To Be Argued By:
Robin L. Cohen
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New York County Clerk's Index No. 651026/18

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.

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

BRIEF FOR DEFENDANTS-RESPONDENTS NICHOLAS S. SCHORSCH, EDWARD M. WEIL, JR., WILLIAM KAHANE AND PETER M. BUDKO

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Defendants Nicholas S. Schorsch, Edward M. Weil, Jr., William M. Kahane, and Peter M. Budko (the "Individuals"), respectfully submit this brief in opposition to the appeals of Westchester Fire Insurance Company ("Westchester"), RSUI Indemnity Company ("RSUI") and Aspen American Insurance Company ("Aspen"; collectively, "Appellants") from the Order of the Supreme Court of the State of New York, New York County (Hon. O. Peter Sherwood, J.S.C.) entered April 29, 2019 (the "Decision"[1]), which granted the Individuals' motion for partial summary judgment and denied, in part, Westchester's and RSUI's motion to dismiss.

COUNTERSTATEMENT OF QUESTIONS PRESENTED

1. Did the trial court properly hold that coverage was not barred for a claim brought by a creditor trust — a distinct, non-insured entity appointed by order of the bankruptcy court to seek recoveries for unsecured creditors — under an insurance exclusion applying to claims brought "on behalf of" an insured against another insured that exempts 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"?

[1] *See* JR-12-20. All citations to "JR" refer to the Joint Record.

2. Did the trial court properly hold that an insurer's coverage defenses that were based on the allegations of the underlying claims and thus warranted no additional discovery were ripe for ruling on summary judgment and, as a matter of law and undisputed fact, did not bar coverage?

3. Did the trial court properly award the Individuals attorneys' fees incurred in defending against the insurers' unsuccessful action seeking a declaration of no coverage?

NATURE OF THE CASE

Westchester, Aspen and RSUI, respectively the seventh- eighth- and ninth-layer excess insurers in a multi-layered program of directors and officers insurance policies, appeal from the ruling of the trial court that the Individuals are entitled to coverage for an underlying claim brought against them. In a vain effort to avoid those obligations, Westchester relied on an inapplicable policy exclusion, mischaracterized the nature of the claim against the Individuals, misstated New York public policy, and when all else failed, engaged in sheer speculation that there "might" be other insurance available to respond to the loss.[2]

[2] These issues were raised in the context of the Individuals' motion for summary judgment directed against Westchester, and a motion by Westchester to dismiss the Individuals' counterclaims. RSUI joined in Westchester's motion; Aspen did not, but nonetheless appeals from the denial of that motion, and the grant of the Individuals' motion for summary judgment.

Now, on appeal, Appellants again rely on mischaracterizations and misstatements of the record to support a denial of coverage. They claim that the trial court's Decision is based on an inappropriate application of the doctrine of *contra proferentem*, despite the fact that the doctrine was never mentioned in the Decision and that the Decision was based on the standard rules of insurance interpretation that both this Court and the New York Court of Appeals have long held control the interpretation of exclusionary language. They suggest that the trial court granted summary judgment on claims not yet ripe for determination, despite the fact that they sought a "dismissal" that would have amounted to a ruling on the merits. Most importantly, they argue that the trial court erred on the merits, despite the fact that as a matter of well-established law and undisputed fact, none of Appellants' defenses are sufficient to deny the Individuals the defense and settlement amounts to which they are entitled.

The Individuals are former officers and/or directors of RCS Capital Corporation ("RCAP"). They have been named as defendants in an action brought by a creditor trust on behalf of RCAP's bankruptcy estate to seek recoveries for the benefit of unsecured creditors of RCAP. Fortunately, RCAP had purchased Directors and Officers ("D&O") policies to protect its officers and directors against such claims. Among other things, those policies require the insurers to advance the costs of defending against potentially covered claims as they are incurred, and to

pay for reasonable settlements of such claims. The primary insurer, as well as the insurer in the coverage layer immediately below Westchester, recognized and fulfilled their obligation to advance the Individuals' defense costs.

Westchester, however, balked. It denied coverage, and within a matter of hours after that denial, commenced this action seeking a declaratory judgment that (1) coverage was barred by the policies' "Insured v. Insured" ("IvI") exclusion; (2) the Individuals supposedly were not sued in their capacity as RCAP directors and thus did not qualify as insureds under the policies; (3) coverage was precluded by New York public policy; and (4) the Individuals had other insurance applicable to the claims. Thereafter, RSUI filed cross-claims asserting these same defenses. When the Individuals responded with counterclaims asserting their right to coverage, Westchester, joined by RSUI, moved to dismiss those claims — essentially seeking a ruling on the merits of Westchester's and RSUI's claim that they owed no coverage obligations. Recognizing that none of the coverage defenses asserted by Westchester involved issues of material fact, and that each should be resolved as a matter of law, the Individuals sought summary judgment seeking dismissal of Westchester's complaint and an affirmative declaration regarding Westchester's coverage obligations.

In its Decision, the trial court correctly recognized that issue was joined on these coverage defenses because the motion to dismiss charted a course to

summary judgment and because the Individuals' counterclaims were intertwined with the defenses raised in Westchester's complaint. Turning to the IvI exclusion, whose applicability Westchester acknowledged could be resolved as a matter of law, the court noted that the exclusion states that it will not act to bar coverage for actions "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*." (emphasis added). Recognizing that the creditor trust is comparable to the other bankruptcy-related entities in that savings clause, the court held that the exclusion did not bar coverage for the action brought by the creditor trust. Contrary to Appellants' mischaracterizations, the Decision did not invoke or apply the doctrine of *contra proferentem* to reach that conclusion (though, because the Individuals had no role in drafting the policy language at issue, it could have properly done so). Rather, the Decision was based on longstanding rules of the New York Court of Appeals holding that an insurer seeking to invoke exclusionary language must show that the language is capable of no interpretation that would support coverage — a standard Appellants cannot meet. Indeed, although the trial court did not reach the issue, the Decision could also be supported on the basis that because the derivative action was brought by an uninsured entity (the creditor trust) on behalf of another uninsured entity (the bankruptcy estate) for the benefit of uninsured unsecured

creditors of RCAP, the IvI exclusion does not bar coverage for that action even absent the savings clause.

The remaining defenses to coverage posited by Westchester were similarly inapplicable, and properly resolved as a matter of law and undisputed fact. First, whether the Individuals are entitled to coverage because they have been sued in their capacity as RCAP directors is controlled by the allegations of the underlying complaint. That complaint seeks to hold the Individuals liable for breach of fiduciary duties that they are alleged to have owed *precisely* because of their status as RCAP directors. Second, Westchester's assertion that coverage was barred by a supposed New York public policy against insurance coverage for disgorgement or ill-gotten gains was properly rejected by the trial court based on the undisputed allegations of the complaint, which does not seek any relief from the Individuals barred by New York public policy. Finally, Appellants' suggestion that they were entitled to seek discovery to determine whether the Individuals have other insurance applicable to their losses, amounts to no more than a fishing expedition and violates the basic principal that summary judgment may not be met or defeated by speculation. In short, the Decision correctly addressed and resolved all of Appellants' stated objections to coverage, and should be affirmed in all respects.

COUNTER-STATEMENT OF FACTS

A. As Part Of A Court-Approved Bankruptcy Plan, Certain Of RCAP's Litigation Assets Are Vested In A Creditor Trust For The Benefit Of RCAP's Unsecured Creditors

Appellants do not deny that the Creditor Trust that brought the action was created by order of the bankruptcy court under Chapter 11 of the United States Bankruptcy Code. Nor do they claim that either the Trust or the bankruptcy estate itself was an insured under the policies, meaning that an action brought by or on behalf of either of those entities could not be brought "on behalf of" an insured. Instead, they attempt to characterize the Trust as essentially no more than a vehicle for RCAP to pursue claims against the Individuals, thus implicating the IvI exclusion. That characterization does not accord with the creation, nature or powers of the Trust.

The undisputed record here shows that, like many companies facing bankruptcy, RCAP recognized that a contentious and prolonged bankruptcy proceeding could result in a significant loss to RCAP's business. (JR-537-38.) Therefore, RCAP negotiated a restructuring support agreement ("RSA") with its creditors, including its largest creditor Luxor Capital Partners ("Luxor"). (*Id.*) The RSA provided for the creation of a litigation trust (the "Creditor Trust"), that would be governed by a creditor trust agreement (the "Creditor Trust Agreement"). (JR-463.) Pursuant to the Creditor Trust Agreement, rather than all of RCAP's

assets vesting in RCAP as debtor under the default provisions of Section 1141 of the bankruptcy code, certain of RCAP's assets would vest in the Creditor Trust as a representative of the bankruptcy estate, a distinct legal entity, under Section 1123(b)(3)(B) of the bankruptcy code.[3] (JR-832, § 2.3(b).) These assets would be held by the Creditor Trust "free and clear of any and all liens, claims, encumbrances, and interests…of all other persons and entities to the maximum extent contemplated by and permissible under Section 1141 of the Bankruptcy Code." (*Id.*, § 2.5(a).) In particular, RCAP would have no "rights or interest in…the Creditor Assets, Litigation Assets or the Creditor Trust." (JR-835, § 2.6.) To ensure this independence, the Creditor Trust would be administered by a trust administrator acceptable to both RCAP and Luxor, which would take direction from a Creditor Trust Board consisting of three Trustees chosen by *creditors* of RCAP. (JR-828, 851-852.)[4]

[3] Section 1141(b) of the bankruptcy code provides that "[e]xcept as otherwise provided in the plan or the order confirming the plan, the confirmation of a plan vests all of the property of the estate in the debtor." Section 1123(b)(3)(B) of the bankruptcy code provides that "a plan may…provide for…the retention and enforcement by the debtor, by the trustee, or by a representative of the estate appointed for such purpose, of any such claim or interest."

[4] In an attempt to undercut this independence, Appellants note that two "Luxor appointees were serving on the RCAP Board of Directors when the RSA was negotiated and approved" and that one of those appointees, Michael Conboy, "would go on to serve as one of the trustees of the Creditor Trust — a role he still holds." (App. Br. at 8.) What Appellants fail to allege is that either of these individuals sat on the board of RCAP when the Creditor Trust brought these claims.

The Creditor Trust was empowered "to investigate, prosecute, settle, liquidate, dispose of, and/or abandon the Creditor Trust Assets...." (JR-853.) These actions would be taken "on behalf of the Creditor Trust." (JR-852, § 5.4(b).) Indeed, the Trust was expressly "established for the purpose of liquidating and distributing the Creditor Trust Assets…with no objective to continue or engage in the conduct of a trade or business, except and to the extent reasonably necessary to, and consistent with its liquidating purpose[.]" (JR-831.) Contrary to Appellants' position that the Creditor Trust's authority was limited to those powers conveyed under Section 1123(b)(3)(B) and the "21 specific actions" the Creditor Trust was "expressly authorized and empowered" to take (App. Br. at 9), the Creditor Trust Agreement provided that the Creditor Trust, as representative of the bankruptcy estate under Section 1123 of the bankruptcy code, would be afforded "the rights and powers provided in the Bankruptcy Code in addition to any rights and powers granted in the Plan Documents," which included the Creditor Trust Agreement. (JR-828, 832) (emphasis added).

The actions of the Creditor Trust were *exclusively* for the benefit of the creditors of RCAP; no Trust assets could revert to RCAP. (JR-835.) To ensure this result, the Creditor Trust Agreement provided that "[i]n no event shall any part of the Creditor Trust Assets revert to or be distributed to or for the benefit of any Debtor or the Reorganized Debtors[.]" (*Id.*, § 2.8(a).) The Creditor Trust

Agreement further provided that if there were any remaining assets after payment to creditors, those assets "shall" be distributed to a 501(c)(3) charity. (JR-835, § 2.8(b).)

As Appellants concede, however, these agreements had no effect until May 16, 2016, when the bankruptcy court issued its confirmation order (the "Confirmation Order"), which incorporated the Creditor Trust Agreement and distinguished between different types of litigation assets. (JR-27, 713, 727, 768.) Specifically, the Confirmation Order provided, in part, that "the Creditor Trust (with respect to Litigation Assets), in accordance with Section 1123(b) of the Bankruptcy Code, shall retain and may enforce, sue on, settle, or compromise… all Claims, rights, Causes of Action, suits, and proceedings…against any Person without the approval of the Bankruptcy Court and the Reorganized Debtors[]…." (JR-775.) By contrast, if any assets could not be transferred to the Creditor Trust, only those assets would remain vested in RCAP and, only in that instance, could the Creditor Trust pursue those assets "on behalf of" RCAP. (JR-769-70, 785, 833.) The Confirmation Order further provided that based on the "totality of the circumstances," including "extensive, arm's-length negotiations," the plan was "proposed with the legitimate and honest purpose of accomplishing [a] successful reorganization[] and maximizing recoveries available to creditors." (JR-739.)

B. The Creditor Trust Brings An Action Against The Individuals For The Exclusive Benefit Of RCAP's Unsecured Creditors

On March 8, 2017, the Creditor Trust brought suit in Delaware Chancery Court against numerous defendants, including the Individuals (the "Creditor Trust Action"). (JR-225.) In support of its authority to bring the suit, the Creditor Trust Complaint cited the section of the bankruptcy court's Confirmation Order that provided the Creditor Trust authority to bring suit "in accordance with section 1123(b) of the Bankruptcy Code," *i.e.*, as a representative of the bankruptcy estate. (JR-235-236.) The Creditor Trust Complaint alleged, in sum and substance, that the Individuals caused RCAP to engage in certain actions to the detriment of RCAP to benefit themselves and AR Capital LLC ("AR Capital"), a different company they owned and controlled.

The Creditor Trust Complaint alleges three counts, only two of which specifically name the Individuals. The first count asserts that RCAP Holdings, the Individuals, and certain other named defendants breached their fiduciary duties to RCAP by causing RCAP to engage in various actions, failing to make sure that decisions were made for RCAP and its subsidiaries by disinterested individuals without conflicting loyalties, wasting RCAP's corporate assets, and perpetrating and failing to inform RCAP of an accounting fraud at a separate, independent company. (JR-295-97.) The second claim asserts that those same defendants

aided and abetted a breach of fiduciary duty to RCAP by knowingly assisting other defendants in breaches of their fiduciary duties to RCAP. (JR-298.) As against the Individuals, the Creditor Trust Complaint seeks a declaration that these defendants breached their fiduciary duties to RCAP and/or aided and abetted such breaches, and an award of damages, an accounting, interest, costs and attorneys' fees. (JR-300.)

C. The Insurance Policies

After being named as defendants in the Creditor Trust Action, the Individuals sought coverage under a D&O liability insurance program purchased by RCAP to protect its directors and officers against liabilities they could face from lawsuits like the Creditor Trust Action. (JR-994-95.) This insurance program consisted of a primary policy and numerous layers of excess policies. (JR-989-92.) Defendant RCAP Holdings and the Individuals were insureds under these policies. (JR-206, 217.) All of these policies were subject to the terms and conditions of the primary policy issued by XL Specialty Insurance Company (the "Primary Policy"). (JR-992.)

The insurance policy issued by Westchester is the seventh-layer excess policy (the "Westchester Policy") in the insurance tower, providing $5 million in coverage excess of $35 million in underlying limits and the applicable retention. (JR-992.) The policy issued by Aspen is the eighth-layer excess policy (the

"Aspen Policy"), and provides $5 million in coverage excess of $40 million in underlying limits and the applicable retention.[5] The Policy issued by RSUI is the ninth-layer excess policy (the "RSUI Policy") and provides $5 million in coverage excess of $45 million in underlying limits and the applicable retention. (JR-1306.) Appellants concede that all carriers below Westchester have exhausted their respective limits. (App. Br. at 13.)

The Primary Policy, issued for the period of April 29, 2014 through April 29, 2015, covers Loss incurred by an Insured Person resulting from a Claim for a Wrongful Act. (JR-216.) "Loss" under the Primary Policy means "damages…settlements…or other amounts (including punitive, exemplary or multiple damages, where insurable by law) and Defense Expenses…[.]" (JR-169.) Regarding defense expenses, the Primary Policy provides that:

> the Insurer will advance Defense Expenses on a current basis…before the disposition of the Claim for which this Policy provides coverage. It is agreed that if it is finally determined by a final, non-appealable adjudication that Loss, including Defense Expenses, incurred is not covered under this Policy, then the Insureds…will repay to the Insurer Loss, including Defense Expenses, paid to them or on their behalf by the Insurer.

(JR-209.)

[5] Because Aspen never joined in the motions below, the Aspen Policy is not part of the record on appeal. It is undisputed, however, that the Aspen policy adopts the terms and conditions of the Primary Policy. Otherwise, there would be no basis for Aspen to adopt the arguments in Westchester's appellate brief.

The Primary Policy defines an "Insured Person" as "any past, present, or future director or officer…of the Company" or the functional equivalent thereof. (JR-217.) It defines "Claim" to include "any civil proceeding in a court of law or equity…." (JR-216.) "Wrongful Act" is defined to mean, in part, "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 "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.) Loss under the Policy is "excess of and will not contribute with any other valid and collectible insurance…." (JR-176.)

The Primary Policy contains the IvI exclusion on which Appellants rely. That exclusion bars coverage for Loss in connection with any Claim brought against an Insured Person, "by, on behalf of, or at the direction of the Company or Insured Person." (JR-167.) However, the IvI exclusion expressly carves out from that exclusion Loss in connection with any Claim that:

> (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; . . .
>
> (viii) is brought by a creditors committee of the Company in the event such Company files for relief under Title 11 of the United States Code.

Id. (the "Bankruptcy Exception.") The Primary Policy also excludes coverage for an insured "acting in their capacity as a[n] Insured Person of any entity other than the Company…." (JR-220.)

D. Westchester's Improper Coverage Denial

A few months after the Creditor Trust Action was filed, and after the primary insurer began advancing defense costs, the Primary Policy, as well as the first through fifth-layer excess policies, were exhausted through payment of a settlement in an unrelated action captioned *Weston v. RCS Capital Corp., et al.*, No. 1:14-CV-10136-GBD (S.D.N.Y.), and a number of other class actions consolidated under the caption *In re American Realty Capital Properties, Inc. Litigation*, No. 15-mc-00040 (S.D.N.Y.). (JR-13.) Following that settlement, the sixth-layer excess insurer Scottsdale Indemnity Company, began advancing defense costs in the Creditor Trust Action.

In March 2018, as the Scottsdale policy neared exhaustion, Westchester, the next insurer above Scottsdale, asserted that coverage for the Creditor Trust Action was barred on various grounds. (JR-1636-42.) First, Westchester claimed that the Creditor Trust Action was brought on behalf of RCAP and, therefore, coverage was barred under the IvI exclusion. Second, it asserted that because the Individuals were "alleged to have acted in capacities other than their RCAP capacities, including actions taken to benefit AR Capital," the Creditor Trust

Action was not covered by Westchester's Policy. Third, it claimed that the Creditor Trust Action seeks relief that is "uninsurable" under New York law. Fourth, it alleged that the Individuals had other insurance coverage applicable to the loss.

E. Westchester And RSUI Sue The Individuals And Move To Dismiss Their Counterclaims

Mere hours after sending its coverage denial letter, Westchester brought the instant action seeking a declaratory judgment that the bases listed in its coverage denial letter barred coverage for the Creditor Trust Action. (JR-1068.) In addition to the Individuals, Westchester named the excess carriers above Westchester in the insurance tower as defendants. RSUI asserted cross-claims against the Individuals, raising the same coverage defenses as Westchester. (JR-1298.) Aspen did not assert any cross-claims.

On March 16, 2018, the Individuals filed an answer and counterclaims against Westchester. (JR-955.) The answer addressed each of Westchester's coverage defenses and the counterclaims sought declaratory relief and asserted breach of contract, and breach of the implied covenant of good faith and fair dealing based on the inapplicability of those defenses. (JR-997-99.) The Individuals also sought attorneys' fees. (JR-1000.) On August 20, 2018, the Individuals filed a similar answer and counterclaims against RSUI. (JR-1352.)

In May 2018, Westchester moved to dismiss the Counterclaims on the ground that coverage was barred by the IvI exclusion.[6] (JR-87-89.) RSUI also moved to dismiss the Counterclaims on the same ground and adopted the arguments raised in Westchester's motion. (JR-2448-2450.) The Individuals opposed the motion to dismiss on the ground that a claim brought by an uninsured creditor trust on behalf of an uninsured bankruptcy estate for the benefit of RCAP's creditors, is not brought on behalf of RCAP and, therefore, does not implicate the exclusion. Alternatively, the Individuals argued that the Creditor Trust fit squarely into the exception to the IvI exclusion for claims brought by bankruptcy-related entities. (JR-1093.) Additionally, the Individuals, recognizing that each of Westchester's and RSUI's coverage defenses could be determined as a matter of law, moved for partial summary judgment on those defenses.[7] (JR-1490-1492.)

F. The Trial Court Denies, In Part, The Motion To Dismiss, And Grants The Individuals' Motion For Partial Summary Judgement

In a Decision dated April 29, 2019, the trial court denied the motion to dismiss the Individuals' Counterclaims for breach of contract, and granted the

[6] The counterclaims against Westchester and RSUI are referred to as the "Counterclaims."

[7] The Individuals did not move for summary judgment on their bad faith claim.

Individuals' motion for partial summary judgment.[8] (JR-12-20.) The court observed that "[t]he Creditor Trust was established for the sole purposes of gathering and distributing creditor assets[,]" and that, under the bankruptcy plan, the Creditor Trust commenced litigation "for the bankruptcy estate." (JR-13.) The trial court further recognized that the "[IvI] exclusion has exceptions for a bankruptcy trustee or a similar authority, since the funds recovered will be used for the benefit of creditors, rather than the company, and are subject to supervision by the bankruptcy court or a regulatory authority." (JR-18.)

The court further noted that the undefined term "comparable authority" is ambiguous and capable of multiple meanings. Citing well-established New York insurance law, including *Federal Insurance Co. v. International Business Machines Corp.,* 18 N.Y.3d 642 (2012) and *Cragg v. Allstate Indemnity Corp.*, 17 N.Y.3d 118 (2011), the court held that the phrase "must be construed against the insurer, particularly since it is being invoked to exclude coverage." (JR-18.) Finding that Westchester and RSUI "have not shown that the exclusion prevents defense and coverage under their respective policies," the court held the exclusion did not bar coverage. (*Id*.)

[8] The trial court granted Westchester's and RSUI's motion to dismiss the Individuals' causes of action for bad faith and declaratory relief.

Recognizing that the Individuals' Counterclaims were "in substance, intertwined with plaintiff's claims," that the dispute involved a pure issue of contract interpretation, and that Westchester and RSUI "charted course for summary judgment" by directing their motion to dismiss to the Individuals' counterclaim alleging that Westchester had breached its coverage obligations, the trial court further found that issue had been joined on Appellants' remaining defenses and rejected them. (*Id.*) Accordingly, the court ordered that upon triggering the attachment points of the Westchester and RSUI policies, those insurers were required to pay the Individuals' defense and indemnity costs in the Creditor Trust Action. (JR-19.) Finally, in accordance with New York law, the court held that the Individuals were entitled to recover attorneys' fees incurred in the coverage action. (*Id.*)

APPLICABLE STANDARD OF REVIEW

A trial court's ruling on either a motion to dismiss or for summary judgment is subject to *de novo* review. *Kolchins v. Evolution Mkts., Inc.,* 31 N.Y.3d 100 (2018) (motion to dismiss); *Zuckerman v. City of New York*, 49 N.Y.2d 557, 562, (1980) (motion for summary judgment). In determining a motion to dismiss, the court must '"accept the facts as alleged in the complaint as true, accord plaintiffs the benefit of every possible favorable inference, and determine only whether the facts as alleged fit within any cognizable legal theory.'" *Goldman v. Metro. Life*

Ins. Co., 5 N.Y.3d 561, 570-71 (2005) (citation omitted). Dismissal based upon documentary evidence is permitted only where such evidence "conclusively establishes a defense to the asserted claims as a matter of law." *Id.*at 571.

In determining a motion for summary judgment, once the moving party makes a prima facie showing of the absence of any genuine factual dispute, "the burden shifts to the [opposing party] to produce evidentiary proof in admissible form sufficient to establish the existence of material issues of fact which require a trial of the action." *Alvarez v. Prospect Hosp.*, 68 N.Y.2d 320, 324 (1986). This Court is authorized to independently search the record and grant summary judgment. *City of New York v. Wausau Underwriters Ins. Co.*, 145 A.D.3d 614, 622 (1st Dep't 2016).

Questions involving the construction of insurance policy language are particularly well-suited to resolution on summary judgment, because '"[t]he construction and effect of a contract of insurance is a question of law to be determined by the court where there is no occasion to resort to extrinsic proof.'" *See, e.g.*, *Oot v. Home Ins. Co. of Ind.*, 244 A.D.2d 62, 66 (4th Dep't 1998) (citations omitted); *Shants, Inc. v. Capital One, N.A.*, 124 A.D.3d 755, 759 (2d Dep't 2015). Undefined terms in an insurance policy are to be given their plain and ordinary meaning. *Matter of Viking Pump, Inc.*, 27 N.Y.3d 244, 257-258 (2016). Insurance contracts must be interpreted "consistent with the reasonable

expectation of the average insured." *See, e.g.*, *Viking Pump*, 27 N.Y.3d at 257; *Cragg v. Allstate Indem. Corp.*, 17 N.Y.3d 118, 122 (2011).

Moreover, the "burden of proving that a claim falls within the exclusions of an insurance policy rests with the insurer." *Neuwirth v. Blue Cross & Blue Shield of Greater N.Y., Blue Cross Assn.*, 62 N.Y.2d 718, 719 (1984). Exclusionary provisions must be construed narrowly and strictly against the insurer as drafter. *Belt Painting Corp. v. TIG Ins. Co.*, 100 N.Y.2d 377, 383 (2003); *Town of Massena v. Healthcare Underwriters Mut. Ins. Co.*, 98 N.Y.2d 435, 444 (2002). '"To negate coverage by virtue of an exclusion, an insurer must establish that the exclusion is stated in clear and unmistakable language, is subject to no other reasonable interpretation, and applies in the particular case.'" *Westview Assoc. v. Guaranty Nat'l Ins. Co.*, 95 N.Y.2d 334, 340 (2000) (citations omitted); *see also American Home Assur. Co. v. Port Auth. of N.Y. & N.J.*, 66 A.D.2d 269, 276 (1st Dep't 1979) (carrier must show its interpretation "is the only construction that can fairly be placed" on exclusionary language at issue). Any ambiguity in exclusionary language must be resolved against the insurer and in favor of coverage. *See, e.g.*, *Cragg* 17 N.Y.3d at 122; *Westview Assoc.*, 95 N.Y.2d at 340. Indeed, any reasonable reading of an exclusion in favor of the policyholder controls as a matter of law. *See, e.g.*, *National Football League v. Vigilant Ins. Co.*, 36 A.D.3d 207, 212-13 (1st Dep't 2006) (insured's "plausible interpretation"

of exclusion supporting coverage "must be sustained"); *Woods v. General Acc. Ins.*, 292 A.D.2d 802, 802-03 (4th Dep't 2002).

Contrary to Appellants' implication (App Br. at 30-31), the standards for the interpretation of exclusionary language employed by the trial court *are not* equivalent to the imposition of the doctrine of *contra proferentem*. To the contrary, even in the wake of the cases cited by Appellants as rejecting the application of that doctrine for "sophisticated insureds,"[9] the Court of Appeals has reconfirmed that the standard interpretive rule that requires ambiguous exclusionary language to be narrowly construed applies, even in cases involving major corporations such as IBM. *See, Federal Ins. Co. v. International Bus. Machs. Corp.,* 18 N.Y.3d 642, 646 (2012).

Finally, under New York law, an insurer's duty to defend is "exceedingly broad." *Regal Constr. Corp. v. National Union Fire Ins. Co. of Pittsburgh, PA*, 15 N.Y.3d 34, 37 (2010). The "same allegations that trigger a duty to defend trigger an obligation to pay defense costs[,]" and "[b]oth 'an insurer's duty to defend and

[9] Appellants cite *Westchester Fire Ins. Co. v. MCI Communications Corp.,* 74 A.D.3d 551 (1st Dep't 2010) and *Cummins, Inc. v. Atlantic Mut. Ins. Co.,* 56 A.D.3d 288, 290 (1st Dep't 2008) as barring the use of *contra proferentem* in this case. (App. Br. at 30-31.) Neither case, however, involved the construction of exclusionary language or negated longstanding New York law requiring that such language be narrowly interpreted in favor of coverage. Indeed, this Court in *Westchester* held that the doctrine would not apply, not simply because the case involved a "sophisticated" insured, but because the language at issue was not ambiguous and, specifically that "*the provision is not an exclusion*." 74 A.D.3d at 551 (emphasis added); *see also Cummins*, 56 A.D.3d at 290.

to pay defense costs under liability insurance policies must be construed broadly in favor of the policyholder.'" *Federal Ins. Co. v. Kozlowski*, 18 A.D.3d 33, 40-41 (1st Dept. 2005) (citations omitted) ("The effective difference between the two defense obligations is who chooses and pays the defense attorney, not whether a defense obligation lies with the insurer."); *QBE Ams., Inc. v. ACE Am. Ins. Co.*, 164 A.D.3d 1136, 1138 (1st Dept. 2018) ("if the underlying actions allege facts that potentially fall within the scope of the coverage, defendants have the obligation to pay plaintiffs' defense costs"); *Lowy v. Travelers Prop. & Cas. Co.*, 2000 WL 526702, at *5, n.4 (S.D.N.Y. May 2, 2000) ("there is no relevant difference between the allegations that trigger an insurer's duty to defend and the allegations that trigger an insurer's obligation to pay defense expenses").[10]

An insurer has a defense obligation whenever a complaint against its insured suggests "a reasonable possibility of coverage" or "contains any facts or allegations which bring the claim even potentially within the protection purchased." *Regal*, 15 N.Y.3d at 37; *see also BP A.C. Corp. v. One Beacon Ins.*

[10] Under New York law, an insurer may be entitled to recoupment of defense costs associated with a claim only if it is ultimately determined that a particular claim is not covered. *Kozlowski*, 18 A.D.3d at 42. Prior to this determination, however, the insurer is required to cover all defense costs. *Id.* The Primary Policy tracks this framework, requiring that the insurer advance defense expenses "on a current basis . . . before the disposition of the Claim for which this Policy provides coverage" subject to repayment only "if it is finally determined by a final, non-appealable adjudication that Loss, including Defense Expenses, incurred is not covered under this Policy…." (JR-209.)

Group, 8 N.Y.3d 708, 714 (2007). An insurer must defend its insured "no matter how groundless, false or baseless the suit may be." *Zurich-American Ins. Cos. v. Atlantic Mut. Ins. Cos.*, 139 A.D.2d 379, 384-85 (1st Dep't 1988). Under both defense obligations, "[t]he ultimate validity of the underlying complaint's allegations is irrelevant….'The existence of the duty is dependent upon whether sufficient facts are stated so as to invoke coverage under the policy."' *Kozlowski*, 18 A.D.3d at 41 (citation omitted).

ARGUMENT

I. THE TRIAL COURT PROPERLY HELD THAT THE IVI EXCLUSION DOES NOT APPLY TO THE CREDITOR TRUST ACTION

Appellants' argument that the IvI exclusion bars coverage for the Creditor Trust Action suffers from three fatal flaws. First, as the trial court properly held, the Creditor Trust Action falls into the Bankruptcy Exception to the IvI exclusion for claims that are brought by entities that are "comparable" to the entities in the Exception. Second, the Bankruptcy Exception applies on the independent ground that the Creditor Trust is a liquidator — one of the entities listed in the Exception. Third, while the trial court did not reach this issue, its holding can be supported on the ground that the IvI exclusion is inapplicable because the Creditor Trust Action was not brought by or on behalf of RCAP.

A. The Trial Court Correctly Held That The Creditor Trust Was A "Comparable Authority" To The Entities In The Bankruptcy Exception To The IvI Exclusion

Appellants assert that the Creditor Trust Action does not fall into the Bankruptcy Exception to the IvI exclusion for claims asserted by a "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." (App. Br. at 12, 20.) The Creditor Trust, however, is comparable to these entities, is a "liquidator," and is an "authority of the Company."[11]

1. The Creditor Trust Is A "Comparable Authority" To The Entities In The Bankruptcy Exception

Appellants concede that the term "comparable" as used in the Bankruptcy Exception must be construed to "embrace" entities that are "similar in nature" to the entities in the Bankruptcy Exception. (App. Br. at 20.) Here, as the trial court noted, the term comparable authority is not defined in the Primary Policy, and one unifying theme underlying these entities is that they recover funds "for the benefit of creditors, rather than the company." (JR-13.) Like these entities, the Creditor

[11] Appellants' IvI argument rests extensively on evidence that is extrinsic to the insurance policies and Creditor Trust Action Complaint. This evidence may not be considered in determining Appellants' duty to pay defense costs. *Fitzpatrick v. American Honda Motor Co.*, 78 N.Y.2d 61, 66 (1991).

Trust is a distinct entity that is not beholden to RCAP, was created by order of the bankruptcy court pursuant to statutory authority, and was created to investigate, liquidate and/or dispose of assets as a representative of the bankruptcy estate and for the benefit of creditors. (JR-832, 852-853). In fact, the Creditor Trust had all the "rights and powers provided in the Bankruptcy Code *in addition to any rights and powers granted in the Plan Documents*[.]" (JR-832) (emphasis added). Thus, the Creditor Trust's authority was co-extensive with the powers of any of the other entities listed in the Bankruptcy Exception, and is, under any reasonable interpretation, a "comparable authority" to those entities.[12]

Appellants' strenuous efforts to selectively and narrowly define the entities in the Exception in such a way as to exclude the Creditor Trust do not withstand scrutiny. For example, the Creditor Trust is a "liquidating trust" (JR-698, 822) created by order of the bankruptcy court pursuant to Chapter 11 of the bankruptcy code, for the purpose of managing, investigating and liquidating company assets as a representative of the bankruptcy estate and for the exclusive benefit of creditors (JR-831, § 2.2(a).) This definition is consistent with the undefined term

[12] This broad grant of authority is typical of bankruptcy plans, which can provide creditor trusts "with the same or similar abilities possessed by insolvency trustees, receivers, examiners, conservators, liquidators, rehabilitators or similar officials." *See*, *e.g.*, *In re Advance Watch Co. Ltd.*, 2016 WL 323367, at *10 (Bankr. S.D.N.Y. Jan. 25, 2016).

"liquidator" in the Bankruptcy Exception.[13] Further, the bankruptcy code equates a bankruptcy trustee with a representative of a bankruptcy estate like the Creditor Trust. *Compare* 11 U.S.C. 1123(b)(3)(B) (providing for the "retention and enforcement…by the trustee, or by a representative of the estate appointed for such purpose, of any such claim…" *with* 11 U.S.C. 323(a) (providing that a "trustee in a case under [title 11] is the representative of the estate.").[14] Indeed, "[a] Chapter 11 trustee has been described as 'an independent third party whose role is to represent the estate for the benefit of the various parties in interest,'" a description which applies to the Creditor Trust. *Pupo v. Chadwick's of Boston, Inc.*, 2004 WL 2480399, at *4 (S.D.N.Y. Nov. 4, 2004). And the purpose of an examiner is to investigate "any allegations of fraud, dishonesty, incompetence, misconduct,

[13] Appellants admit that "[d]epending on the jurisdiction and the company's business, the entities charged with winding down an enterprise can go by different names." (App. Br. at 24, n. 7.) Appellants specifically cite *In re Bernard L. Madoff Inv. Sec., LLC*, 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), in which a "SIPA" trustee, which Appellants admit would fit into the Bankruptcy Exception as a "comparable authority of the Company," was charged with liquidating a particular subset of assets. This function is comparable to the role played by the Creditor Trust.

[14] Appellants argue that the term "comparable authority" only refers to a "Receiver, Conservator, Rehabilitator, or Liquidator" because the word "or" before the term Examiner is "disjunctive," thereby setting apart the term "Bankruptcy Trustee or Examiner" from the rest of the entities in the Exception. (App. Br. at 21-22.) This argument would make sense only if the word "or" appeared after the word "Examiner" and before the word "any" in the Exception. Moreover, Appellants fault the trial court for purportedly failing to construe the phrase "comparable authority of the Company" in its "context." (App. Br. at 32.) That context, however, necessarily involves the terms "Bankruptcy Trustee" and "Examiner." In any case, the Creditor Trust is also comparable to the other entities in the Bankruptcy Exception.

mismanagement, or irregularity in the management of the affairs of the debtor of or by current or former management of the debtor." *Kovalesky v. Carpenter*, 1997 WL 630144, at *3 (S.D.N.Y. Oct. 9, 1997). This role is "comparable" to the Creditor Trust, which was authorized to bring claims relating to the "management of the debtor…by…former management" and was charged with "investigat[ing]. . . Creditor Trust Assets." (JR-853, § 5.4(b)(viii).)

Moreover, Chapter 11 of the bankruptcy code defines a "custodian" as including a receiver, trustee, "assignee under a general assignment for the benefit of the debtor's creditors," and an agent "under applicable law, or under a contract, that is appointed or authorized to take charge of property of the debtor…for the purpose of general administration of such property for the benefit of the debtor's creditors." *See* 11 U.S.C. § 101(11)(A),(B),(C). Thus, the bankruptcy code considers an assignee or agent acting for the benefit of creditors as comparable to a "receiver" or trustee. Accordingly, and particularly in light of the narrow construction afforded to exclusionary clauses in insurance contracts, and the broad interpretation afforded to exceptions to those exclusions, the trial court properly found that the term "comparable authority" extends to the Creditor Trust. *See Nat'l Football League*, 36 A.D.3d at 212-213 (insured entitled to coverage where it provided "plausible interpretation of. . . [an] exclusion that would result in a determination of coverage"); *Matter of Mostow v. State Farm Ins. Cos.*, 88 N.Y.2d

321, 326 (1996); *Haber v. St. Paul Guardian Ins. Co.*, 137 F.3d 691, 695 (2d Cir. 1998); *Boro Park Land Co., LLC v. Princeton Excess Surplus Lines Ins. Co.*, 140 A.D.3d 909, 911 (finding that IvI exclusion did not bar coverage where policy was ambiguous as to whether an individual was an insured); *Nocella v. Fort Dearborn Life Ins. Co. of New York*, 99 A.D.3d 872, 876 (2d Dep't 2012) ("exceptions to exclusions are generally construed broadly to find coverage"); *Borg-Warner Corp. v. Insurance Co. of N. Am.*, 174 A.D.2d 24, 33 (3d Dep't 1992) (same); *Ment Bros. Iron Works Co., Inc. v. Interstate Fire & Cas. Co.*, 702 F.3d 118, 124 (2d Cir. 2012).

To avoid this conclusion, Appellants argue that the Creditor Trust does not possess the "shared, defining characteristics of the listed" entities. (App. Br. at 24.) Specifically, Appellants argue that the Creditor Trust did not "supersede RCAP's management," did not have authority over "the debtor's entire business," was not appointed during the pendency of the bankruptcy proceeding, and is not "disinterested" "in the debtor or its estate." (App. Br. at 24-25.) These varied, diverse entities, however, cannot be limited to the narrow, self-serving, and inaccurate characteristics cited by Appellants.

For example, Appellants describe an "Examiner" as an independent officer that assists the bankruptcy court and "*may*" be granted authority to oversee "*some*" of the company's operations. (App. Br. at 23-24) (emphasis added). Appellants

also cite authorities for the proposition that a liquidator is, variously, a "person appointed to wind up a business's affairs," an "entity" appointed under statute, an entity whose "function" is to "run" a company, and an entity with "wide-ranging authority over the debtor's assets…" (App. Br. at 22-23.) Further, a receiver is often appointed pre-bankruptcy, does not necessarily have management control over a debtor's "entire business," and does not "supersede" a debtor's management of a company. *See e.g.*, 1 Collier Bankruptcy Practice Guide P 14.11 (2019) (comparing a receiver that is empowered to "administer only a portion of a debtor's assets" with a receiver empowered to administer all of a debtor's assets); *id.* (noting that a custodian is defined to include a "nonbankruptcy court receiver or trustee authorized by law, or by contractual agreement, to take charge of the debtor's property for the benefit of the debtor's creditors"); *id*. at P 14.20 (noting that a "Custodian," which includes a receiver, can be "ousted by the filing of the involuntary case from administering the nonbankruptcy liquidation"). Moreover, a trustee's power over estate property and the debtor is subject to court approval in many instances under the bankruptcy code. *See* 11 U.S.C §§ 363(b)(1), 364(b), and 365(a). Similarly, a trustee's powers to investigate a debtor are subject to a court's contrary or limiting order. *See* 11 U.S.C. § 1106(a)(3). Moreover, under Section 721 of the bankruptcy code, a Chapter 7 trustee may not operate a business of the debtor without authorization by the court. Thus, contrary to Appellants'

assertion, these entities do not all wield authority over the "debtor's entire business," are not all created during the pendency of a bankruptcy proceeding, and do not necessarily "supersede" the management of the company.

Moreover, although Appellants assert that all of these entities are "disinterested" in the "debtor or its estate" and "adverse" to the debtor (App. Br. at 25), they only cite two cases pertaining to trustees. Appellants cite no authority for the proposition that *all* of the entities listed in the Bankruptcy Exception are required to be adverse to a debtor or disinterested in the estate or its creditors. In fact, counsel for Westchester conceded at oral argument that even a trustee is only adverse to the company "in many times." (JR-29-30.) Further, the very purpose of a liquidator is to liquidate assets for the benefit of creditors. Similarly, in carrying out its fiduciary obligations to creditors, "a trustee is to be an active agent for the prosecution of the interests of all creditors of the estate." *In re Consupak, Inc.*, 87 B.R. 529, 539 (Bankr. N.D. Ill. 1988). There is also an exception to the IvI exclusion for a claim brought by a creditors committee — an entity that owes fiduciary duties only to creditors, not the debtor. *Pan Am Corp. v. Delta Air Lines, Inc.*, 175 B.R. 438, 514 (S.D.N.Y. 1994). These characteristics apply equally to

the Creditor Trust, which also has fiduciary duties to creditors that are beneficiaries of the Trust. (JR-697.)[15]

Given that Appellants cannot establish that the phrase "comparable authority of the Company" is inapplicable to the Creditor Trust, Appellants instead attack the trial court's initial conclusion that the phrase is ambiguous. In particular, they mischaracterize the Decision as holding that the term "comparable authority" is ambiguous *solely* because it is not defined under the policies, and claim that in so holding, the Court "abdicated its threshold duty to construe the phrase…in its context." (App. Br. at 32.) In reality, however, the court noted that the phrase is undefined and, in a separate sentence, that it is ambiguous. (JR-18.) Moreover, in reaching its conclusion, the court expressly considered the unifying theme behind the exceptions to the IvI exclusion for a bankruptcy trustee or "similar authority" and accurately noted that in the context of these entities, "the funds recovered will be used for the benefit of creditors, rather than the company[.]" (*Id*.) In so doing, the court applied the standards set forth by the New York Court of Appeals in *Federal Insurance Co. v. International Business Machines Corp.*, 18 N.Y.3d 642, 646 (2012), requiring that a court reviewing an insurance policy "must decide

[15] Appellants also erroneously note that the Creditor Trust was not appointed or created by the bankruptcy court. (App. Br. at 26.) This argument ignores that the Creditor Trust is a creation of the Confirmation Order under the authority of the bankruptcy code. Counsel for Westchester conceded this fact at oral argument. (JR-27.)

whether…there is a 'reasonable basis for a difference of opinion' as to the meaning of the policy" and, if so "the language at issue would be deemed to be ambiguous and thus interpreted in favor of the insured." (citations omitted).

2. Appellants' Interpretation Of The Undefined Term "Authority Of The Company" Is Inconsistent With The Plain Terms Of The Bankruptcy Exception

Appellants' argument that the Creditor Trust is not an "authority of the Company" (App. Br. at 27) is equally inconsistent with the nature of the entities in the Exception and would severely limit coverage in a way that no reasonable insured could have anticipated. Moreover, in arguing that an "authority *of* the Company" must exercise "power and control" *over* the company, Appellants improperly ask this Court to rewrite the policies.

As noted, certain of the entities listed in the Bankruptcy Exception do not necessarily possess authority either *of* or *over* a company. For example, a receiver can take possession of a particular asset of a company and a liquidator can be charged with liquidating a particular asset, without either of these entities having any power or control over the "Company." Similarly, the scope of authority of a bankruptcy trustee is subject to various limitations set forth in the bankruptcy code. Further, a creditors committee, one of the entities identified in another exception to the IvI exclusion, is characterized as being "of the Company," despite owing no fiduciary duties to the debtor and not having "administrative power and control"

(App. Br. at 27) over a Company (*see* 11 U.S.C. § 1103). Thus, read in the context of the exceptions to the exclusion, the undefined term "authority of the Company" encompasses instances where the entities enumerated in the exception — and entities that are similar in nature to those entities — exercise independent authority over a company's assets and/or exercise authority that originated with a company.[16] Here, that is exactly what the Creditor Trust was authorized to do, exercise authority over RCAP assets that vested in the Creditor Trust for the benefit of creditors under the Confirmation Order. This result is particularly warranted because the term "authority of the Company" is undefined in the policy, and exceptions to exclusionary clauses must be broadly construed in favor of coverage.[17]

Moreover, Appellants' argument that the Creditor Trust is not an authority *of* RCAP is inconsistent with their argument for why the IvI exclusion is implicated in the first place — that the Creditor Trust brought claims "on behalf" of RCAP because the Creditor Trust was not "independent…to RCAP," and simply stepped

[16] On its face, the meaning of the word "of" as used in the Bankruptcy Exception is "a function word to indicate origin or derivation." OF, Meriam Webster Dictionary, https://www.merriam-webster.com/dictionary/of.

[17] Appellants' argue that RCAP itself avoided the appointment of a bankruptcy trustee or examiner in order to avoid the appointment of an authority over RCAP. (App. Br. at 27.) This argument ignores that the Bankruptcy Exception is not limited to bankruptcy trustees and examiners.

into RCAP's shoes to bring these claims as a mere assignee "with RCAP's full blessing and cooperation." (App. Br. at 3, 25.) Indeed, by arguing that the Creditor Trust derived its authority from RCAP and was so intertwined with RCAP that it brought claims on its behalf despite being a distinct legal entity, Appellants effectively concede that the Creditor Trust is an "authority *of* the Company," thereby implicating the Exception to the exclusion.

3. The Trial Court's Conclusion Is Consistent With The Purpose Of The IvI Exclusion

Appellants' argument that the purpose of the IvI exclusion confirms their interpretation of the Bankruptcy Exception (App. Br. at 28) is both flawed and ironic given that one of the primary cases on which they rely for the purported "aims" of the IvI exclusion found that a standard of review whereby the purpose of the exclusion could inform an insurer's coverage obligations is a "mushy, messy standard that would be hell for an insurance company to apply." *Level 3 Commc'ns, Inc. v. Fed. Ins. Co.*, 168 F.3d 956, 959 (7th Cir. 1999). In any case, the purpose of the IvI exclusion is to protect an insurance company against "collusive suits between the insured corporation and its insured officers and directors." *In Re Buckeye Countrymark*, Inc., 251 B.R. 835, 840-841 (S.D.Ohio 2000); *Am. Cas. Co. v. F.D.I.C.*, 791 F. Supp. 276, 278 (W.D. Okla. 1992), *aff'd sub nom. Am. Cas. Co. of Reading, Pa. v. F.D.I.C.*, 33 F.3d 62 (10th Cir. 1994)

("The obvious intent behind the 'insured vs. insured' exclusion is to protect the insurer from collusive suits among a bank and its directors and officers"); *Fid. & Deposit Co. of Maryland v. Zandstra*, 756 F. Supp. 429, 431 (N.D. Cal. 1990) (same); *Alstrin v. St. Paul Mercury Ins. Co.*, 179 F. Supp. 2d 376, 404 (D. Del. 2002). Here, Appellants do not even allege that there is collusion between RCAP and the Individuals, nor could they given the highly adversarial nature of the Creditor Trust Action.[18]

Appellants attempt to expand the purpose of the IvI exclusion to include instances in which the debtor assigns claims to a creditor trust on the ground that this circumstance presents "a distinct possibility of collusion" because the debtor has an incentive to use the claims to obtain concessions from its creditors. (App. Br. at 28, citing *In re R.J. Reynolds*, 315 B.R. 674, 681 (Bankr. W.D. Va. 2003) (*Terry*)). As noted, however, despite agreeing that the applicability of the IvI exclusion was ripe for resolution on summary judgment, Appellants glaringly failed to allege, let alone provide any evidence of, collusion in this case between RCAP and the Individuals.

[18] The Creditor Trust Action is so adversarial that the Creditor Trust has filed for equitable subordination under the bankruptcy code to ensure that no proceeds obtained in the Creditor Trust Action inure to the benefit of the Individuals. That is the antithesis of collusion. (JR-1116, n. 18; JR-1159-1182.)

Moreover, the Creditor Trust is not a mere contractual assignee. *In re Palmaz Sci., Inc.*, 2018 WL 3343597, at *12 (Bankr. W.D. Tex. June 4, 2018) (noting that a litigation trust is not a "mere assignee"). Rather, as the trial court recognized, it was a creation of an order of a bankruptcy court. (JR-27.) Thus, the court's conclusion regarding the applicability of the Bankruptcy Exception is consistent with the stated scope and purpose of the IvI exclusion.

4. The Bankruptcy Exception Applies On The Independent Ground That The Creditor Trust Is A Liquidator Of Estate Assets

Although the trial court correctly concluded the Creditor Trust was comparable to entities listed in the Bankruptcy Exception, it could also have reached the conclusion that the Bankruptcy Exception was applicable solely on the independent ground that the Creditor Trust is a liquidator.

The Creditor Trust is a "liquidating trust" (JR-523, 698, 822) appointed by order of the bankruptcy court pursuant to Chapter 11 of the bankruptcy code, for the express purpose of liquidating assets as a representative of the bankruptcy estate and for the benefit of creditors (JR-831, § 2.2(a)). Such trusts are common and both the trusts themselves and the trustees of such trusts are referred to as "liquidators." *See, e.g.*, *In re Oversight & Control Comm'n of Avanzit, S.A.*, 385 B.R. 525, 535–36 (Bankr. S.D.N.Y. 2008) (noting that "Chapter 11 plans, particularly liquidation plans, often create liquidation trusts to pursue causes of

action for the benefit of the unsecured creditors"); *NHB Advisors, Inc. v. Monroe Capital LLC*, 2013 WL 6906234, at *1 (Del. Ch. Dec. 27, 2013) (referring to the trustee of a liquidating trust as the "liquidator" of the trust); *In re: Residential Capital, LLC*, No. 12-12020 (MG), 2013 WL 12161584, at *96 (Bankr. S.D.N.Y. Dec. 11, 2013) (confirming Chapter 11 plan that referred to trustees of a liquidating trust appointed pursuant to Section 1123(b)(3)(B) of the bankruptcy code as the "liquidating trustees").[19]

Given the ubiquity of liquidating trusts in the bankruptcy context, and the fact that such trusts, as well as their trustees, are referred to as "liquidators," it is reasonable to construe the undefined term "Liquidator" in the Bankruptcy Exception as encompassing the Creditor Trust. *Nocella*, 99 A.D.3d at 876 (noting that "exceptions to exclusions are generally construed broadly to find coverage"); *Borg-Warner Corp.*, 174 A.D.2d at 33 (same). Indeed, the average insured would consider a trust authorized by order of a bankruptcy court to liquidate assets to be a liquidator. *Cragg*, 17 N.Y.3d at 122 ("Insurance contracts must be interpreted according to common speech and consistent with the reasonable expectations of

[19] In fact, the very first case Appellants rely on in support of their erroneous argument that the Creditor Trust Action was brought on behalf of RCAP (App. Br. at 17) — *Indian Harbor Ins. Co. v. Zucker*, 860 F.3d 373, 375 (6th Cir. 2017) — involved a claim brought by a liquidating trust. The insurance policy in that case, however, did not include an exception to the IvI exclusion for claims brought by a liquidator. Thus, the court had no occasion to assess the issue here — whether a claim brought by a liquidating trust would fall into an exception to the IvI exclusion.

the average insured"); *Dryden Mut. Ins. Co. v. Goessl*, 117 A.D.3d 1512, 1514 (4th Dep't 2014), *aff'd*, 27 N.Y.3d 1050 (2016) (same).

To avoid this conclusion, Appellants assert that the Creditor Trust is not comparable to a liquidator because a liquidator is "an independent and statutorily-appointed entity that has actual power and control of the company, used to wind down the company's business." (App. Br. at 22.) Appellants rely on two cases and Black's law dictionary for this proposition. (*Id*.) Both of these cases, however, involve a particular *type* of liquidator — a liquidator of an insolvent insurance company under the authority of the insurance code. Moreover, the Black's law dictionary definition that Appellants rely on is at odds with the more common definition of a liquidator: "an individual appointed by law to liquidate assets." Liquidator, Meriam Webster Dictionary, https://www.merriamwebster.com/dictionary/liquidator. Here, the Creditor Trust and its trustee were appointed by the bankruptcy court under statutory authority for the express purpose of "liquidating and distributing the Creditor Trust Assets." (JR-831, § 2.2(a).) If Appellants wanted to severely narrow the type of liquidator that would implicate the Bankruptcy Exception, they should have done so expressly in their policies, not by hindsight interpretation. Thus, the trial court's decision should be affirmed on this alternative ground as well.

B. The Decision Should Also Be Affirmed On The Alternate Ground That The Creditor Trust Action Was Not Brought By Or On Behalf Of An Insured

Contrary to Appellants' mischaracterization (App. Br. at 17), the trial court neither held nor "assumed" that, absent the Bankruptcy Exception, the IvI exclusion would bar coverage. Rather, the Decision never addressed that issue, moving directly to the language of the Exception. In fact, as a matter of law and undisputed fact, the court's ruling could also have been supported on the basis that the exclusion did not apply because the Creditor Trust Action was not brought by or on behalf of an insured. *Matter of Stephen & Mark 53 Assoc. LLC v. New York City Dept. of Envtl. Protection*, 168 A.D.3d 440, 440 (1st Dep't 2019) (affirming based "on an alternative basis argued to but not reached by the motion court").

Contrary to Westchester's assertion that the case law is "nearly-uniform" in holding that actions by creditor trusts are subject to IvI exclusions (*id.*), numerous courts, including the most recent court to address this issue, have concluded that a claim brought on behalf of a bankruptcy estate and/or on behalf of creditors, is not brought on behalf of the company or the debtor. *See In re Palmaz Scientific, Inc.*, 2018 WL 3343597, at *4-12 (Bankr. W.D. Tex. June 4, 2018).[20] This result is

[20] *See also In re Buckeye, 251 B.R. at 840-41* (Bankr. S.D. Ohio 2000) (claim brought by trustee as representative of bankruptcy estate is brought on behalf of creditors, not debtor, and therefore not subject to Exclusion); *Alstrin v. St. Paul Mercury Ins. Co.*, 179 F. Supp. 2d 376, 404 (D. Del. 2002) (finding that IvI exclusion did not "apply to claims brought by a bankruptcy Estate Representative against the former directors and officers of the Debtor . . . because the Debtor's

particularly warranted because the term "on behalf of" is not defined in the Primary Policy, and exclusionary clauses must be interpreted narrowly and in favor of coverage. *Am. Home Assur. Co.* 66 A.D.2d at 276; *Beazley Ins. Co., Inc. v. Ace Am. Ins. Co.,* 150 F. Supp. 3d 345, 351 (S.D.N.Y. 2015); *Westview*, 95 N.Y.2d at 340; *Cragg*, 17 N.Y.3d at 122.[21]

In an attempt to force the Creditor Trust Action into the exclusion, Appellants make several flawed arguments. First, their suggestion that their interpretation of the IvI exclusion is "[c]onsistent with nearly-uniform decisions of other courts" (App. Br. at 17), aside from ignoring a substantial body of case law, is based on cases whose facts differ in critical ways from those presented here. For example, *Indian Harbor Insurance Company v. Zucker*, 860 F.3d 373 (6th Cir.

Estate Representative . . . and the Debtor . . . are separate entities."); *In re C.M. Meiers Co., Inc.,* 2016 WL 9458553, at *10 (Bankr. C.D. Cal. Dec. 20, 2016) ("the bankruptcy trustee did not assert the claims 'by, on the behalf of, or in the right of the Insured Entity' but has instituted the claims on behalf of the estate and for the benefit of its creditors"); *Fed. Ins. Co. v. Cont'l Cas. Co.,* 2006 WL 3386625, at *16-20 (W.D. Pa. Nov. 22, 2006) (finding that the term "on behalf of" in an IvI exclusion was ambiguous, and that a litigation trust that brought claims for the benefit of creditors did not trigger the IvI exclusion).

[21] Appellants could have drafted a provision to address this contingency by identifying a bankruptcy estate as an Insured or precluding coverage for claims brought by an *assignee* of an Insured. *See e.g.*, *In re Fort Worth Osteopathic Hosp., Inc.,* 387 B.R. 706, 710 (Bankr. N.D. Tex. 2008) (addressing IvI Exclusion which provided: "no coverage will be available under this Policy for any Claim brought by or on behalf of . . . *the bankruptcy estate or the Insured Entity in the capacity as Debtor in Possession*") (emphasis added); *Scalia v. Equitable Life Assur. Soc. of U.S.*, 263 A.D.2d 537, 537 (2d Dep't 1999) (ruling in favor of insured where insurer "could have easily removed the ambiguity in this case by adding a few simple words to the policy.").

2017), involved a stipulation that (1) the CEO had no liability for any conduct after the filing of a bankruptcy petition, (2) the CEO's pre-petition liability would be capped at the amount recovered from the Company's insurer, and (3) the CEO was *required* to sue its insurer in the event the CEO was denied insurance coverage. *Id.* at 375. In short, an officer of the company colluded with the trust to reduce his own liability at the expense of the insurer.[22]

In *Biltmore Associates, LLC v. Twin City Fire Insurance Company*, 572 F.3d 663 (9th Cir. 2009), a lawsuit was found to have been "instigated and continued" by the company itself because the company filed a complaint in the underlying case, and then assigned its claims to the creditors' trust…." *Id.* at 670. Similarly, in *Niemuller v. National Union Fire Insurance Co.*, 1993 WL 546678, at *5 (S.D.N.Y. Dec. 29, 1993), nearly *one year after* a company commenced litigation against a former director, it assigned its claim against the director to third parties. Here, the Creditor Trust Action was not brought by RCAP and then assigned mid-litigation to the Creditor Trust. To the contrary, the Creditor Trust brought the Creditor Trust Action in its own right, as a representative of the bankruptcy estate and for the sole benefit of RCAP's creditors.[23] (JR-831-32, 835.) Neither the

[22] *Indian Harbor*, which contained a powerful dissent, was readily distinguished in the recent *Palmaz* case. *See Palmaz*, 2018 WL 3343597, at *8-10.

[23] Under Chapter 11 of the bankruptcy code, the commencement of a case under §§ 301, 302 or 303 creates the bankruptcy estate, which is comprised of all of the interests of the debtor in

bankruptcy estate, nor the creditors on whose behalf the Creditor Trust Action was brought are insureds, rendering the IvI exclusion inapplicable.

Appellants also rely on *In re R.J. Reynolds*, 315 B.R. 674, 679 (Bankr. W.D. Va. 2003), in which the court found that an IvI exclusion applied to claims brought by a litigation trustee because the trust had obtained these litigation rights by voluntary assignment. However, an assignment of litigation rights in the context of a Chapter 11 bankruptcy — such as the assignment here — is not an ordinary "contractual assignment," but rather, "a vesting of assets from one entity to another entity to otherwise accomplish the effect of § 1141(b), which automatically vests all property of the estate in the debtor unless the plan or order confirming the plan provides otherwise." *Palmaz*, 2018 WL 3343597, at *6.

Even if these cases stood for the proposition for which Appellants' cite them, it would only mean that there is a range of opinion regarding whether a claim brought on behalf of a bankruptcy estate for the benefit of creditors constitutes a claim brought "on behalf" of a company or debtor. Appellants, however, must do more than present one potential interpretation of the exclusion that would bar coverage; they must show that it is the *only* reasonable

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possession as of the commencement of the case. 11 U.S.C. § 541. A representative of the bankruptcy estate, such as the creditor trust, may be appointed under Section 1123 of the bankruptcy code. The debtor in possession is a separate entity, possessing certain of the powers and duties of a trustee. 11 U.S.C. § 1107.

interpretation — a high burden they simply cannot meet. Indeed, at most, this range of opinion simply establishes that the term "on behalf of" is ambiguous and must be interpreted in favor of coverage. *Lefrak Org., Inc. v. Chubb Custom Ins. Co.*, 942 F. Supp. 949, 957 (S.D.N.Y. 1996) (finding exclusionary language ambiguous based, in part, on the "range and variety of judicial opinions" on interpretation of that language and granting partial summary judgment in favor of insured); *Little v. MGIC Indem. Corp*., 836 F.2d 789, 796 (3d Cir. 1987) ("[T]hat different courts have arrived at conflicting interpretations of" language in an insurance policy "is strongly indicative of the policy's essential ambiguity."); *Textron, Inc. v. Aetna Cas. & Sur. Co.*, 754 A.2d 742, 748-49 (R.I. 2000) ("'diversity of judicial thought [as to the meaning of terms in an insurance contract] is proof positive' of ambiguity.") (citation omitted).

Finally, Appellants argue that the Creditor Trust itself stated once in a single pleading that it brought the Creditor Trust Action on behalf of RCAP (App. Br. at 10, 19). The Creditor Trust, however, made this single remark in an opposition to a motion to dismiss. (JR-316.) Reference to this extrinsic evidence cannot defeat Appellants' duty to advance defense costs, which is determined *solely* with respect to allegations in the underlying complaint. Here, the underlying complaint does not contain any allegation purporting to bring the action on behalf of RCAP.

In any case, the statement, in context, clearly is no more than a short-hand colloquialism that Appellants have sought to turn into a term of art. Indeed, in making this remark, the Creditor Trust cited to paragraph 14 of its Complaint which, relying on the Confirmation Order, alleged that the Trust "had been assigned certain claims and causes of action held by the Debtors or their estates." (JR-235, 316.) Thus, it is clear that this isolated, colloquial use of "on behalf of" was simply shorthand for describing the complex history of how these claims came to be in the possession of the Creditor Trust. Here, where the term "on behalf of" is susceptible to numerous, reasonable interpretations that would result in coverage, the exclusion must be construed in accordance with those interpretations. *National Football League*, 36 A.D.3d at 212 (insured entitled to coverage where it provided "plausible interpretation of. . . [an] exclusion that would result in…coverage").

II. THE TRIAL COURT PROPERLY GRANTED SUMMARY JUDGMENT WITH RESPECT TO APPELLANTS' REMAINING COVERAGE DEFENSES

In addition to the IvI exclusion, Appellants asserted three additional coverage defenses: (1) the Individuals were not acting in an insured capacity; (2) the Individuals had "other insurance"; and (3) the Creditor Trust Action sought uninsurable Loss. These defenses were ripe for adjudication, required no additional discovery, and were properly rejected by the trial court.

A. The Trial Court Correctly Concluded That The Remaining Coverage Defenses Could Be Adjudicated

1. Issue Was Joined On Appellants' Coverage Defenses

Appellants' argument that issue was not joined on their remaining defenses (App. Br. at 15-16, 34, 41) omits critical facts and mischaracterizes the trial court's opinion.[24] The court did not simply find that issue was joined because Appellants had charted a course for summary judgment. Rather, the primary basis of the court's ruling was that the Counterclaims were "intertwined with plaintiff's claims" and that the dispute involved a matter of "contract interpretation." (JR-17-18.) These findings were consistent with the record and applicable law.

Among the relief the Individuals sought in their summary judgment motion was dismissal of "Westchester's Complaint with prejudice." (JR-1525.) That complaint asserted four causes of action, each seeking a declaration that one of the four defenses to coverage Westchester asserted barred coverage for the Creditor Trust Action. Issue thus was joined on those claims for relief by means of the Individuals' Answer. Further, the Counterclaims directly targeted the coverage defenses in Westchester's complaint, and asserted that they were invalid. Thus, the notion that issue was not joined on these defenses is both factually inaccurate and

[24] Appellants concede that issue was joined on the applicability of the IvI exclusion (App. Br. at 41.)

the height of sophistry. It speaks volumes that Appellants cannot cite a single case where a court found that issue had not been joined on coverage defenses that appeared in a complaint where the complaint was answered and where the counterclaims sought resolution of those very defenses.

2. Appellants' Indemnity Obligations Were Ripe For Review

Although Appellants argue to this Court that their indemnity obligations are not ripe for adjudication because the Creditor Trust Action has not been resolved (App. Br. at 34-35), they have failed to preserve that argument with respect to their "capacity" or "other insurance" defenses. In the court below, Appellants argued only that their disgorgement defense would not be ripe for resolution until the conclusion of the Creditor Trust Action. Accordingly, they may not argue for the first time on appeal that their capacity and other insurance defenses are also not ripe for review. *See Aguirre v. City of New York*, 214 A.D.2d 692, 694 (2d Dep't 1995).[25]

In any case, an "action against insurers, including excess carriers, is permitted prior to judgment where the…'potential liability' might well reach into the coverage contracted for." *Cabrini Med. Ctr. v. KM Ins. Brokers*, 142 A.D.2d

[25] The defense costs incurred by the Individuals are sufficient to completely exhaust Westchester's and Aspen's layers of coverage. Thus, their argument that resolution of their indemnity obligation is premature is moot.

529, 530 (1st Dep't 1988); *Mt. McKinley Ins. Co. v. Corning Inc.*, 33 A.D.3d 51, 57 (1st Dept. 2006); *Stoncor Grp., Inc. v. Peerless Ins. Co.*, 322 F. Supp. 3d 505, 511 (S.D.N.Y. 2018). Here, Appellants' face significant potential liability in the Creditor Trust Action which would reach Appellants' layers of coverage.[26]

Appellants' contrary authority is readily distinguishable. In *American Empire Surplus Lines Insurance Company v. EM & EM Chimney & Masonry Repair, Inc.*, 2017 WL 4118390, at *6 (E.D.N.Y. Aug. 30, 2017), *report and recommendation adopted*, 2017 WL 4119266 (E.D.N.Y. Sept. 15, 2017), the court found that the coverage dispute was not ripe because no underlying action had yet been filed. Similarly, *FSP, Incorporated v. Societe Generale*, 2003 WL 124515, at *4 (S.D.N.Y. Jan. 14, 2003) (history omitted), involved a dispute over "future, anticipated claims." In contrast, the Individuals' claims here arise from an active, pending attempt to hold them liable for damages.

B. The Individuals Were Entitled To Summary Judgment On The Merits Of The Remaining Defenses

In order to defeat the Individuals' motion for partial summary judgment based on a need for additional discovery, Appellants were required to "demonstrate that further discovery might lead to relevant evidence or that facts essential to

[26] If anything, if a full resolution of the Creditor Trust Action were required to resolve the issues underlying the Individuals' claim for breach, that would only mean that the court erred in dismissing the Individuals' declaratory judgment claim.

justify opposition to the motion were exclusively within the knowledge and control of" the Individuals. *One Reason Rd., LLC v. Seneca Ins. Co., Inc.*, 163 A.D.3d 974, 977 (2d Dep't 2018). Appellants failed to satisfy this burden. Regarding their defense obligations, Appellants' erroneous argument that more discovery is needed to determine the applicability of these defenses is an admission that Appellants have not yet concluded that these defenses bar coverage. Until such a determination is made, Appellants must advance all defense costs.[27] *Kozlowski*, 18 A.D.3d at 42; JR-209. Further, regarding both defense costs and indemnity, for the reasons stated below, no discovery is needed to resolve these meritless defenses.

1. The Creditor Trust Action Targets The Individuals In An Insured Capacity

Appellants' argument that there is a dispute of fact as to whether the Creditor Trust Action targets the Individuals in an insured capacity is undermined by the allegations of the Creditor Trust Complaint. That complaint alleges that the Individuals breached fiduciary duties to RCAP as directors and/or officers of RCAP by causing RCAP to take certain actions that were allegedly to its

[27] Appellants' argument that the Individuals do not "need immediate advancement" is both unsupported by the record and irrelevant. (App. Br. at 14.) This is not an appeal from a motion granting a preliminary injunction. Rather, because Appellants' policies require that they advance defense costs, the Individuals are entitled to summary judgment requiring Appellants to fulfill that obligation.

detriment. (JR-296-97.) Thus, there is no issue of fact regarding whether the Individuals are alleged to have engaged in a "Wrongful Act" while "acting in [their] capacity[ies] as" Insured Persons of RCAP. (JR-218.) Further, the Claim was not made against the Individuals for any actions they took as "Insured Persons" of any other entity.

Appellants seek to avoid this conclusion by arguing that the Individuals may have been acting in a non-insured capacity because they are alleged to have exploited RCAP "to benefit AR Capital and enrich themselves." (App. Br. at 36-37.) The Individuals' alleged motives and whether their actions resulted in a benefit to AR Capital, however, is irrelevant to the capacity in which they are alleged to have acted in breaching their fiduciary duties. Indeed, courts have declined to apply capacity exclusions so broadly. In *Zayed v. Arch Insurance Co.*, 932 F. Supp. 2d 956, 970-71 (D. Minn. 2013), for example, the court found that a dual capacity exclusion did not bar coverage because it would be "senseless" to hold that an insured breached duties to a corporation by undertaking acts on behalf of an entirely different entity.

Appellants also argue that the Individuals may have acted in their personal capacities as controlling shareholders of RCAP. However, the Creditor Trust Complaint accuses the Individuals of breaching fiduciary duties to RCAP "as officers, directors, and controlling shareholders" of RCAP by causing RCAP to

engage or not engage in certain actions to its detriment. (JR-296-97.) Thus, to the extent, as Appellants speculate, additional discovery could show that the Individuals may have caused RCAP to engage in certain conduct in their capacities as controlling shareholders, they would necessarily have been acting in a "functionally equivalent role" to directors and officers and, therefore, would still be acting in an insured capacity. (JR-217.) Notably, Appellants fail to cite a single case that supports the proposition that a "capacity" exclusion bars coverage for a person who is alleged to have breached duties to a company by causing the company to engage in conduct as both a director *and* controlling shareholder of that company. Indeed, given that controlling shareholders often serve as directors, and that both directors and controlling shareholders owe fiduciary duties to a company, Appellants' counterintuitive and unsupported interpretation of the exclusion would eviscerate a large swath of D&O coverage.

It is no surprise, therefore, that Appellants' cases are inapposite. Appellants cite *National Union Fire Insurance Company of Pittsburgh, Pa. v. Jordache Enterprises, Inc.*, 235 A.D.2d 333 (1st Dep't 1997), which includes no factual recitation regarding the nature of the underlying allegations. Related decisions, however, reveal that *Jordache* was a case about piercing the corporate veil and comingling assets, and the complaint and a stipulation of settlement in that case targeted the insureds in a personal capacity. *Nat'l Union Fire Ins. Co. of*

Pittsburgh, Pa. v. Jordache Enterps., 205 A.D.2d 341, 341 (1st Dep't 1994). When the insurer denied coverage on this ground, counsel for the insured altered the stipulation of settlement to reflect that it was targeting the insureds in their capacities as directors and officers. *Id*. The trial court determined that there was no coverage because "in piercing the corporate veil it is clear that [the insureds] were acting in their own personal capacities" and that the "corporate entity was a sham." *Jordache Enterprises, Inc. v. Nat'l Union Fire Ins. Co. of Pittsburgh, Pa.*, 204 W. Va. 465, 470 (W. Va 1998). No such facts or allegations are implicated here, let alone the gamesmanship of counsel in *Jordache*.

Further, in *Jacobson Family Investments, Inc. v. National Union Fire Insurance Company of Pittsburgh, PA*, 129 A.D.3d 556, 559 (1st Dep't 2015), there was "overwhelming evidence" that the insured had engaged in wrongful conduct in a non-covered capacity. And, in *Law Offices of Zachary R. Greenhill, P.C. v. Liberty Insurance Underwriters, Inc.*, 147 A.D.3d 418, 419 (1st Dep't 2017), the court held that a professional liability policy did not apply because the attorney who sought coverage was acting as a CEO of a company in a non-covered capacity. None of these cases bear any resemblance to the facts here, as set forth and alleged in the controlling allegations of the Creditor Trust Complaint. Accordingly, as a matter of law and undisputed fact, the Individuals established that they were sued in an insured capacity.

2. The Trial Court Correctly Found That There Is No New York Public Policy That Would Bar Coverage For The Action

Westchester and RSUI sought a declaration that there was "no indemnity coverage...to the extent the Creditor Trust Action seeks disgorgement, a constructive trust, and/or the return of alleged ill-gotten gains that are uninsurable under New York law." (JR-1066, 1090, 1325.) In opposition to the Individuals' motion for partial summary judgment, however, Westchester narrowed this defense to a circumstance in which the Individuals are "*held liable* for disgorgement of ill-gotten gains or constructive trust." (JR-1485) (emphasis added.) Similarly, on appeal, Appellants limit this defense to a circumstance where the "remedy" ordered in the Creditor Trust Action is uninsurable. (App. Br. at 38.) Thus, Appellants concede that coverage for a settlement of the Creditor Trust Action would not constitute uninsurable Loss.[28]

This concession is consistent with New York public policy, which permits overriding the freedom to contract in only two narrow instances: (1) where coverage is sought for punitive damage awards; and (2) where it has been established that the insured "acted with the intent to harm or injure others." *J.P. Morgan Sec. Inc. v. Vigilant Ins. Co.*, 21 N.Y.3d 324, 335 (2013). This principle

[28] Appellants also concede that this defense would not apply to coverage for defense costs (JR-1486.)

was reaffirmed by this Court in *J.P. Morgan Securities Inc. v. Vigilant Insurance Company*, 126 A.D.3d 76, 87 (1st Dep't 2015), which based its decision on the prior finding by the Court of Appeals that "one of the two situations in which the contractual language of a policy may be overwritten is where an insured engages in conduct 'with the intent to cause injury.'" Based on this formulation, the Court distinguished between coverage for the settlement in *Vigilant Insurance Co. v. Credit Suisse First Boston Corp.*, 2003 WL 24009803 (Sup. Ct. NY Cty. 2003), which was barred by public policy because it involved an admission by the insured to a recitation of findings linking the payment of disgorgement to intentional wrongdoing, and coverage for the settlement in *National Union Fire Insurance Co. of Pittsburgh, Pa. v. Xerox Corp.*, 6 Misc 3d 763 (Sup. Ct. N.Y. Cty. 2004), which did not include this admission and, therefore, was not barred by public policy. *J.P. Morgan*, 126 A.D.3d at 88.

Here, the Creditor Trust Action does not allege that the Individuals intended to harm anyone and does not seek punitive damages. Thus, there is no public policy basis for barring coverage for the Creditor Trust Action, let alone a settlement of that action. Indeed, Appellants fail to cite a single case where coverage was barred based on public policy for a civil litigation which did not allege an intent to injure, much less for a settlement of that action with no admission of liability. Instead, Appellants rely on two cases where SEC orders,

and the insureds' admission to the findings of fact in those orders, established that the insureds had committed wrongdoing. (App. Br. 38-39.) Thus, the trial court properly found that Appellants' indemnity obligations were ripe for review and that no public policy bars coverage here.

3. The Trial Court Properly Rejected Appellants' Speculative "Other Insurance" Argument

Appellants' argument that they were entitled to discovery on whether the Individuals are covered by other insurance rests on pure conjecture and, thus, as a matter of well-established New York law, is insufficient to defeat summary judgment. *Fook Cheung Lung Realty Corp. v. Yang Tze River Realty Corp.*, 94 A.D.3d 560, 561 (1st Dep't 2012) (insurers request for discovery to oppose motion "reflected an ineffectual mere hope"); *Essex Ins. Co. v. Michael Cunningham Carpentry*, 74 A.D.3d 733, 734 (2d Dep't 2010) ("The hope and speculation that evidence sufficient to defeat the motion might be uncovered during discovery was an insufficient basis to deny the motion"); *Guerrero v. Milla*, 135 A.D.3d 635, 636 (1st Dep't 2016) (same). Indeed, if an insurer could evade coverage by means of such speculation, the "other insurance" clauses routinely contained in insurance policies would be an automatic "get-out-of coverage-free-card" allowing an insurer to demand onerous discovery before making any payment — including the advancement of defense costs clearly required by the policy language. Tellingly,

Appellants fail to cite a single case where a court ordered discovery to permit an insurer to engage in a fishing expedition to locate "other" insurance policies, or where a court found that an insurer was not required to cover a claim based on the insurer's mere conclusory assertion that there might be other insurance available to the insured.[29]

Moreover, the parties most incentivized to access other potential insurance policies are the Individuals. Yet, insurance coverage counsel for the Individuals affirmed that the Individuals have not submitted invoices from this action to any other insurance program, and that there is no other insurance available. (JR-1528.) Appellants may not delay their obligation to contemporaneously advance defense costs and to cover the cost of a potential settlement based on rank speculation.

III. THE TRIAL COURT PROPERLY AWARDED THE INDIVIDUALS' ATTORNEYS' FEES

Under well-established New York law, policyholders forced to successfully defend themselves against insurer actions seeking a declaration of no coverage are entitled to recover the fees incurred in connection with that defense. *U.S. Underwriters Ins. Co. v. City Club Hotel, LLC*, 3 N.Y.3d 592, 597 (2004); *Am. Home Assur. Co. v. Port Auth. of N.Y. & N.J.*, 123 A.D.3d 633, at *1 (1st Dep't

[29] The only cases Appellants cite are a 1991 decision of the Seventh Circuit merely stating the general proposition that overlapping insurance coverage is common, and a 1995 Missouri case in which the court ordered an *insurer* to produce its own policies to an insured. (App. Br. at 40.)

2014). Thus, the trial court's award of attorneys' fees to the Individuals was in full accord with this well-established principle.

Appellants' only retort is to attempt to limit this rule to policies that include a duty to defend, rather than a duty to pay defense costs. (App. Br. at 43.) Courts, however, have applied this rule to insurance policies that include a duty to pay defense costs. *See e.g.*, *Admiral Ins. Co. v. Weitz & Luxenberg*, *P.C.*, 2002 WL 31409450, at *5 (S.D.N.Y. Oct. 24, 2002). Further, Appellants cite no authority for the proposition that this rule does not extend to a coverage dispute over advancement of attorneys' fees.

Moreover, the duty to pay defense costs and the duty to defend are co-extensive under New York law, and the policy only permits allocation of defense costs between covered and uncovered claims if there is a "determin[ation] by a final, non-appealable adjudication that Loss, including Defense Expenses, incurred is not covered under this Policy." (JR-209.) Indeed, under basic rules of contract and insurance policy construction, that specific provision for the treatment of defense expenses controls over any provision more generally providing for an allocation of "Loss." *Cronos Group Ltd. v. XComIP, LLC,* 156 A.D.3d 54, 61 (1st Dep't 2017). Thus, Appellants' reliance on notions of allocation to defeat their obligation to pay attorneys' fees is erroneous, and the trial court's award of fees should be affirmed.

CONCLUSION

For all of the foregoing reasons, the Decision should be affirmed in its entirety.

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Respectfully submitted,

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