To be Argued by:
ALLEN W. BURTON
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New York Supreme Court
Appellate Division – First Department

Appellate Case Nos.: 2019-4402 2019-4831 2019-5327 2019-5328

WESTCHESTER FIRE INSURANCE CO.,

Plaintiff-Appellant,

– against –

NICHOLAS S. SCHORSCH, EDWARD M. WEIL, JR., WILLIAM KAHANE, PETER M. BUDKO and BRIAN S. BLOCK,

Defendants-Respondents,

RCAP HOLDINGS, LLC, STARR INDEMNITY & LIABILITY CO., AXIS INSURANCE CO. and XL SPECIALTY INSURANCE CO.,

Defendants,

– and –

ASPEN AMERICAN INSURANCE CO. and RSUI INDEMNITY CO.,

Defendants-Appellants.

BRIEF FOR PLAINTIFF-APPELLANT

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QUESTIONS PRESENTED

1. Whether an insurance policy clause restoring coverage for certain claims "brought by the Bankruptcy Trustee or Examiner of the Company, or any assignee of such Trustee or Examiner, any Receiver, Conservator, Rehabilitator, or Liquidator or comparable authority of the Company" applies to a claim brought by an entity that is not listed in the clause and holds no comparable authority of the Company.

The trial court answered the question in the affirmative.

2. Whether three distinct coverage defenses can be resolved on summary judgment, where application of each defense depends on resolution of the underlying action, which has not yet been resolved, and on resolution of disputed material facts, which have not yet been subjected to discovery.

The trial court answered this question in the affirmative.

3. Whether an insured may recover attorneys' fees in an insurer-initiated declaratory judgment action suit even when the policy disclaims any duty to defend.

The trial court answered this question in the affirmative.

PRELIMINARY STATEMENT

This case involves a "D&O" liability insurance policy Westchester Fire Insurance Company ("Westchester") issued to RCS Capital Corporation ("RCAP"), which covers certain claims asserted against RCAP directors and officers.[1] Like almost all D&O policies, the Westchester Policy excludes claims brought against one Insured (including RCAP or any of its directors and officers) by or on behalf of another Insured. These "Insured vs. Insured" or "IvI" exclusions are common because they maintain the distinction between "third party" liability and "first party" casualty insurance (including underwriting and premium differences).

Also like most D&O policies, the IvI Exclusion here contains an exception restoring coverage for such claims when asserted by specified persons who have replaced RCAP's management and assumed control over RCAP during the pendency of a bankruptcy proceeding. This "Bankruptcy Trustee Exception" applies to claims "brought by the Bankruptcy Trustee or Examiner of the Company, or any assignee of such Trustee or Examiner, any Receiver,

[1] The policy is Westchester Excess Liability Insurance Policy Number G27447594 001 ("Westchester Policy"). The relevant directors and officers here, who are seeking coverage from Westchester, are Nicholas Schorsch, Edward Weil, Jr., William Kahane, Peter Budko, and Brian Block (collectively the "ARC Parties").

Conservator, Rehabilitator, or Liquidator or comparable authority of the Company."

After an accounting scandal at an affiliated company decimated RCAP's business, RCAP's management made a pitch to creditors in order to maintain control over the company. The pitch was simple: if the creditors would support RCAP's proposed chapter 11 plan of reorganization, RCAP would agree to create, upon its emergence from bankruptcy, a trust for the benefit of RCAP's creditors (the "Creditor Trust") and assign to the Creditor Trust certain causes of action RCAP had against certain of its former directors and officers, including the ARC Parties. The plan came to fruition and, as a result, RCAP was able to retain full control over its business during bankruptcy as debtor-in-possession and restructured with its significant assets intact. In exchange, RCAP assigned to the Creditor Trust certain of its litigation claims, including the claim for which the ARC Parties now seek coverage from Westchester.

If RCAP had itself sued the ARC Parties, the IvI Exclusion would unquestionably apply. Yet the trial court found coverage here, where the Creditor Trust, as RCAP's assignee, sued the ARC Parties standing in RCAP's shoes. The trial court relied on the Bankruptcy Trustee Exception for its finding. But the trial court is wrong. The Bankruptcy Trustee Exception explicitly applies to seven specific persons: a "Bankruptcy Trustee or Examiner of the Company," "any

assignee of such Trustee or Examiner," "Receiver," "Conservator," "Rehabilitator," or "Liquidator." The Creditor Trust is not one of those persons (nor an assignee of a Bankruptcy Trustee or Examiner). Nor is the Creditor Trust a "comparable authority of the Company." The Creditor Trust exercises none of the control over RCAP that the specified persons would exercise, owes no fiduciary duties to RCAP, and did not even exist until RCAP emerged from bankruptcy. The Creditor Trust is nothing more than RCAP's voluntary assignee and the Bankruptcy Trustee Exception makes no provision for an assignee other than the assignee of a Trustee or Examiner.

The trial court's contrary conclusion lacks merit. The court identified only one reason the Bankruptcy Trustee Exception applies: the phrase "comparable authority of the Company" is ambiguous because the policy does not explicitly define it, and hence must be construed against Westchester. That analysis is directly contrary to settled New York law holding that an insurance policy phrase is not ambiguous merely because it is undefined in the policy itself. New York law instead requires courts to determine the meaning of an undefined phrase, if possible, by reading the phrase in context and applying normal rules of construction.

Here, context and standard interpretative rules—especially the well-recognized principle of *ejusdem generis*, which literally means "of the same

kind"—make clear that a "comparable authority of the Company" refers to a person that is an authority of the company *comparable to the previously specified persons*. Because the Creditor Trust is nothing like the other listed persons in the Bankruptcy Trustee Exception, the claim the Creditor Trust asserts is not exempted from the IvI Exclusion. The trial court's contrary ruling should be reversed, and the case should be remanded with instructions to enter judgment for Westchester.

In addition to its legally erroneous interpretation of the Bankruptcy Trustee Exception, the trial court also erred in adjudicating the Respondents' summary judgment motions. While all parties agreed that the IvI Exclusion was ready for determination as a matter of law, Westchester asserted multiple alternative coverage defenses that were *not* ripe for summary judgment, including the defenses that (i) some or all of the Insureds' conduct arose in an uninsured capacity, (ii) the judgment in the as-yet-unresolved underlying action will require the Insureds to disgorge ill-gotten gains, which are uninsurable under New York law, and (iii) other valid and collectible insurance covers the loss. Those defenses are highly fact-intensive and cannot be resolved without discovery.

Finally, the trial court also erred in awarding the ARC Parties attorneys' fees incurred in litigating the coverage dispute. Although parties generally bear their own fees under New York law, there is an exception for insureds who successfully defend an action brought by their insurer. That exception applies, however, only

when the insurance policy imposes on the insurer a duty to defend its insured, and the Westchester Policy here expressly *disclaims* any duty to defend. The Westchester Policy instead requires only that Westchester *pay* the costs of defending covered claims, subject to an allocation between covered and uncovered claims. And because Westchester's declaratory judgment action is unquestionably *not* covered by its Policy, Westchester has no obligation to allocate payments to defense of the action.

NATURE OF THE CASE

A. RCAP's Restructuring

RCAP was part of an integrated real estate enterprise comprising dozens of companies directly or indirectly owned by the ARC Parties and others, including traded and non-traded real estate investment trusts, a wholesale broker-dealer, retail broker-dealers, and an investment banking and advisory business. JR-542–43. On October 29, 2014, American Realty Capital Properties, Inc. ("ARCP")—an affiliated ARC Party-controlled entity—disclosed that publicly reported financial information had been misstated and was "intentionally not corrected." JR-543. RCAP's stock price, along with ARCP's, plummeted. JR-273, 276.

Reeling from the effects of the accounting scandal, RCAP hired a Chief Strategy Officer to lead RCAP's efforts to restructure its debt or sell all or part of its business. JR-535–36. RCAP understood that "a protracted or contentious

chapter 11 process" could result in "a significant loss" of RCAP's business, particularly its independent retail advisory customers who would be "leery of transacting business and maintaining accounts with subsidiaries of bankrupt entities." JR-537–38.

Accordingly, to "grease the skids" and avoid a contentious restructuring or liquidation under which it would lose control of its operations, RCAP, its largest creditor Luxor Capital Partners ("Luxor"), and other lien holders engaged in an "extensive" negotiation process in late 2015 and early 2016, culminating in a Restructuring Support Agreement ("RSA") that RCAP and its creditors executed on January 29, 2016. JR-538. The RSA set forth the outline of the restructuring plan and was "crucial to the survival of the Debtors," by ensuring that RCAP's business could continue and allowing RCAP to remain as debtor-in-possession. JR-538–39.[2]

Luxor, which held approximately 82% of the value of RCAP's unsecured debt, played an "active role" with "extensive" involvement in the RSA negotiations. JR-619–20; *see also* JR-539, 553. In exchange for restructuring its debt holdings, Luxor would have majority control over a litigation trust that "was

[2] *See also* JR-616 ("It is my belief that the [RSA] is the lynchpin of the Debtors' consensual restructuring . . . ."); JR-687 ("[W]e were scared that . . . if we didn't orchestrate this right and we had people delaying [the RSA] process, [then] we would lose most [of RCAP's enterprise value].").

designed to seek funds from AR Capital and . . . Mr. Schorsch and his parties." JR-682. RCAP would provide the trust with a $12 million war chest (later increased to $15 million) to fund litigation against the ARC Parties. JR-683–84. In its final form, RCAP proposed to "establish a Creditor Trust, which shall . . . (ii) prosecute the causes of action transferred to the Creditor Trust," JR-463, consisting primarily of "all claims and causes of action . . . held by the Company [RCAP], the RCS Debtors and Non-RCS Debtors' estates." JR-463. In short, the Creditor Trust would take title to RCAP's causes of action against the ARC Parties—just as RCAP agreed.

Two Luxor appointees were serving on the RCAP Board of Directors when the RSA was negotiated and approved: Michael Conboy, who was also Chairman of RCAP's Executive Committee, and Jeffrey Brown. JR-619–20, 975. Both are Insured Persons under the Westchester Policy and, as such, are also Insureds. Conboy would go on to serve as one of the trustees of the Creditor Trust—a role he still holds. JR-851, 881 (signature page). Luxor's counsel during the RSA negotiations would go on to represent the Creditor Trust in the Creditor Trust Action against the ARC Parties.

On January 31, 2016, RCAP filed its agreed voluntary petition for relief under chapter 11 of the Bankruptcy Code in the United States Bankruptcy Court for the District of Delaware. JR-536. As contemplated by the RSA, the court did

not appoint any Bankruptcy Trustee or Examiner, allowing RCAP's board and management to maintain control of RCAP as a debtor-in-possession. JR-602 ("The Debtors have operated as debtors-in-possession since their respective Petition Dates . . . ."). RCAP emphasized from the start of the case that "no request has been made for the appointment of a trustee or an examiner," JR-581, and continued to stress throughout the process that "[n]o trustee or examiner has been appointed in these chapter 11 cases." JR-896; *see also* JR-916 (same).

In May 2016, the bankruptcy court approved the Debtors' Fourth Amended Joint Plan of Reorganization (the "Plan"). In approving the Plan, the bankruptcy court approved the Creditor Trust Agreement, JR-768–69, but did not weigh the appointment of the Creditor Trust or any Creditor Trustees under the standards for appointing a bankruptcy trustee. *See* 11 U.S.C. § 1104. Nor did the Plan vest the Creditor Trust with all the powers and duties of a bankruptcy trustee. Instead, the Creditor Trust's powers were limited to those conveyed under 11 U.S.C. § 1123(b)(3)(B) and the 21 specific actions the Creditor Trust Agreement "expressly authorized and empowered" the Creditor Trust Board to take. JR-832, 852–55.

The Plan became effective on May 23, 2016. In accordance with the RSA and pursuant to the Creditor Trust Agreement, the Plan formalized the voluntary, contractual assignment of certain litigation claims from RCAP to the Creditor

Trust. *See* JR-695–701; JR-832–33. Among other things, the Creditor Trust Agreement: (i) provides that "the Creditor Trust shall be the successor-in-interest to the Debtors with respect to any Creditor Trust Causes of Action," JR-832; and (ii) requires RCAP to cooperate with the Creditor Trust regarding any litigation that the Creditor Trust brings, JR-862. Thus, the Plan and Creditor Trust Agreement together reflect the implementation of RCAP's pre-petition assignment agreement with Luxor, vesting in the Creditor Trust the same rights RCAP chose to assign before the bankruptcy. JR-776.

B. The Creditor Trust Action Is a Claim "on Behalf of RCAP and its Subsidiaries"

As planned, the Creditor Trust (through the same counsel Luxor used in pre-bankruptcy negotiations) sued the ARC Parties and other affiliated non-Insured parties in March 2017 (the "Creditor Trust Action"). JR-994. As the Creditor Trust explained in its pleadings, it seeks to recover "on behalf of RCAP and its subsidiaries," JR-316, as an assignee of the "claims and causes of action" held by RCAP, its "predecessor-in-interest." JR-235–36. According to the Delaware Chancery Court, the "crux of the Complaint" is that the ARC Parties exploited the "ownership structure" of RCAP, including "a confusing blizzard" of various related entities, turning RCAP into a cost center for AR Capital. JR-2135–27. The Creditor Trust Action asserts breach of fiduciary duty and other causes of action, alleging that the ARC Parties and others engaged in misconduct in various

capacities, including as "controlling shareholders," JR-343, and by using their influence to control "minions" and "managers with deep ties and loyalty to the Schorsch empire," JR-249, 261.

C. The ARC Parties Sought Liability Coverage for the Creditor Trust Action

The ARC Parties pursued coverage for the Creditor Trust Action under the Westchester Policy and other excess policies issued to RCAP. JR-994–95. In the tower of D&O insurance policies that RCAP purchased for the company and its officers and directors, XL Specialty Insurance Company issued the primary policy (Number ELU134102-14, the "Followed Policy"), a claims-made policy with a policy period from April 29, 2014 to April 29, 2015. JR-989. The Westchester Policy represents RCAP's seventh layer of excess coverage, and has an "attachment point" of $35 million. JR-992. The Westchester Policy is a true excess policy, obligating Westchester to pay only "for Loss by reason of exhaustion by payments of all Underlying Policy Limits of all underlying policies." JR-131.

Coverage under the Westchester Policy follows form to the Followed Policy, meaning that Westchester agreed to provide coverage "in accordance with the terms, definitions, conditions, exclusions and limitations of the Followed Policy." JR-131. Among those terms is the IvI Exclusion, which eliminates coverage for "any Claim made against an Insured Person . . . : by, on behalf of, or at the

direction of the Company or Insured Person." JR-167–219. The IvI Exclusion has eight exceptions that restore coverage under specific circumstances. One of those exceptions, the "Bankruptcy Trustee Exception," restores coverage to the extent that a claim:

> (ii) is brought by the Bankruptcy Trustee or Examiner of the Company, or any assignee of such Trustee or Examiner, any Receiver, Conservator, Rehabilitator, or Liquidator or comparable authority of the Company.

JR-167; *see also* JR-219. In the event of a bankruptcy, the Westchester Policy expressly defined "Insured" to "include the Company as debtor in possession," meaning the IvI Exclusion would also apply to any claim brought by RCAP as debtor-in-possession against another Insured. JR-175.

The Westchester Policy provides coverage only for Loss, defined as "damages, judgments, settlements or other amounts and Defense Expenses in excess of the Retention that the Insured is legally obligated to pay." JR-162. "[M]atters which are uninsurable under the law pursuant to which this Policy is construed" do not constitute Loss under the Westchester Policy. JR-169. All Loss is "specifically excess of and will not contribute with any other valid and collectible insurance." JR-176. In addition to RCAP and its directors and officers, the Westchester Policy defines numerous other Schorsch-related entities as Insureds and Additional Insureds. *See, e.g.*, JR-1610, 1614–19.

The Westchester Policy covers Wrongful Acts, defined as (i) "any actual or alleged act, error, omission, misstatement, misleading statement, neglect, or breach of duty by any Insured Person while acting in his or her capacity as an . . . Insured Person of the Company," or (ii) "any matter asserted against an Insured Person solely by reason of his or her status as a director or officer of the Company." JR-179, 218. An Insured Person is "any past, present, or future director or officer . . . of the Company." JR-217. There is no coverage for any claims "in any way involving an Insured Person acting in their capacity as a[n] Insured Person of any entity other than the Company." JR-220.

Westchester has no obligation to defend any Insureds under the Westchester Policy; that duty falls to the Insureds. JR-209, 218, 221 ("It shall be the duty of the Insured and not the duty of the Insurer to defend any Claim under this Policy."). Westchester does have the duty to pay for "Defense Expenses" incurred as part of covered Loss, *see supra* at 12, but Westchester also has the right to allocate Loss between "covered and uncovered matters." JR-221.

D. Proceedings Below

After a settlement in a separate case that did not implicate the IvI Exclusion exhausted nearly all layers of insurance below Westchester, Westchester denied coverage for the Creditor Trust Action on numerous grounds on March 2, 2018. Westchester immediately initiated this action against the ARC Parties seeking a

no-coverage declaration for the Creditor Trust Action. For completeness, Westchester amended its complaint on March 13, 2018, to include RCAP's excess insurers. JR-1069–92. Westchester asserted that the IvI Exclusion completely bars coverage for the Creditor Trust Action. Westchester further contended, in the alternative, that there is no coverage to the extent that (i) the ARC Parties were not acting in their capacities as Insured Persons or were acting "in any way" involving their capacities as officers or directors of another company, (ii) the ARC Parties are liable for the return of ill-gotten gains, which is uninsurable under New York law, and (iii) there is other valid and collectible insurance for the same claims. JR-1048–67; *see also* 1639–42.

The ARC Parties answered Westchester's amended complaint and filed Counterclaims, alleging breach of contract and bad faith against Westchester, and seeking a declaration of coverage. JR-1003–46. There is no claim that the ARC Parties need immediate advancement of defense costs for the Creditor Trust Action because the ARC Parties' first layer Difference-in-Conditions ("DIC") insurer, Everest National Insurance Company ("Everest"), has agreed to provide drop-down coverage to the extent there is no coverage under the Westchester Policy due

to, among other things, the application of the IvI Exclusion or other coverage defenses. JR-1420, 2082, 2084, 2108.[3]

Westchester did not answer the ARC Parties' Counterclaims, but instead moved to dismiss them for failure to state valid legal claims for coverage, breach of contract, and bad faith. JR-89–119. Westchester argued that the IvI Exclusion categorically bars coverage for the Creditor Trust Action because it is a Claim brought "on behalf of" RCAP by RCAP's assignee. Westchester further argued that the Bankruptcy Trustee Exception did not apply because the contractually created Creditor Trust was (i) not one of the listed persons or assignees, (ii) never an "authority of the Company," and (iii) not "comparable" to a Liquidator or any of the other listed persons.

Although issue was not joined on the ARC Parties' Counterclaims because Westchester's motion to dismiss tolled its answer, the ARC Parties nevertheless moved for partial summary judgment on their Counterclaims. JR-1490–1526. In addition to the purely legal coverage issue presented by the IvI Exclusion, the ARC Parties also sought judgment on Westchester's separate and distinct defenses to

[3] A DIC event occurs when, among other situations, "the insurer(s) of the Underlying Insurance are not liable for such Non-Indemnified Loss." JR-2084. The Everest policy does not contain an IvI exclusion. JR-2108.

coverage, notwithstanding that no discovery has occurred and those defenses involved several open factual issues.

The trial court heard oral argument on Westchester's motion to dismiss and the ARC Parties' summary judgment motion on April 23, 2019, and issued its opinion on April 25, 2019. The trial court assumed that the Creditor Trust Action triggered the IvI Exclusion, and then held that the Bankruptcy Trustee Exception nonetheless restored coverage. JR-18. Although the Creditor Trust is not among the specific persons listed in the Bankruptcy Trustee Exception, the trial court held that the Creditor Trust constituted a "comparable authority" of the Company. JR-18. The court did not explain how the Creditor Trust constituted an "authority of the Company," nor did the court compare the Creditor Trust to the listed persons in any way or hold that it possesses status or authority comparable to the listed persons. Instead, the court merely held that the phrase "comparable authority" of the Company is ambiguous and "must be construed against the insurer" because it "is not defined" formally in the Policy. JR-18. The court accordingly held that the Creditor Trust Action fell within the Bankruptcy Trustee Exception, rendering the IvI Exclusion inapplicable.

The trial court then decided that Westchester must "pay for all defense and indemnity costs" up to the Westchester Policy's limits, summarily rejecting Westchester's three alternative coverage defenses. JR-19. The trial court found

that summary judgment was ripe because Westchester had "unequivocally charted course for summary judgment," JR-15, despite Westchester's contention that it required discovery on its alternative coverage defenses. The trial court also found that Westchester must pay for "indemnity costs," JR-19, even though the basis for any indemnification obligation is unknown because the underlying Creditor Trust Action is still unresolved.

ARGUMENT

I. THE IVI EXCLUSION UNAMBIGUOUSLY PRECLUDES COVERAGE

Consistent with nearly-uniform decisions of other courts, the trial court correctly assumed that the IvI Exclusion generally applies to the Creditor Trust Action, because the action is a suit "against an Insured Person," (i.e., the ARC Parties) brought "by, on behalf of, or at the direction of [RCAP]" by its contractual assignee, the Creditor Trust. *See Indian Harbor Ins. Co. v. Zucker*, 860 F.3d 373, 375 (6th Cir. 2017) (applying IvI exclusion where debtor "assigned its rights to the Liquidation Trust" because, "[a]s a voluntary assignee, the Trust stands in [the debtor]'s shoes and possesses the same rights subject to the same defenses"); *Biltmore Assocs. v. Twin City Fire Ins. Co.*, 572 F.3d 663, 671 (9th Cir. 2009) (IvI exclusion applied to claims brought by debtor and transferred to creditor

committee).[4] The Creditor Trust itself acknowledged that it was suing the ARC Parties—undisputedly Insured Persons under the Westchester Policy—"on behalf of RCAP and its subsidiaries." JR-316.

The Creditor Trust Action accordingly is excluded from coverage unless the ARC Parties can satisfy *their* burden to show that one of the exceptions to the Exclusion applies. *See Platek v. Town of Hamburg*, 24 N.Y.3d 688, 694, 697 (2015) (finding no coverage after insured failed to show exception to exclusion applied). The ARC Parties and the trial court relied on the Bankruptcy Trustee Exception, which restores coverage only for claims brought by either (i) "the Bankruptcy Trustee or Examiner of the Company, or any assignee of such Trustee or Examiner," or (ii) "any Receiver, Conservator, Rehabilitator, or Liquidator or comparable authority of the Company." JR-167. That exception has no application: the Creditor Trust is not one of the persons expressly listed in the

[4] *See also Reliance Ins. Co. of Ill. v. Weis*, 148 B.R. 575, 583 (E.D. Mo. 1992) ("there is no ambiguity" in the IvI exclusion—"[a]ny lawsuit brought on behalf of [the company] against its former officers falls within this exclusion"); *aff'd in part,* 5 F.3d 532 (8th Cir. 1993); *Terry v. Fed. Ins. Co. (In re R.J. Reynolds - Patrick Cty. Mem'l Hosp., Inc.)*, 315 B.R. 674, 679–80 (Bankr. W.D. Va. 2003) (IvI exclusion applied to claims voluntarily transferred to litigation trust because trust was "mere assignee" whose powers arose from "provisions in the plan, not directly by operation of statute"); *Niemuller v. Nat'l Union Fire Ins. Co.*, No. 92-CV-0070, 1993 U.S. Dist. LEXIS 18476, at *7–*8 (S.D.N.Y. Dec. 29, 1993) (applying IvI exclusion to dismiss claims because "an assignee steps into the shoes of the assignor and gains only so much as that to which the assignor is entitled").

exception, nor is it an "authority of the Company," much less a "comparable" authority to any of the specified persons.

A. The Bankruptcy Trustee Exception Does Not Apply Because the Creditor Trust Is Not One of the Specified Persons or a Comparable Authority of the Company

The Bankruptcy Trustee Exception has no application here, for three principal reasons reflected in the plain language of the exception itself. First, the Creditor Trust is not one of the expressly listed persons to whom the exception applies. Second, the Creditor Trust is not "comparable" to any of the listed persons. Third, the Creditor Trust is not an "authority of the Company." Bending the exception's language to encompass the Creditor Trust would undermine the IvI Exclusion's central objectives.

1. *The Creditor Trust Is Not One of the Specified Persons in the Bankruptcy Trustee Exception*

The Bankruptcy Trustee Exception exempts from the IvI Exclusion claims against Insureds asserted by several specific persons: a "[1] Bankruptcy Trustee or [2] Examiner of the Company, or [3] any assignee of such Trustee or Examiner, [4] any Receiver, [5] Conservator, [6] Rehabilitator, or [7] Liquidator." The Creditor Trust is not among those persons.

The Creditor Trust obviously is not a receiver, conservator, rehabilitator, or liquidator of RCAP. No such entity was appointed in RCAP's restructuring. Nor is the Creditor Trust the bankruptcy trustee or company examiner, as even the

ARC Parties acknowledged below. JR-2443 (conceding that it would be false to contend that the Creditor Trust was actually a bankruptcy trustee or examiner). Likewise, the Creditor Trust is not an *assignee* of any bankruptcy trustee or examiner. As RCAP itself repeatedly emphasized in court filings, "[n]o trustee or examiner [was] appointed" during RCAP's restructuring. JR-896. Rather, it was RCAP *itself*, acting as debtor-in-possession, that assigned its own claims to the Creditor Trust. Although the Bankruptcy Trustee Exception specifically references certain assignees (i.e., assignees of the Bankruptcy Trustee or Examiner), it makes no mention of other assignees, such as an "assignee of the Company" like the Creditor Trust.

2. *The Creditor Trust Is Not "Comparable" to the Specified Persons*

In addition to the expressly listed persons, the Bankruptcy Trustee Exception extends to a "comparable authority of the Company." Even assuming for the moment that the Creditor Trust constitutes an "authority of the Company"—in fact, it does not, *see infra* at 26–27—the Creditor Trust is not an authority "comparable" to the listed persons.

Under the well-established doctrine of *ejusdem generis*, a general term that follows a list of specific terms is "construed to embrace only objects similar in nature to those objects enumerated by the preceding specific words." 2A Norman J. Singer & Shambie Singer, SUTHERLAND STATUTES & STATUTORY

CONSTRUCTION § 47:17 (7th ed. 2018); *see also* Antonin Scalia & Bryan A. Garner, READING LAW: THE INTERPRETATION OF LEGAL TEXTS 208 (West 2012) (to identify "genus" of specific terms, courts should consider all words together and "ask what category would come into the reasonable person's mind"). New York courts routinely apply the *ejusdem generis* interpretive rule to give meaning to otherwise undefined general words and phrases that appear alongside a list of more specific terms. *See*, *e.g.*, *Uribe v. Merchs. Bank*, 91 N.Y.2d 336, 340–41 (1998); *Lend Lease (U.S.) Constr. LMB Inc. v. Zurich Am. Ins. Co.*, 136 A.D.3d 52, 57–58 (1st Dep't 2015); *Miller Tabak + Co., LLC v. Senetek PLC*, 118 A.D.3d 520, 521–22 (1st Dep't 2014); *Zacharius v. Kensington Publ'g Corp.*, 42 Misc. 3d 1208(A), at *5 (Sup. Ct. N.Y. Cty. 2014).

Applied here, the *ejusdem generis* rule dictates an unambiguous conclusion: because the Creditor Trust is not "comparable" to the other persons listed in the Bankruptcy Trustee Exception, it does not fall within the Exception's plain terms. To start, the phrase "comparable authority of the Company" refers back to the persons immediately preceding the phrase, i.e., "Receiver, Conservator,

Rehabilitator, or Liquidator."[5] The Creditor Trust is in no way "comparable" to any of those persons.

But even if "comparable authority" refers further back to the "Bankruptcy Trustee or Examiner of the Company," the Creditor Trust still is not "comparable" to any of the listed persons. With one irrelevant exception, the listed persons all share common features: control over the company, an obligation to settle affairs with creditors, and a fiduciary duty to the company. A liquidator, for example, is an independent and statutorily-appointed entity that has actual power and control of the company, used to wind down the company's business. LIQUIDATOR, BLACK'S LAW DICTIONARY (11th ed. 2019) ("A person appointed to wind up a business's affairs, esp. by selling off its assets."); *see also Consol. Edison Co. v. Ins. Dep't of State*, 140 Misc. 2d 969, 973 (Sup. Ct. N.Y. Cty. 1988) (noting that

[5] The "or" before the word "Examiner" is disjunctive, syntactically setting the phrase apart from the subsequent phrase "any Receiver, Conservator, Rehabilitator, or Liquidator or comparable authority of the Company." *See Special Situations Fund III QP, L.P. v. Overland Storage, Inc.*, 2017 NY Slip Op. 32125(U), 2017 WL 4517773, at *12 (Sup. Ct. N.Y. Cty. Sept. 27, 2017) (quoting *Houge v. Ford*, 44 Cal. 2d 706, 712 (1955) (noting that, "in its ordinary sense," the word "or" marks an alternative, such as "either this or that")); *Chevron Oil Co. v. Barlow*, 406 F.2d 687, 691–92 (10th Cir. 1969) (holding "or" should not be substituted for "and"). Further, the phrase "the Bankruptcy Trustee or Examiner" uses the definite article, indicating that only "the Bankruptcy Trustee or Examiner" would qualify for treatment under that portion of the exception. The phrase "any Receiver, Conservator, Rehabilitator or Liquidator," on the other hand, uses a determiner, indicating that whichever one of the class chosen would qualify.

liquidator's "function is to 'run' the company"). Further, a liquidator owes fiduciary duties to both the company and its creditors. *See, e.g.*, *Corcoran v. Ardra Ins. Co.*, 156 A.D.2d 70, 75 (1st Dep't 1990) (describing liquidator's fiduciary obligations); 6 Collier on Bankruptcy ¶ 704.02 (16th ed. 2019) (describing powers and duties of Chapter 7 trustee, the federal equivalent of a liquidator, including "wide-ranging authority over the debtor's assets and, in the case of a corporate debtor, over the debtor itself").

The Exception's other named persons share the same characteristics.[6] *See In re Cty. Seat Stores, Inc.*, 280 B.R. 319, 325–26 (Bankr. S.D.N.Y. 2002) (bankruptcy trustee is a "statutory invention, with powers that far exceed those of a corporation or debtor-in-possession" that it must wield for "the protection of the entire community of interests" of a debtor); *1185 Ave. of Ams. Assocs. v. Resolution Tr. Corp.*, 22 F.3d 494, 497–98 (2d Cir. 1994) (chapter 7 bankruptcy trustee "is analogous to a receiver"); *Kovalesky v. Carpenter*, No. 95 Civ. 3700,

[6] The only person with slightly different powers is the "Examiner," who acts as an independent officer to assist a bankruptcy court in investigating the company's assets and operations. 11 U.S.C. § 1104(c); 7 Collier on Bankruptcy ¶ 1104.03 (16th ed. 2019). An examiner may be granted authority to oversee some aspects of the company's operations. *See, e.g.*, *In re Charles St. African Methodist Episcopal Church of Bos.*, 499 B.R. 66, 116 (Bankr. D. Mass. 2013) (appointing examiner to oversee and monitor company's insurance coverage). The Creditor Trust here has no such authority. Nor is it acting *on a court's behalf* to assess RCAP's operations, which is the defining feature of an examiner.

1997 WL 630144, at *4 (S.D.N.Y. Oct. 9, 1997) (conservators seek to return company to viability and are treated as "quasi-judicial officer"); *In re Ames Dep't Stores Inc.*, 512 B.R. 736, 739 (S.D.N.Y. 2014) (rehabilitator is state-created entity that bears powers and responsibilities similar to bankruptcy trustee).[7]

By contrast, the Creditor Trust possesses exactly none of those shared, defining characteristics of the listed persons. The Creditor Trust did not supersede RCAP's management and never had independent authority whatsoever over RCAP—let alone the "wide-ranging" authority to take control of the debtor's entire business that the other specified persons wield. *See supra* 21–23. Accordingly, the Creditor Trust did not, and could not, have any obligation to resolve RCAP's debts to creditors during RCAP's bankruptcy. In fact, unlike the listed persons that a court may appoint during the pendency of an insolvency proceeding, the Creditor Trust did not even exist until after the Plan (and accompanying voluntary assignment) became effective. Nor does the Creditor

[7] Depending on the jurisdiction and the company's business, the entities charged with winding down an enterprise can go by different names. For example, a failing stock brokerage may be liquidated under the Securities Investor Protection Act of 1970 ("SIPA"), and a SIPA Trustee appointed to liquidate the assets. *See, e.g.*, *In re Bernard L. Madoff Inv. Sec., LLC*, No. 15 Civ. 1151, 2016 WL 183492, at *3 (S.D.N.Y. Jan. 14, 2016), *aff'd sub nom. Matter of Bernard L. Madoff Inv. Sec., LLC*, 697 F. App'x 708 (2d Cir. 2017) (describing SIPA Trustee's statutory powers to liquidate brokerage's assets). The "comparable authority of the Company" language would therefore capture an entity like a SIPA Trustee, while continuing to exclude the company's contractual assignee.

Trust owe any fiduciary duties to RCAP. In short, the Creditor Trust was contractually *denied* the broad control and obligations that the specifically listed persons assume as a matter of law, and it is instead limited to the powers RCAP chose to give it. *See* JR-852–57.

The specifically listed persons share another distinct feature that separates them from the Creditor Trust: they are *disinterested*, i.e., they have no personal interest in the debtor or its estate, so they can fulfill simultaneous duties to the debtor and its creditors. *See*, *e.g.*, *In re Cty. Seat Stores, Inc.*, 280 B.R. at 327 (bankruptcy trustee must be disinterested and "truly adverse" to debtor); *In re R.J. Reynolds - Patrick Cty. Mem'l Hosp., Inc.*, 315 B.R. at 680 (same); 11 U.S.C. § 1104(b) (only a "disinterested person" can serve as trustee). The Creditor Trust here is precisely the opposite: the whole point of the Creditor Trust is to assert RCAP's assigned claims for the benefit of RCAP's creditors, especially its largest creditor Luxor. The Creditor Trust is the product of RCAP's pre-bankruptcy deal-making with RCAP's largest creditor, Luxor, and was "designed to seek funds from . . . Mr. Schorsch and his parties," *see* JR-682. As an entity designed to monetize (for the benefit of RCAP's largest creditor) the rights assigned to it—with a former RCAP director serving as one of its trustees and with RCAP's full blessing and cooperation—the Creditor Trust cannot be independent, disinterested, or adverse to RCAP. *See* JR-691 (Creditor Trust was "biggest source[] of

recovery" for Luxor); JR-688 (discussing Luxor's demands for a litigation trust); JR-619–20 (describing Luxor's "extensive prepetition involvement in negotiating the" RSA).

The bankruptcy court's approval of the Plan, which included the Creditor Trust Agreement, changes nothing. The bankruptcy court did not make any finding as to the Creditor Trust's qualifications or disinteredness, as it would for any bankruptcy trustee appointment. *See* 11 U.S.C. § 1104(d) ("[T]he United States trustee, after consultation with parties in interest, shall appoint, *subject to the court's approval*, one disinterested person other than the United States trustee to serve as trustee or examiner . . . . ") (emphasis added). This is because the bankruptcy court did not appoint or create the Creditor Trust. Rather, the bankruptcy court confirmed RCAP's consensual Plan, which, by agreement with RCAP's creditors, called for the Creditor Trust to be created by the Creditor Trust Agreement.

Accordingly, because the Creditor Trust is not "comparable" to the other persons specified in the Bankruptcy Trustee Exception, the Bankruptcy Trustee Exception does not apply, and the IvI Exclusion precludes coverage.

3. *The Creditor Trust Is Not an "Authority of the Company"*

To fall within the Bankruptcy Trustee Exception, the Creditor Trust not only must be "comparable" to the other listed persons, it also must be an "authority of

the Company." It decidedly is not. In plain English, an "authority" is a "person or organization having political or administrative power and control." AUTHORITY, Oxford Dictionary (2018 ed.); *see also Lend Lease (US) Constr. LMB Inc.*, 136 A.D.3d at 57 ("[I]t is common practice for the courts of this State to refer to the dictionary to determine the plain and ordinary meaning of words to a contract."). The Creditor Trust never had "power and control" *of the Company*—RCAP—or of any aspect of RCAP's business. Rather, the Creditor Trust was a contractual assignee that received only what RCAP voluntarily assigned to it. *See* JR-775–77.

At most, then, the Creditor Trust had "power and control" over the claims assigned to it, but none over RCAP itself. RCAP's own conduct throughout its bankruptcy reveals that the Creditor Trust was never "an authority of the Company." RCAP strenuously avoided the appointment of a bankruptcy trustee or examiner that would require RCAP to cede power and control of its business, which would have led to a "protracted or contentious chapter 11 process," resulting in "a significant loss" of RCAP's business. *See* JR-537–38. The ARC Parties cannot now argue that the Creditor Trust is an "authority of [RCAP]," when RCAP agreed to create the Creditor Trust to avoid the appointment of an "authority of [RCAP]" in the first place. JR-895–96 ("No trustee or examiner has been appointed in these chapter 11 cases.").

4. *Interpreting the Exception to Include the Creditor Trust Would Contravene the IvI Exclusion's Objectives*

Interpreting the Bankruptcy Trustee Exception to encompass the Creditor Trust would undermine the purposes of the IvI Exclusion. As courts have recognized an IvI exclusion serves the twin aims of (i) preventing a company from attempting to "push the costs of mismanagement onto an insurance company just by suing (and perhaps collusively settling with) past officers who made bad business decisions," *Zucker*, 860 F.3d at 375, and (ii) reducing the risk of "bitter disputes that erupt when members of a corporate, as of a personal, family have a falling out and fall to quarreling," *Level 3 Commc'ns, Inc. v. Fed. Ins. Co.*, 168 F.3d 956, 958 (7th Cir. 1999). It would make no sense to allow a company to circumvent an IvI exclusion by simply assigning its otherwise excluded claims, whether in a bankruptcy or otherwise, to a third party in exchange for an up-front benefit. *See Niemuller*, 1993 U.S. Dist. LEXIS 18476, at *7–*8 ("[A]n assignee steps into the shoes of the assignor and gains only so much as that to which the assignor is entitled.").

Not surprisingly, appellate courts addressing such efforts have rejected them. *See supra* at 17–18 & n.4. These courts have recognized that the rationale behind the IvI Exclusion applies to assignments of claims like these because the debtor may have a powerful incentive to use the claims against its directors and officers as a bargaining chip "to obtain a larger concession from the creditors," which is

"especially true when the plan is a plan of reorganization and the debtor contemplates continuing its operations," raising "a distinct possibility of collusion." *In re R.J. Reynolds - Patrick Cty. Mem'l Hosp., Inc.*, 315 B.R. at 681. "Because risks such as collusion and moral hazard are much greater for claims by one insured against another insured on the same policy than for claims by strangers, liability policies typically exclude them from coverage." *Biltmore Assocs., LLC*, 572 F.3d at 669.

Concerns about collusion or in-fighting by or among insureds do not apply when it is a bankruptcy trustee, examiner, liquidator or any of the other specified persons that brings the claim. The appointment of an entity like a bankruptcy trustee is "almost always effected in contravention of the wishes of a debtor." *In re R.J. Reynolds - Patrick Cty. Mem'l Hosp., Inc.*, 315 B.R. at 679; *see also* 11 U.S.C. § 1104(a)(1) (bankruptcy trustee only appointed "for cause, including fraud, dishonesty, incompetence, or gross mismanagement of the affairs of the debtor"). This fundamental adverseness, together with the persons' independence, disinterest, and statutory powers, sanitizes the claim of the risk of collusion that animate the IvI Exclusion. *In re Cty. Seat Stores*, 280 B.R. at 327 (trustee's position as a "statutory entity, and not a mere assignee or successor-in-interest" makes it "a truly adverse party" so as to avoid "fears of collusion"). The Bankruptcy Trustee Exception accordingly restores coverage for claims brought by

such persons. Claims brought by the insured company's assignee, by contrast, directly implicate the very concerns about collusion and in-fighting that underlie the IvI Exclusion, and allowing coverage for them would leave any insured company free to cut a deal with its creditors (as RCAP did) to convert its insurance into a "pot" of money for its creditors, *see Biltmore Assocs.*, 572 F.3d at 674, forcing "its insurer to pay for the poor business decisions of its officers or managers," *Greenman-Pedersen Inc. v. Travelers Cas. & Sur. Co. of Am.*, No. 10 Civ. 2777, 2011 WL 3796336, at *4 n.5 (S.D.N.Y. Aug. 10, 2011).

B. The Trial Court's "Ambiguity" Theory Is Incorrect

As the foregoing analysis shows, the Bankruptcy Trustee Exception plainly has no application here, as a matter of law. The trial court reached a contrary conclusion for but one stated reason: the phrase "comparable authority of the Company" is ambiguous because it "is not defined" in the Policy itself, and thus "must be construed against the insurer" under the doctrine of *contra proferentem*. JR-18. That analysis is incorrect.

To start, this Court has held that the *contra proferentem* doctrine does not apply to a "sophisticated policyholder," *Westchester Fire Ins. Co. v. MCI Commc'ns Corp.*, 74 A.D.3d 551, 551 (1st Dep't 2010), at least where, as here, the policyholder participates in negotiating policy terms and participates in the program by taking on a self-insured retention. *Cummins, Inc. v. Atl. Mut. Ins. Co.*,

56 A.D.3d 288, 290 (1st Dep't 2008) ("[D]octrine of contra proferentem does not apply as . . . plaintiff, while not an insurance company, had equal bargaining power and acted like an insurance company by maintaining a self-insured retention.").

More importantly, under New York law, a contractual term or phrase is not deemed ambiguous simply because the policy itself does not define it. *See Fed. Ins. Co. v. Int'l Bus. Machs. Corp.*, 18 N.Y.3d 642, 649 (2012) (insurance policy not ambiguous because term "fiduciary" was "undefined"); *Jacobson Family Invs., Inc. v. Nat'l Union Fire Ins. Co.*, 102 A.D.3d 223, 233 (1st Dep't 2012) (while term "loss" was "undefined in the policy," "the policy was not ambiguous on its face"); *Slattery Skanska Inc. v. Am. Home Assur. Co.*, 67 A.D.3d 1, 14–15 (1st Dep't 2009) ("[A]lthough the term 'circumvent' is not specifically defined in the policy, the lack of a definition does not, in and of itself, mean that the word must be ambiguous."); *Hugo Boss Fashions, Inc. v. Fed. Ins. Co.*, 252 F.3d 608, 617 (2d Cir. 2001) ("[T]he fact that the language of the contract itself does not specify the meaning of a disputed term does not entail that an ambiguity sufficient to trigger the *contra proferentem* [doctrine] exists.").

Nor is a policy ambiguous "because the challenged provisions could have been worded differently," *Fed. Ins.*, 18 N.Y.3d at 650, or "because the parties interpret them differently," *Mount Vernon Fire Ins. Co. v. Creative Hous. Ltd.*, 88 N.Y.2d 347, 352 (1996). Rather, courts faced with an interpretive dispute over an

undefined term must utilize all standard tools of contract construction before concluding that a provision is ambiguous and construing it against the drafter or insurer. *See Schering Corp. v. Home Ins. Co.*, 712 F.2d 4, 10 n.2 (2d Cir. 1983) (trial court erred "because *contra preferentem* is used only as a matter of last resort, after all aids to construction have been employed") (citing *Hartford Accident & Indem. Co. v. Wesolowski,* 33 N.Y.2d 169, 172 (1973)); *Uribe*, 91 N.Y.2d 336 (applying *ejusdem generis* and *expressio unius* maxims to construe contract).

The trial court here abdicated its threshold duty to construe the phrase "comparable authority of the Company" in its context, especially by failing to analyze the persons that must be comparable. Even if RCAP were not a sophisticated policyholder with its own substantial bargaining power, the court would be obliged to analyze the policy language fully and fairly, not simply to construe every undefined term against Westchester. Despite that obligation, the court did not say one word about the other listed persons or their shared characteristics, nor did it explain "what category would come into the reasonable person's mind" by considering the listed persons collectively. Scalia &. Garner, READING LAW, *supra*, at 208. Again, the listed persons reflect a category of disinterested entities statutorily or judicially empowered to control the insured company's operations, where there is no risk of collusion to shift business losses

onto a third-party liability policy. *See supra* at 25–26. The Creditor Trust does not fall within that category: it is not disinterested and does not control RCAP's operations in any respect, but instead was created specifically to pursue liability coverage for claims assigned by RCAP that indisputably would *not* be covered absent the assignment. *See Niemuller*, 1993 U.S. Dist. LEXIS 18476, at *12 (applying IvI exclusion and noting that "ordinary assignees have neither independent claims nor any greater rights than those belonging to their assignors"). In this regard, the Bankruptcy Trustee Exception's reference to "any assignee of such Bankruptcy Trustee or Examiner" (but not RCAP) is telling. Accordingly, the Bankruptcy Trustee Exception does not exempt such claims from the normal operation of the IvI Exclusion.

II. THE TRIAL COURT ERRED IN GRANTING SUMMARY JUDGMENT ON SEPARATE COVERAGE DEFENSES

Summary judgment as to any claim is inappropriate where, as here, material factual disputes remain. N.Y. CPLR 3212(f) (summary judgment not appropriate where "facts essential to justify opposition may exist but cannot then be stated"). Moreover, when determining a motion for summary judgment, courts must analyze the evidence "in the light most favorable to the party opposing the motion, and all reasonable inferences must be resolved in that party's favor." *Rollins v. Fencers Club, Inc.*, 128 A.D.3d 401, 402 (1st Dep't 2015) (quoting *Udoh v. Inwood Gardens, Inc.,* 70 A.D.3d 563, 565 (1st Dep't 2010)); *see also Quoizel, Inc. v.*

Hartford Fire Ins. Co., 102 A.D.3d 492, 493 (1st Dep't 2013) (affirming denial of parties' cross motions for summary judgment where material issue of fact remained); *Positive Influence Fashions, Inc. v. Seneca Ins. Co*., 43 A.D.3d 796, 797 (1st Dep't 2007) (summary judgment improper where moving party failed to show "beyond any doubt" that no material issue of fact existed). Where, as here, facts supportive of the party opposing summary judgment have not been discovered because they are exclusively in the moving party's possession, summary judgment is premature. *See State Farm Fire & Cas. Ins. Co. v. Meis,* 23 A.D.3d 372, 373 (2d Dep't 2005) (pre-discovery motion for summary judgment premature in insurance coverage dispute). Of course, these standards apply fully to insurance coverage disputes. *See Grening v. Empire Mut. Ins. Co.*, 101 A.D.2d 550, 554 (1st Dep't 1984) (holding that "[s]ummary judgment was improvidently granted" on driver's claim against insurance company); *Perfect Film & Chem. Corp. v. Honey*, 32 A.D.2d 900, 900 (1st Dep't 1969) (reversing trial court where "issues of fact" precluded summary judgment concerning claims that, potentially, were not covered by insurance policy).

In addition to its defense based on the IvI Exclusion—which all agree was a purely legal issue ripe for adjudication based on the existing pleadings and related bankruptcy court materials—Westchester asserted three *other* coverage defenses, none of which were ripe for adjudication when the ARC Parties moved for

summary judgment on them. In particular, the trial court's summary judgment order appears to hold Westchester liable to indemnify the insureds against the Creditor Trust Action, even though that action has not yet been resolved. JR-19. As a general matter, "claims concerning indemnification obligations are not ripe for adjudication until liability has been imposed upon the party to be indemnified." *Am. Empire Surplus Lines Ins. Co. v. EM & EM Chimney & Masonry Repair, Inc.*, No. CV 16-1541, 2017 WL 4118390, at *6 (E.D.N.Y. Aug. 30, 2017), *report & recommendation adopted*, 2017 WL 4119266 (E.D.N.Y. Sept. 15, 2017); *see also FSP, Inc. v. Societe Generale*, No. 02 CV 4786, 2003 WL 124515, at *4 (S.D.N.Y. Jan. 14, 2003) (same), *aff'd & remanded*, 350 F.3d 27 (2d Cir. 2003); *Atl. Mut. Ins. Co. v. Terk Techs. Corp.*, 309 A.D.2d 22, 33 (1st Dep't 2003) (Andrias, J., concurring in result) ("[T]he issue of coverage with respect to indemnity was necessarily deferred pending a determination of the underlying action."). Here, the questions whether, and to what extent, Westchester's other coverage defenses apply depend on the outcome of the underlying action, as well as other as-yet-unresolved factual issues. Accordingly, it was premature to adjudicate them on summary judgment.

A. Material Disputes of Fact Remain Unresolved for Westchester's Three Defenses Independent of the IvI Exclusion

Westchester asserted three coverage defenses wholly independent of the IvI Exclusion: (1) the ARC Parties were not acting in their insured capacity as officers

of RCAP; (2) the Westchester Policy does not cover ill-gotten gains; and (3) other insurance covers the action. None of those defenses were ripe for adjudication before any discovery and before the Creditor Trust Action was resolved.

1. *Disputed Issues of Material Fact Preclude Summary Judgment as to Whether the ARC Parties' Conduct Arose in an Insured Capacity*

The Westchester Policy only provides coverage for Wrongful Acts, which include an Insured Person's conduct "while acting in his or her capacity as an . . . Insured Person of the Company," or "any matter asserted against an Insured Person solely by reason of his or her status as a director or officer of the Company." JR-179. The Westchester Policy's Insured Capacity Exclusion reinforces this limitation of the insuring agreement, excluding coverage for claims "arising out of" or "in any way involving" an Insured Person acting in his or her capacity as an officer or director for a *different* entity. JR-219–20. Accordingly, if the Creditor Trust's Claim against the ARC Parties reveals that they engaged in wrongdoing while acting as non-Insureds, no coverage exists.

Disputed issues of fact remain as to whether the Creditor Trust's allegations arise from conduct committed by the ARC Parties acting in capacities other than as RCAP directors and officers. According to the Delaware Chancery Court, "the crux" of the Creditor Trust Action is that the ARC Parties and other defendants exploited RCAP's "ownership structure" *to benefit AR Capital and enrich*

themselves. *See* JR-2135; *see also* JR-234–35, 295–97 (alleging that the ARC parties breached their fiduciary duties "as controlling shareholders"). In other words, the ARC Parties were allegedly acting in their personal capacities, or in their capacities as RCAP and AR Capital controlling shareholders, rather than as officers and directors of RCAP. If so, their conduct would not be covered under the Westchester Policy. *See Nat'l Union Fire Ins. Co. v. Jordache Enters.*, 235 A.D.2d 333, 333 (1st Dep't 1997) (no coverage for actions defendants took in their personal capacities, rather than in their capacities as directors and officers).

Moreover, material issues remain as to whether the ARC Parties' conduct arose "solely" by reason of their status as directors or officers of the Company, as required to avoid the Insured Capacity Exclusion. *See Jacobson Family Invs., Inc. v. Nat'l Union Fire Ins. Co.*, 129 A.D.3d 556, 558 (1st Dep't 2015) (coverage denied where insured acted in "hybrid" capacity and coverage only extended to conduct performed "solely" in one capacity); *Law Offices of Zachary R. Greenhill, P.C. v. Liberty Ins. Underwriters, Inc.*, 147 A.D.3d 418, 420 (1st Dep't 2017) (coverage exclusion applied to professional liability policy where claims arose from attorney's conduct not as attorney, but as CEO). Making this determination is inherently fact-intensive, especially because disentangling the ARC Parties' conduct from their multiple roles as (i) RCAP officers and directors, (ii) shareholders of RCAP and AR Capital, and (iii) additional roles that discovery

may uncover, will require further fact development. *See Mau v. Twin City Fire Ins. Co.*, No. 1:16-cv-325, 2017 WL 4479731, at *5 (D.N.D. Oct. 3, 2017) (no coverage under D&O policy for officer who acted in capacity of shareholder for another entity). Accordingly, the trial court erred in granting summary judgment on Westchester's insured capacity defense.

2. *Disputed Issues of Material Fact Preclude Summary Judgment as to Whether the ARC Parties Will Be Required to Disgorge Ill-Gotten Gains in the Creditor Trust Action*

Westchester also asserted a defense based on the "uninsurable loss" doctrine, which prohibits coverage for amounts representing the return of ill-gotten gains through, among other things, disgorgement or constructive trust. Under that doctrine, if the ARC Parties are effectively required in the Creditor Trust Action to return ill-gotten gains (whether it is called disgorgement, constructive trust, or otherwise), the Westchester Policy cannot cover those amounts. Because it is, as yet, unknown what remedy will result in the Creditor Trust Action, it was premature to rule that the Westchester Policy must indemnify that remedy.

Under New York law, the "risk of being directed to return improperly acquired funds is not insurable." *Vigilant Ins. Co. v. Credit Suisse First Bos. Corp.*, 10 A.D.3d 528, 528 (1st Dep't 2004); *see also J.P. Morgan Secs. Inc. v. Vigilant Ins. Co.*, 21 N.Y.3d 324, 337 (2013) (insured should not be allowed to "retain the ill-gotten gains by transferring the loss to its carrier"); *Millennium*

Partners, L.P. v Select Ins. Co., 68 A.D.3d 420, 420 (1st Dep't 2009). In *J.P. Morgan*, the Court of Appeals held that because the case was at an "early juncture" where the ultimate remedy was still unknown, the *insurers* were not entitled to dismissal of a coverage action based on the uninsurable loss doctrine. *J.P. Morgan Secs. Inc.*, 21 N.Y.3d at 337. The parties are reversed here, but the result is the same: because it cannot be known definitively at this stage whether the Creditor Trust Action will result in an uninsurable loss, the insureds are not entitled to summary judgment on the uninsurable loss defense.

3. *Disputed Issues of Material Fact Preclude Summary Judgment as to Whether the Creditor Trust Action Is Covered by Other Insurance*

Finally, the trial court erred in granting summary judgment on Westchester's "other insurance" defense, which is based on the Westchester Policy provision stating that coverage will be "specifically excess of and will not contribute with any other insurance." JR-176. This defense asserts that the ARC Parties may be insured under other insurance policies that cover similar or identical risks as the RCAP D&O policies.

According to the trial court, summary judgment on this defense was appropriate because Westchester's complaint alleged that "exhaustion of the other coverage is imminent." JR-18–19. That allegation, however, referred only to exhaustion of *underlying insurance*—i.e., insurance directly below the Westchester

Policy in RCAP's D&O tower—not to exhaustion of other *types* of insurance in RCAP's coverage towers that may be applicable to the Creditor Trust Action. That Action involved a "confusing blizzard of entities" (in the Delaware Chancery Court's words) that were controlled by the ARC Parties. JR-2127. Many of those entities appear to have had insurance coverage that may overlap with the Westchester Policy. *See Winstead v. J.C. Penney Co.*, 933 F.2d 576, 577 (7th Cir. 1991) ("Nothing is more common than overlapping insurance coverage."). In fact, even the RCAP D&O polices define numerous other Schorsch-related entities as Insureds and Additional Insureds. *See, e.g.*, JR-1610, 1614–19.

Westchester has not yet had any opportunity for discovery to determine what other policies exist and to what extent they provide coverage overlapping with the Westchester Policy. Summary judgment is not appropriate where "facts essential to justify opposition may exist but cannot then be stated." N.Y. CPLR 3212(f); *see also Universal Underwriters Ins. Co. v. Dean Johnson Ford, Inc.*, 905 S.W.2d 529, 535–36 (Mo. Ct. App. 1995) (summary judgment improper "unless and until [party] produces all such policies and unless and until it can be determined that such policies do not provide coverage"). Because material facts remain both unknown and unresolved as to whether the ARC Parties were insured under insurance policies covering similar or identical risks, summary judgment is improper.

B. The Trial Court's Assertion that Westchester "Charted a Course for Summary Judgment" on These Separate Defenses is Both Irrelevant and Wrong

To justify its premature summary judgment ruling, the trial court asserted that the parties had "charted a course for summary judgment as plaintiff's motion to dismiss is aimed at defendants' first counterclaim." JR-18. That assertion is both legally irrelevant and factually erroneous.

As an initial matter, the court seems to have conflated the question whether the ARC Parties' motion was procedurally ripe for a *ruling* with the distinct question whether the motion should be *granted* based on the virtually non-existent record supporting the motion. The fact that a motion has been fully briefed by both parties and presented to the court for decision has essentially nothing to do with whether the law and existing record support granting the motion. Here, as shown, the record does not support summary judgment against Westchester on its non-IvI Exclusion coverage defenses, because material disputes of fact remain as to all three defenses.

Further, and in any event, nowhere did Westchester represent to the court that summary judgment was ripe because its factual evidence had been fully developed. A court may consider summary judgment ripe when the non-movant makes "unequivocally clear" that it is "laying bare [its] proof." *Pesce v. Leimsider*, 72 N.Y.S.3d 760, 762 (2d Dep't 2018). But as *Pesce* holds, a party

does not deliberately chart a course for summary judgment where the party would have engaged in discovery had it known that summary judgment was ripe for decision. *Id.* Without discovery on the separate coverage defenses, Westchester could not—and certainly did not—agree that its other coverage defenses were ripe for adjudication on the existing record.

III. THE TRIAL COURT ERRED IN AWARDING ATTORNEYS' FEES FOR DEFENSE OF THE DECLARATORY JUDGMENT ACTION

The trial court erroneously held that Westchester was obligated to pay the ARC Parties' attorneys' fees in the declaratory judgment action "[b]ecause the insured versus insured exclusion does not apply." JR-19. That conclusion completely ignores the fact that the Westchester Policy only requires Westchester to *advance* litigation costs and does not impose a *duty to defend* the ARC Parties. *See* JR-209, 218, 221 ("It shall be the duty of the Insured and not the duty of the Insurer to defend any Claim under this Policy."). In addition to expressly disclaiming any duty to defend, the Westchester Policy also permits Westchester to allocate costs between "covered and uncovered matters," JR-221, which is incompatible with such a duty.

The distinction between a duty to advance fees and a duty to defend is critical to the question whether the ARC Parties can recover attorneys' fees for the declaratory judgment action. The general rule, of course, is that a winning litigant is not entitled to attorneys' fees. As pertinent here, courts have recognized a

narrow exception to that rule only where an insurer has a duty to defend—*not* where, as here, the insurer's obligation is only to pay for the defense of covered matters. *See U.S. Underwriters Ins. Co. v. City Club Hotel, LLC*, 3 N.Y.3d 592, 598 (2004) (holding that "recovery of attorneys' fees is" appropriate where "incidental to the insurer's contractual duty to defend"); *Liberty Surplus Ins. Corp. v. Segal Co.*, 420 F.3d 65, 70 (2d Cir. 2005) (declining to extend "narrow exception" beyond cases where insurer had duty to defend).

The duty to defend differs from the duty to pay for the defense of covered losses in one respect critical to the fee-shifting issue here. Whereas a duty to defend requires the insurer to defend the entire claim, *including* matters that would not be covered by the policy if proven, *see QBE Ams., Inc. v. ACE Am. Ins. Co.*, 44 Misc. 3d 1224(A), at *4–6 (Sup. Ct. N.Y. Cty. 2014), *aff'd*, 164 A.D.3d 1136 (1st Dep't 2018), the duty to pay defense costs extends only to payment for costs of *covered matters*. JR-221. The latter duty permits the insurer to *allocate* its payments between costs for covered matters and costs for uncovered matters, as the Westchester Policy here expressly provides. *QBE Ams., Inc.*, 44 Misc. 3d 1224(A), at *4–6. In other words, the insured has no broad or general right to a defense that would encompass costs of litigating its right to a defense; rather, the insured's contractual right is limited to payment of specific costs that were incurred to defend against covered matters.

The insurer's right to allocate defense cost payments solely to *covered* matters makes all the difference in this context. There is no argument that Westchester's declaratory judgment action against the ARC Parties is itself a claim covered by the Policy. JR-216. And Westchester has no contractual obligation to pay the costs associated with defending against uncovered matters. Because Westchester instead is contractually entitled to allocate payment solely to covered matters, it need not, consistent with the general rule that a prevailing party should bear its own attorneys' fees, pay for the defense of the uncovered declaratory judgment action Westchester brought against the ARC Parties.

CONCLUSION

For the foregoing reasons, this Court should reverse the trial court's (A) grant of the ARC Parties' motion for partial summary judgment in its entirety and specifically on the issues of breach of contract, coverage, attorneys' fees, and costs of defense, and (B) declaration that, upon triggering the Westchester Policy, Westchester is obligated to pay for defense and indemnity costs incurred in the Creditor Trust Action up to that policy's limits. Further, this Court should dismiss the ARC Parties' Counterclaims against Westchester and hold that the IvI Exclusion applies to bar coverage for the Creditor Trust Action. This Court should also enter judgment holding that (A) Westchester is not liable for the ARC Parties'

attorneys' fees in the declaratory judgment action, and (B) Westchester's other coverage defenses and indemnity obligations were not ripe for adjudication.

Dated: July 8, 2019

Respectfully submitted,

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Dated: July 8, 2019

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STATEMENT PURSUANT TO CPLR 5531

New York Supreme Court

Appellate Division – First Department

WESTCHESTER FIRE INSURANCE CO.,

Plaintiff-Appellant,

– against –

NICHOLAS S. SCHORSCH, EDWARD M. WEIL, JR., WILLIAM KAHANE, PETER M. BUDKO and BRIAN S. BLOCK,

Defendants-Respondents,

RCAP HOLDINGS, LLC, STARR INDEMNITY & LIABILITY CO., AXIS INSURANCE CO. and XL SPECIALTY INSURANCE CO.,

Defendants,

– and –

ASPEN AMERICAN INSURANCE CO. and RSUI INDEMNITY CO.,

Defendants-Appellants.

1. The index number of the case in the court below is 651026/18.

2. The full names of the original parties are as above. There have been no changes.

3. The action was commenced in Supreme Court, New York County.

4. The action was commenced on or about March 2, 2018 by the filing of a Summons and Complaint. The Answers were served thereafter.

5. The nature and object of the action is as follows: insurance, declaratory judgment.

6. The appeal is from the decisions and orders of the Honorable O. Peter Sherwood, entered on April 29, 2019 (as to motion seqs. 001, 002, and 008), and May 8, 2019 (as to motion seq. 009).

7. This appeal is being perfected on a full reproduced joint record.