trustees to sue insureds, as an exception to the policy's general exclusion against coverage for claims brought by one insured against another. *See* Doc. 73-1, Policy § 8(H)(c), as amended by endorsement 9 ("The Company shall not be liable for Loss on account of any Claim made against any Insured: . . . c. brought or maintained by or on behalf of any Insured in any capacity except: . . . (vii) *in the context of a bankruptcy proceeding* by or against the Insured pursuant to Chapter 7 or Chapter 11 of the United States Bankruptcy Code, as amended, a Claim brought or maintained by an examiner or trustee of such Insured, if any, or any assignee of such examiner or trustee.") (emphasis added).

See Doc. # 71 p.11.[7] (It should be noted that this was done *before* Federal agreed to advance defense costs on behalf of Mr. Morriss.) However, the Court's order found that there was a prima facie case of such violations by "the Defendants," including the Investment Entities. Doc. # 17 p.2. Moreover, these *prima facie* findings were made based on the *ex parte* pleadings of the SEC which to date have not even been answered. Rather, two of the defendants, Mr. Morriss and Morriss Holdings, LLC, have filed motions to dismiss, on which this Court has yet to rule, challenging the sufficiency of the SEC's pleadings.

Indeed, throughout its memorandum, the SEC presumes Mr. Morriss's culpability. *See, e.g.*, Doc. # 91 p.16 ("Morriss could not have any expectation the Insurance Policy would cover his fraudulent activities"). It is true that the Court has found that the Plaintiff made a sufficient showing of a *prima facie* case of securities laws violations by the Defendants, for purposes of instituting an asset freeze. Doc. # 17 p.2. As the Plaintiff itself has argued, "[a]n asset freeze is appropriate to maintain the status quo and to prevent the Defendants from dissipating investors' funds." Doc. # 6 p.36. However, this does not establish the Defendants' culpability. *Cf. Rose v. Mitchell*, 443 U.S. 545, 575, 99 S. Ct. 2993 (1979) ("[Grand jury proceeding] is not a proceeding in which the guilt or innocence of a defendant is determined, but merely one to decide whether there is a prima facie case against him."); *S.E.C. v. Comcoa Ltd.*, 887 F. Supp. 1521, 1524 (S.D. Fla. 1995) ("The ultimate remedies available to the court include disgorgement, restitution, and rescission. To preserve a basis for such remedies, the district court may impose an interim asset freeze."). Mr. Morriss is still

[7] Similarly, in the *Stanford International Bank* case, the court's findings of prima facie securities law violations did not keep the court from holding that insurance proceeds could be used for defense costs. *See* Doc. # 73-3, *S.E.C. v. Stanford Int'l Bank, Ltd.*, No. 3:09-cv-298, 2009 U.S. Dist. Lexis 124377, **11-12 (N.D. Tex. Oct. 9, 2009); *S.E.C. v. Stanford Int'l Bank, Ltd.*, No. 3:09-cv-298, Doc. # 8 ¶ 4 (N.D. Tex. Feb. 17, 2009) (asset freeze order finding "good cause" to believe Defendants engaged in securities law violations) (attached hereto as Exhibit 1).

entitled to defend himself against the SEC's charges, and is entitled, both under the plain language of the policy and applicable case law, to coverage of the defense costs related to the SEC's charges.

The SEC further tries to confuse this Court by arguing that Mr. Morriss has refused to comply with the Court's orders and his discovery obligations. *See* Doc. # 91 pp.4-5. First, this argument is unsupported by the facts. Mr. Morriss has merely asserted his Fifth Amendment rights with respect to the accounting ordered by this Court, which is a far cry from a refusal to comply.[8] Mr. Morriss has timely responded and made objections to the SEC's request for production of documents. Second, the February 8, 2012 letter and February 6, 2012 email quoted by the SEC in its response were followed up by another letter, on February 15, 2012, which the SEC did not include for the Court, but which is attached hereto as Exhibit 2. This letter made clear that extraordinary efforts were undertaken to locate all documents belonging to the Receiver. In fact, Mr. Morriss personally cooperated with an inspection of Morriss Holdings, LLC conducted by the Receiver, her counsel and a videographer on or about January 18, 2012, just one day after this Court entered the Order appointing the Receiver.[9] The Receiver immediately took possession of all receivership documents found during that inspection. Subsequently, on January 27, 2012, Mr. Morriss's counsel delivered additional documents to the Receiver that were found in a cabinet that could not be unlocked during the inspection. The February 6, 2012 email merely notes the reality that there are not funds available to retain the services of outside vendors. The only activity that has been suspended is the retention of additional outside vendors to expedite the unearthing of documents

[8] The SEC insinuates that Mr. Morriss's invocation of the Fifth Amendment – in this case and in his bankruptcy proceeding – somehow inappropriately deprives it of discovery to which it is entitled, and that this should for some reason affect whether Mr. Morriss is entitled to insurance coverage for his defense costs. However, the issue of Mr. Morriss's Fifth Amendment rights – which he has asserted given the pendency of a criminal investigation – is completely irrelevant to the issue before the Court on this motion, namely whether Federal is precluded from advancing defense costs on behalf of Mr. Morriss pursuant to the Policy.

[9] This inspection was conducted before Mr. Morriss knew that a criminal investigation was underway.

belonging to the Receiver that the Receiver had missed when she personally went through the documents at Morriss Holdings, LLC. In the February 8, 2012 letter, Mr. Morriss's counsel informed the Receiver of additional documents that were subsequently located. The February 8, 2012 letter and the February 15, 2012 letter both reference documents missed by the Receiver during her inspection that Mr. Morriss has gone the extra step to deliver to the Receiver. As noted in the February 15, 2012 letter, Mr. Morriss had to wait six days for instructions from the Receiver as to how to make the newly found documents available. Immediately upon receiving those instructions, the documents were made available to the Receiver. If other documents belonging to the Receiver are found, those documents will also be delivered, as is clearly stated in the February 15, 2012 letter. Despite the fact that the SEC's arguments with respect to discovery are wholly irrelevant to whether the law or equity dictate that insurance proceeds are subject to the asset freeze, Mr. Morriss certainly does not want to leave this Court with the impression that he has not been complying with its Orders.

III. The Policy and Case Law Support Mr. Morriss's Claim for Coverage of Defense Costs

The Plaintiff does not distinguish the cases cited by Mr. Morriss in support of his contractual right to coverage. It is not true, as the Plaintiff suggests, that defense cost coverage is only permitted when it is certain not to exhaust the policy limits. *See, e.g., In re Allied Digital Technologies, Corp.*, 306 B.R. 505, 513 (Bankr. D. Del. 2004) ("The bottom line is that the Trustee seeks to protect the amount he may receive in his suit against the directors and officers while limiting coverage for the defense costs of the directors and officers. This is not what the directors and officers bargained for. In bringing the action against the directors and officers, the Trustee knew that the proceeds could be depleted by legal fees and he took that chance. The law does not support the Trustee's request to regulate defense costs.").

In addition, the Plaintiff completely ignores the policy's priority of payments clause.[10] As one court explained when faced with the same issue as in this case, payment of policy proceeds pursuant to such a clause "does not diminish the protection the Policy affords the estate, as such protection is only available after the Costs of Defense are paid." *In re Laminate Kingdom, LLC*, 2008 WL 176637, *3 (Bankr. S.D. Fla. Mar. 13, 2008). Indeed, the Plaintiff itself quotes this very passage from *Laminate Kingdom* in support of its statement that courts have permitted access to insurance proceeds "only after concluding . . . the debtor had no actual right to the proceeds." Doc. # 91 pp.17-18. This is exactly Mr. Morriss's point: just as the debtor in *Laminate Kingdom*, the entity insureds in this case have no right to the proceeds precisely because there is a priority of payments clause. As the court in *Laminate Kingdom* explained:

> In this case, the Policy provides coverage for the directors and officers ***and*** the debtor. In such circumstances, the proceeds ***may be*** property of the estate if depletion of the proceeds would have an adverse effect on the estate to the extent the policy actually protects the estate's other assets from diminution.
>
> Having noted that distinction, the Court believes the depletion of proceeds to pay the Costs of Defense does not diminish the protection afforded the estate's assets under the terms of the Policy. The Policy's "Priority of Payments Endorsement" specifically requires that the proceeds be used first to pay non-indemnifiable loss for which coverage is provided under Coverage A of this Policy, which coverage includes the Costs of Defense. Then, only after such payments are made, and only if proceeds remain after payment of such Costs of Defense, will the Trustee or the estate be paid any proceeds. Thus, under the language of the Policy itself, the estate has only a contingent, residual interest in the Policy's proceeds; and, payment of the proceeds in accordance with the "Priority of Payments Endorsement" does not diminish the protection the Policy affords the estate, as such protection is only available after the Costs of Defense are paid.

2008 WL 176637, at *3 (emphasis in original) (citations omitted).

[10] The Plaintiff also claims that the policy involved here does not contain a bankruptcy clause as in the *Downey Financial* case. Doc. # 91 p.17 n.6. However, the policy does in fact provide that "Bankruptcy or insolvency of an Insured or the estate of an Insured Person shall not relieve the Company of its obligations . . . under this Policy." Doc. 73-1, Policy § 23. Thus, the policy's priority of payments clause remains operative notwithstanding the bankruptcy or insolvency of any insured.

Thus, despite the Plaintiff's suggestion to the contrary, the fact that the policy here affords entity coverage (as there was in *Laminate Kingdom*) is not dispositive. *See* Doc. # 91 p.17 n.5. As several courts have observed, a receiver or trustee only has the property rights to which the entity at issue is entitled. Therefore, if a corporate insured's right to policy proceeds is subordinate to individual insureds' rights under the policy, so too are the receiver's or trustee's rights. In all the cases Mr. Morriss cites involving priority of payment clauses, the courts have enforced these clauses. The Plaintiff's opposition is based on a series of speculations – that there might be other claims, that those claims might be covered by the policy, and that coverage of Mr. Morriss's defense costs might diminish the amount available to pay other covered claims.

CONCLUSION

Therefore, Mr. Morriss respectfully requests that the Court enter an order providing that notwithstanding the Court's orders of January 17, 2012, January 27, 2012, or any other similar order which the Court may enter, Federal is authorized to make payments under the Policy up to the Policy's Limit of Liability to or for the benefit of any Insured Persons or for the benefit of an Organization for defense costs incurred in connection with this litigation or any related Claim.

Respectfully submitted this 12th day of March, 2012.

ASHCROFT HANAWAY, LLC
By: /s/ Catherine L. Hanaway
Catherine L. Hanaway, # 41208MO
222 S. Central Avenue, Suite 110
St. Louis, MO 63105
Phone: (314) 863-7001
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chanaway@ashcroftlawfirm.com

CERTIFICATE OF SERVICE

I hereby certify that on March 12, 2012, the foregoing was filed electronically with the Clerk of the Court to be served by operation of the Court's electronic filing system upon the following:

Stephen B. Higgins
Brian A. Lamping
Thompson Coburn, LLP
One US Bank Plaza
St. Louis, MO 63101
314-552-6000
314-552-7000 (fax)
Counsel for the Receiver

Brian T. James
Robert K. Levenson
Adam L. Schwartz
Securities and Exchange Commission
801 Brickell Avenue, Suite 1800
Miami, FL 33131
305-982-6300
305-536-4146 (fax)
Counsel for the Plaintiff

David S. Corwin
Vicki L. Little
Sher Corwin LLC
190 Carondelet Plaza, Suite 1100
St. Louis, Missouri 63105
314-721-5200
314-721-5201 (fax)
Counsel for Defendant Morriss Holdings, LLC

/s/ Catherine L. Hanaway
Catherine L. Hanaway, # 41208MO
Attorney for Defendant Burton Douglas Morriss

ORIGINAL

IN THE UNITED STATES DISTRICT COURT
FOR THE NORTHERN DISTRICT OF TEXAS
DALLAS DIVISION

SECURITIES AND EXCHANGE COMMISSION,	§	
	§	
Plaintiff,	§	
	§	
v.	§	Case No.:
	§	
STANFORD INTERNATIONAL BANK, LTD., STANFORD GROUP COMPANY, STANFORD CAPITAL MANAGEMENT, LLC, R. ALLEN STANFORD, JAMES M. DAVIS, and LAURA PENDERGEST-HOLT	§	3-09CV0298-L
	§	
Defendants.	§	

TEMPORARY RESTRAINING ORDER, ORDER FREEZING ASSETS, ORDER REQUIRING AN ACCOUNTING, ORDER REQUIRING PRESERVATION OF DOCUMENTS, AND ORDER AUTHORIZING EXPEDITED DISCOVERY

This matter came before me, the undersigned United States District Judge, this 16th day of February 2009, on the application of Plaintiff Securities and Exchange Commission ("Commission") for the issuance of a temporary restraining order against Defendants Stanford International Bank, Ltd. ("SIB"), Stanford Group Company ("SGC"), Stanford Capital Management, LLC ("SCM"), R. Allen Stanford ("Stanford"), James M. Davis ("Davis"), and Laura Pendergest-Holt ("Pendergest-Holt") (collectively, "Defendants"), and orders freezing assets, requiring an accounting, prohibiting the destruction of documents, pulling the passports of Stanford, Davis, and Pendergest-Holt, authorizing expedited discovery, and alternative service of process and notice. On the basis of the papers filed by the Commission, and argument of Commission counsel, the Court finds as follows:

1. This Court has jurisdiction over the subject matter of this action and over the Defendants.

EXHIBIT 1

2. The Commission is a proper party to bring this action seeking the relief sought in its Complaint.

3. Venue is appropriate in the Northern District of Texas.

4. There is good cause to believe that Defendants have engaged in, and are engaging in, acts and practices which did, do, and will constitute violations of Section 17(a) of the Securities Act of 1933 ("Securities Act") [15 U.S.C. § 77q(a)], Section 10(b) of the Securities Exchange Act of 1934 ("Exchange Act") [15 U.S.C. §78j(b)], Exchange Act Rule 10b-5 [17 C.F.R. § 240.10b-5], Sections 206(1) and 206(2) of the Investment Advisers Act of 1940 ("Advisers Act") [15 U.S.C. §§ 80b-6(1), (2)], and Section 7(d) of the Investment Company Act of 1940 ("Investment Company Act") [15 U.S.C. § 80a-7(d)].

5. There is good cause to believe that Defendants will continue to engage in the acts and practices constituting the violations set forth in paragraph 4 unless restrained and enjoined by an order of this Court.

6. There is good cause to believe that Defendants used improper means to obtain investor funds and assets. There is also good cause to believe that Defendants will dissipate assets and that some assets are located abroad.

7. An accounting is appropriate to determine the disposition of investor funds and to ascertain the total assets that should continue to be frozen.

8. It is necessary to preserve and maintain the business records of Defendants from destruction.

9. This proceeding is one in which the Commission seeks a preliminary injunction.

10. The timing restrictions of Fed. R. Civ. P. 26(d) and (f), 30(a)(2)(C) and 34 do not apply to this proceeding in light of the Commission's requested relief and its demonstration of good cause.

11. Expedited discovery is appropriate to permit a prompt and fair hearing on the Commission's Motion for Preliminary Injunction.

12. There is good cause to believe that Stanford, Davis, and Pendergest-Holt may seek to leave the United States in order to avoid responsibility for the fraudulent acts alleged herein.

IT IS THEREFORE ORDERED THAT:

A. Defendants, their officers, directors, agents, servants, employees, attorneys, and all other persons in active concert or participation with them, are restrained and enjoined from violating Section 17(a) of the Securities Act [15 U.S.C. § 77q(a)], directly or indirectly, in the offer or sale of any security by the use of any means or instruments of transportation or communication in interstate commerce or by the use of the mails, by:

(1) employing any device, scheme, or artifice to defraud; or

(2) obtaining money or property by means of any untrue statement of material fact or any omission to state a material fact necessary in order to make the statement(s) made, in the light of the circumstances under which they were made, not misleading; or

(3) engaging in any transaction, practice, or course of business which operates or would operate as a fraud or deceit upon the purchaser;

B. Defendants, their officers, directors, agents, servants, employees, attorneys, and all other persons in active concert or participation with them, are restrained and enjoined

from violating Section 10(b) of the Exchange Act or Rule 10b-5 [15 U.S.C. § 78j(b) and 17 C.F.R. §240.10b-5], directly or indirectly, in connection with the purchase or sale of any security, by making use of any means or instrumentality of interstate commerce, or of the mails, or of any facility of any national securities exchange:

(1) to use or employ any manipulative or deceptive device or contrivance in contravention of the rules and regulations promulgated by the Commission;

(2) to employ any device, scheme, or artifice to defraud;

(3) to make any untrue statement of a material fact or omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading; or

(4) to engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person;

C. Stanford, Davis, Pendergest-Holt, SGC, SCM, their officers, directors, agents, servants, employees, attorneys, and all other persons in active concert or participation with them, are restrained and enjoined from violating Sections 206(1) and 206(2) of the Advisers Act [15 U.S.C. §§80b-6(1), (2)], directly or indirectly, by use of the mails or any means or instrumentality of interstate commerce, by:

(1) employing any device, scheme, or artifice to defraud any client or prospective client; or

(2) engaging in any transaction, practice, or course of business which operates as a fraud or deceit upon any client or prospective client;

D. SIB, SGC, their officers, directors, agents, servants, employees, attorneys, and all other persons in active concert or participation with them, are restrained and enjoined from violating Section 7(d) of the Investment Company Act [15 U.S.C. §80a-7(d)], directly or indirectly, by use of the mails or any means or instrumentality of interstate commerce, by:

(1) acting as an investment company, not organized or otherwise created under the laws of the United States or of a State, and offering for sale, selling, or delivering after sale, in connection with a public offering, any security of which such company is the issuer; or

(2) acting as a depositor of, trustee of, or underwriter for such a company; unless

(3) the Commission, upon application by the investment company not organized or otherwise created under the laws of the United States or of a State, issues a conditional or unconditional order permitting such company to register and to make a public offering of its securities by use of the mails and means or instrumentalities of interstate commerce.

5. Defendants, their officers, directors, agents, servants, employees, attorneys, and all other persons in active concert or participation with them, who receive actual notice of this Order by personal service or otherwise, and each of them, are hereby restrained and enjoined from, directly or indirectly, making any payment or expenditure of funds belonging to or in the possession, custody, or control of Defendants, or effecting any sale, gift, hypothecation, or other disposition of any asset belonging to or in the possession, custody, or control of Defendants, pending a showing to this Court that Defendants have sufficient funds or assets to satisfy all claims

arising out of the violations alleged in the Commission's Complaint or the posting of a bond or surety sufficient to assure payment of any such claim. This provision shall continue in full force and effect until further ordered by this Court and shall not expire.

6. All banks, savings and loan associations, savings banks, trust companies, securities broker-dealers, commodities dealers, investment companies, other financial or depository institutions, and investment companies that hold one or more accounts in the name, on behalf or for the benefit of Defendants are hereby restrained and enjoined, in regard to any such account, from engaging in any transaction in securities (except liquidating transactions necessary to comply with a court order) or any disbursement of funds or securities pending further order of this Court. This provision shall continue in full force and effect until further order by this Court and shall not expire.

7. All other individuals, corporations, partnerships, limited liability companies, and other artificial entities are hereby restrained and enjoined from disbursing any funds, securities, or other property obtained from Defendants without adequate consideration. This provision shall continue in full force and effect until further order by this Court and shall not expire.

8. Defendants are hereby required to make an interim accounting, under oath, within ten days of the issuance of this order or three days prior to any hearing on the Commission's Motion for Preliminary Injunction, whichever is sooner: (1) detailing all monies and other benefits which each received, directly or indirectly, as a result of the activities alleged in the Complaint (including the date on which the monies or other benefit was received and the name, address, and telephone number of the person paying the money or providing the benefit); (2) listing all current assets wherever they may be located and by whomever they are being held (including the name and address of the holder and the amount or value of the holdings); and (3)

listing all accounts with any financial or brokerage institution maintained in the name of, on behalf of, or for the benefit of, Defendants (including the name and address of the account holder and the account number) and the amount held in each account at any point during the period from January 1, 2000 through the date of the accounting. This provision shall continue in full force and effect until further order by this Court and shall not expire.

9. Defendants, their officers, directors, agents, servants, employees, attorneys, and all other persons in active concert or participation with them, including any bank, securities broker-dealer, or any financial or depositary institution, who receives actual notice of this Order by personal service or otherwise, and each of them, are hereby restrained and enjoined from destroying, removing, mutilating, altering, concealing, or disposing of, in any manner, any books and records owned by, or pertaining to, the financial transactions and assets of Defendants or any entities under their control. This provision shall continue in full force and effect until further order by this Court and shall not expire.

10. The United States Marshal in any judicial district in which Defendants do business or may be found, or in which any Receivership Asset may be located, is authorized and directed to make service of process at the request of the Commission.

11. The Commission is authorized to serve process on, and give notice of these proceedings and the relief granted herein to, Defendants by U.S. Mail, e-mail, facsimile, or any other means authorized by the Federal Rules of Civil Procedure.

12. Expedited discovery may take place consistent with the following:

A. Any party may notice and conduct depositions upon oral examination and may request and obtain production of documents or other things for inspection and copying from parties prior to the expiration of thirty days

after service of a summons and the Plaintiff Commission's Complaint upon Defendants.

B. All parties shall comply with the provisions of Fed. R. Civ. P. 45 regarding issuance and service of subpoenas, unless the person designated to provide testimony or to produce documents and things agrees to provide the testimony or to produce the documents or things without the issuance of a subpoena or to do so at a place other than one at which testimony or production can be compelled.

C. Any party may notice and conduct depositions upon oral examination subject to minimum notice of seventy-two (72) hours.

D. All parties shall produce for inspection and copying all documents and things that are requested within seventy-two (72) hours of service of a written request for those documents and things.

E. All parties shall serve written responses to written interrogatories within seventy-two (72) hours after service of the interrogatories.

13. All parties shall serve written responses to any other party's request for discovery and the interim accountings to be provided by Defendants by delivery to the Plaintiff Commission address as follows:

UNITED STATES SECURITIES AND EXCHANGE COMMISSION
Fort Worth Regional Office
Attention: David Reece
Burnett Plaza, Suite 1900
801 Cherry Street, Unit #18
Fort Worth, TX 76102-6882
Facsimile: (817) 978-4927

and by delivery to other parties at such address(es) as may be designated by them in writing. Such delivery shall be made by the most expeditious means available, including e-mail and facsimile.

14. Stanford, Davis, and Pendergest-Holt shall surrender their passports, pending the determination of the Commission's request for a preliminary injunction, and are barred from traveling outside the United States.

15. Defendants, their directors, officers, agents, servants, employees, attorneys, depositories, banks, and those persons in active concert or participation with anyone or more of them, and each of them, shall:

(a) take such steps as are necessary to repatriate to the territory of the United States all funds and assets of investors described in the Commission's Complaint in this action which are held by them, or are under their direct or indirect control, jointly or singly, and deposit such funds into the Registry of the United States District Court, Northern District of Texas; and

(b) provide the Commission and the Court a written description of the funds and assets so repatriated.

16. Defendants shall serve, by the most expeditious means possible, including e-mail and facsimile, any papers in opposition to the Commission's Motion for Preliminary Injunction and for other relief no later than 72 hours before any scheduled hearing on the Motion for Preliminary Injunction. The Commission shall serve any reply at least 24 hours before any hearing on the Motion for Preliminary Injunction by the most expeditious means available, including facsimile.

17. Unless extended by agreement of the parties, the portion of this order that constitutes a temporary restraining order shall expire at 5 o'clock p.m. on the 2nd day of March 2009 or at such later date as may be ordered by this Court. All other provisions of this order shall remain in full force and effect until specifically modified by further order of this Court. Unless the Court rules upon the Commission's Motion for Preliminary Injunction pursuant to Fed. R. Civ. P. 43(e), adjudication of the Commission's Motion for Preliminary Injunction shall take place at the United States Courthouse, Northern District of Tex Dallas, Texas, on the 1st day of March, 2009, at 10 o'clock a.m. 1100 Commerce Street Dallas Texas 75242 (Earl Cabell Bldg).

EXECUTED AND ENTERED at 11:40 o'clock a.m. CST this 16th day of February 2009.

UNITED STATES DISTRICT JUDGE

ASHCROFT HANAWAY™

February 15, 2012

Claire M. Schenk
Matthew S. Darrough
Thompson Coburn LLP
One US Bank Plaza
St. Louis, MO 63101

Re: *SEC v. Morriss, et al.*, Case No. 4:12-cv-80-CEJ

Dear Ms. Schenk and Mr. Darrough,

Thank you for your reply, yesterday, to my letter dated February 8, 2012 (the "Hanaway Feb. 8 letter") and for supplying delivery instructions for documents belonging to the Receivership Entities. As stated in the Hanaway February 8 letter, we identified approximately one additional bankers' box of Receivership Entities' documents that we have been prepared to deliver to you since such date. If additional documents belonging to Receivership Entities are located, we will deliver them according to your instructions. Your letter asserts that you were not informed during your inspection of the Morriss Holdings, L.L.C. offices that some documents were stored in the basement. However, I was informed that you were told that there were documents in the basement and that you declined to inspect the basement.

With respect to your statement that you will bring issues regarding documents belonging to the Receivership Entities to the attention of the Court, I will be pleased to inform the Court that: 1) on January 18, 2012, one day after the Receivership Order was entered, Doug Morriss immediately and voluntarily, opened the offices of Morriss Holdings, L.L.C. to the Receiver and allowed a thorough inspection of the premises, which inspection included videotaping; 2) two additional boxes that were located in a locked file cabinet were produced on January 27, 2012 after the cabinet lock was broken to gain access; and 3) the Hanaway Feb. 8 letter informed you that additional documents were available for immediate delivery to you and that you did not send instructions for delivery thereof for six days.

Your letter concludes with an invitation to provide you with advice as to how to manage the assets in the Receivership. To date, three former officers of the Receivership Entities, Ameet Patel, Wynne Morriss and Dixon Brown, have spent at least 12 hours providing you such information. Furthermore, I have been informed that investors have attempted to contact you to engage in such dialogue and have been directed to submit their concerns to the website.

As expressed in my email of February 2, 2012 (the "February 2nd email") to Ms. Schenk, the Receiver, and Adam Schwartz, counsel to the SEC, we would like to reach a mutually

EXHIBIT 2

agreeable and expeditious recommendation to the Court that Federal Insurance Company ("Chubb") be allowed to advance defense costs for Mr. Morriss in the matter of *SEC v. Morriss, et al.;* Case 4:12-cv-80-CEJ, notwithstanding the asset freeze order. To that end, the February 2nd email attached a proposed stipulated order allowing Chubb to advance defense costs notwithstanding the asset freeze order. Your letter dated February 8, 2012 (the "Receiver February 8th letter"), a conference call held on February 8, 2012 (the "February 8th call") and Stephen Higgins' letter dated February 6, 2012 (the "February 6 letter") make clear that the Receiver objects to stipulation to such an order.

In the Receiver February 8th letter, you reiterate several requests for information made during the February 8th call regarding what you characterize as "the proposal as contemplated by Federal Insurance Company ("Chubb") and Mr. Morriss." This characterization, together with the content of the Receiver February 8th letter, seem to indicate a belief that submission of Mr. Morriss' claim is a proposed agreement requiring approval of the Receiver. More accurately, Mr. Morriss is an "Insured Person", as that term is defined in Chubb Policy Number 8207-6676 (the "Chubb Policy"), who has made a claim pursuant to the Chubb Policy, and the terms of Mr. Morriss' coverage are governed by the contractual terms of the Chubb Policy.

Yesterday, February 13, 2012, David Topol, counsel to Chubb, sent a letter to the Receiver and to me setting forth the terms of coverage and reservation of rights. This letter should satisfy your request for "A copy of the coverage position letter that Mr. Topol advised was in process to Mr. Morriss." With respect to your requests for the three items identified in footnote 1, all of this correspondence, if it exists, would have been written by Chubb or counsel for Chubb. We will defer to Chubb to respond to those specific requests.[1]

Your letter further addresses three other requests for information:

1. "*We expressed concern over Chubb's stated reimbursement right vis-à-vis defense costs advanced on behalf of Morriss and related security to ensure that the reimbursement obligation could be satisfied should a no coverage determination be made. Again, we are looking for any reservations or agreements concerning reimbursement rights and any thoughts on security sufficient to ensure that uncovered does not deplete policy proceeds;*"

---

[1] "Coverage position letters, including any declinations, reservation of rights letters, or coverage acknowledgment letters issue by Chubb to date with respect to Mr. Morris's (sic) claims for coverage, other individual claims, or company claims;
A copy of any proposed allocation arrangement between Mr. Morriss and Chubb. Here, you indicated that such an allocation was contemplated on a going forward basis to reflect a 70% satisfaction of defense costs from Chubb and a 30% satisfaction from Mr. Morriss. We assume that there is some written documentation memorializing the arrangement and would like to see a copy of same;
Similarly, we are desirous of understanding whether there is an intention to pay all or part of the past incurred defense costs out of policy proceeds under the proposal. As such, we are interested in understanding what sums are involved, who they were incurred by, who the payment would be directed to, the involved allocation, and the documentation concerning such arrangement(s);"

We have serious concerns regarding this particular request. As we understand your request, you are asking Mr. Morriss to pledge some security against the future liability contingent upon an adjudication of fraud. Mr. Morriss, as the Receiver is well aware, has filed for personal bankruptcy. Your request is essentially a request for Mr. Morriss to make a fraudulent conveyance.

This is particularly troublesome given that the Receiver has filed motions in that bankruptcy case seeking the appointment of a trustee and, in the alternative, the conversion of the case to a Chapter 7. Since both the trustee and Mr. Morriss have moved to have the case dismissed, the Receiver is effectively seeking to force Mr. Morriss to stay involuntarily in bankruptcy.

Since the Receiver is both opposing the stipulation to allow Chubb to advance Mr. Morriss' defense costs and seeking to hold Mr. Morriss in bankruptcy against his will, whether or not it is intended, the natural result of the Receiver's actions would be to prevent Mr. Morriss from having counsel to defend himself in the SEC action.

2. *"We have continuing concern with the depletion of insurance proceeds for Mr. Morris's (sic) defense and inquired about the hourly rates for Ms. Hanaway and/or others that would be involved on his behalf. Namely, we would like you to provide identification of attorney staffing, the relationship of such attorneys to Ms. Hanaway's firm, and all of the hourly rates that would be involved with the defense when related cost would be paid from policy proceeds;"*

The rates that we have agreed to with Chubb, after adjustment for the Chubb allocation, are as follows:

Catherine Hanaway: $555
Other partner-level professionals: $350-$555
Of counsel and Associates: $200-$350
Paralegals: $100-$160

3. *"Finally, we inquired into the suggested means of monitoring defense expenditures going forward. Specifically, we asked if there was any thought about limiting such defense expenditures through a cap and utilizing a reporting process or if there are other means that you would propose to evaluate policy depletion should your proposal or like proposal go forward. If there are litigation guidelines involved, we would like a copy of those guidelines as well."*

Since it was made clear during the February 8th call that the Receiver intends to seek reimbursement of the costs of defending the Receivership Entities against the SEC's complaint, we are interested to learn what caps and monitoring mechanisms either are in place or would be agreeable to you on managing the defense costs advanced to the Receiver. We would be open to

discussing and considering similar controls. Chubb does have litigation guidelines that I assume they can provide to you.

Due to the objections raised by you and Mr. Higgins on the Receiver's behalf, we obviously cannot in good faith recommend any compromise regarding existing rights or disclosing related information without your legal justification for the Receiver's authority over such issues. Notwithstanding the Receiver and SEC's expressed concern over the prospective rights of investors to an insurance policy contingent upon possible future judicial adjudications, Mr.Morriss has a present, acknowledged contractual right to receive payments of his defense costs up to the amount of the Chubb Policy limitations.

While you've made clear your objections and unwillingness to agree to the stipulation, we still are not aware of the legal basis which supports the Receiver's ability to dictate the terms whereby Chubb complies with its present legal obligation to Mr. Morriss.

On the other hand, our earlier proposed stipulation sets forth substantial authority and case law to support Chubb's intention to honor its contractual obligations to Mr. Morriss as a covered insured, subject to a reservation of rights. So that we may better inform our client as to any reason why he might consider compromising or limiting his present rights, please provide us with the legal basis for the Receiver's authority.

I look forward to quickly resolving these matters. Please let me know if you have any questions regarding this letter.

Sincerely,

Catherine L. Hanaway

Catherine Hanaway