SUPREME COURT OF THE STATE OF NEW YORK — New York COUNTY
PRESENT: O. PETER SHERWOOD PART 49
Justice

WESTCHESTER FIRE INSURANCE CO.,

Plaintiff,

-against-

NICHOLAS S. SCHORSCH, *et al.*,

Defendants,

INDEX NO. 651026/2018
MOTION DATE _____
MOT. SEQ. NO. 001
MOT. CAL. NO. _____

The following papers, numbered 1 to _____ were read on this motion to dismiss.

	PAPERS NUMBERED
Notice of Motion/ Order to Show Cause — Affidavits — Exhibits ...	
Answering Affidavits — Exhibits	
Replying Affidavits	

Cross-Motion: ☐ Yes ☐ No

Upon the foregoing papers, it is ordered that this motion to dismiss is decided in accordance with the accompanying decision and order.

MOTION/CASE IS RESPECTFULLY REFERRED TO JUSTICE FOR THE FOLLOWING REASON(S):

Dated: April 25, 2019

O. PETER SHERWOOD, *J.S.C.*

Check one: ☐ FINAL DISPOSITION ☑ NON-FINAL DISPOSITION
Check if appropriate: ☐ DO NOT POST ☐ REFERENCE
☐ SUBMIT ORDER/ JUDG. ☐ SETTLE ORDER/ JUDG.

SUPREME COURT OF THE STATE OF NEW YORK
COUNTY OF NEW YORK: COMMERCIAL DIVISION PART 49

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WESTCHESTER FIRE INSURANCE CO.,

Plaintiff,

-against-

NICHOLAS S. SCHORSCH, EDWARD M. WEIL, JR., WILLIAM KAHANE, PETER M. BUDOKO, BRIAN S. BLOCK, RCAP HOLDINGS, LLC, ASPEN AMERICAN INSURANCE CO., RSUI INDEMNITY CO., STARR INDEMNITY & LIABILITY CO., AXIS INSURANCE CO., AND XL SPECIALTY INSURANCE CO.,

Defendants.

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DECISION AND ORDER
Index No.: 651026/2018

Mot. Seq. Nos.: 001, 002 and 008

O. PETER SHERWOOD, J.:

Plaintiff moves, pursuant to CPLR 3211 (a) (1) and(7), to dismiss the counterclaims of Nicholas S. Schorsch, Edward M. Weil, Jr., William Kahane, Peter M. Budko (the Individual Defendants) and Brian S. Block (Block) (Motion Sequence Number 001). The Individual Defendants have moved, pursuant to CPLR 3212, for partial summary judgment (Motion Sequence Number 002). RSUI Indemnity Co. (RSUI) has moved, pursuant to CPLR 3211 (a) (1) and (7), to dismiss the counterclaims filed by the Individual Defendants and Block and RCAP Holdings, LLC (RCAP) (Motion Sequence Number 008). The motions are consolidated for disposition and decided as noted below.

Underlying Allegations

Plaintiff issued an excess liability directors and officers policy, policy number G27447594001, (the Policy) for the period April 29, 2014 through April 29, 2015 to RCAP. The Policy was the seventh level of a tower of policies over the primary policy issued by XL Specialty Insurance Company, policy number ELU13410214 (the Primary Policy). The Policy provides $5 million in coverage, excess of $35 million in coverage in the Primary Policy and other levels of excess coverage, subject to applicable retention limits. The Primary Policy covers RCAP, as well as the Individual Defendants and Block, since they were officers and directors of RCAP.

The Policy is subject to the terms, conditions and definitions of the Primary Policy, that is, it is a follow form policy.

On March 31, 2016, RCAP filed for chapter 11 bankruptcy in the United States Bankruptcy Court in Delaware, pursuant to a Restructuring Support Agreement (the Restructuring Agreement), which provided for a creditor trust (the Creditor Trust). The Creditor Trust was established for the sole purposes of gathering and distributing creditor assets and RCAP transferred its creditor assets to the Creditor Trust under the supervision of a three-member board. On May 19, 2016, the Bankruptcy Court issued a final confirmation order (the Bankruptcy Court Order), approving the bankruptcy plan, which included provisions allowing the Creditor Trust to commence and resolve litigation to obtain assets for the bankruptcy estate.

On March 8, 2017, the Creditor Trust commenced an action in Delaware Chancery Court (the Delaware Action) against various parties including the Individual Defendants, Block, RCAP and other entities, entitled *RCS Creditor Trust v Nicholas S. Schorsch et. al*, case number 2017-0178, alleging breach of fiduciary duty to RCAP for the benefit of a different company, AR Capital LLC (AR Capital), in which the individual defendants and Block had ownership interests. Plaintiff was notified of this potential claim.

A settlement of an action entitled *Weston v RCS Capital* in the United States District Court for the Southern District of New York (the Weston Action) has exhausted $31 million in coverage under the Primary Policy and the first five levels of excess coverage and plaintiff has asserted that exhaustion of the coverage under it is "imminent" (complaint, § 84). On March 2, 2018, plaintiff issued its denial letter (the Denial Letter). The Denial Letter denied coverage based upon an exclusion for insured versus insureds claims, that the Individual Defendants and Block were not being sued due to RCAP status, alleged uninsurability of the claims, alleged other coverage and the wrongful conduct of Block. On November 9, 2017, Block was found guilty of securities fraud, conspiracy to commit securities fraud, filing false statements in Securities and Exchange Commission (SEC) filings and false certification of filings with the SEC. Everest National Insurance Company (Everest) has agreed to drop down coverage. Aspen American Insurance

Company (Aspen), Starr Indemnity and Liability Company (Starr) and RSUI are also excess insurers and they have each issued reservation of rights letters to deny coverage in the Delaware Action.

Plaintiff contends the insured versus insured exclusion precludes coverage, since it prevents a company from recovering business losses caused by its own officers and directors. It asserts the Creditor Trust is not protected by the exceptions from this exclusion for a bankruptcy trustee or examiner, receiver, conservator, liquidator "or other comparable authority." It states that RCAP assigned its claims to the Creditor Trust, that this entity is not substantively independent and disinterested in the same way that a bankruptcy trustee or similar entity is and, consequently, it is not a comparable authority. Plaintiff further claims coverage is unavailable for intentionally dishonest, fraudulent or criminal activity, based upon New York public policy.

RSUI's excess policy, policy number NHS657034, (the RSUI Policy) is also a follow form policy and RSUI's motion adopts the same arguments made in plaintiff's motion (Fitzpatrick affidavit, ¶¶ 1, 3-4).

The Individual Defendants assert that the Delaware Action was brought against them for purported breaches of their duty to RCAP as officers and directors and that the primary and lower level excess insurers all agreed to defense and coverage. They also contend that by failing to read the Primary Policy's exclusion narrowly, plaintiff has breached its obligations to defend them and provide coverage of the Delaware Action. They state that the phrase "comparable authority" is ambiguous and that, construing the exclusion in the proper narrow manner, the Creditor Trust was the substantive equivalent of a creditor committee, since under the Restructuring Agreement, the Creditor Trust was established to obtain funds for RCAP's creditors. The Individual Defendants also state that the public policy exception is narrow and does not apply to them. They therefore claim that plaintiff and RSUI's motions against them should be denied, their motion for summary judgment should be granted, and the court should issue an appropriate declaration that, upon triggering and attachment of the Policy, plaintiff is obligated to defend them in the Delaware Action, to pay defense costs incurred in that action, to provide coverage up to the limits of plaintiff's Policy, and to pay the costs of defending this action.

Procedural Issues

Generally, the court may not consider a request for summary judgment prior to the joinder of issue unless the defendants "'unequivocally' chart[ed] a course for summary judgement" (*Primedia Inc., v SBI USA LLC*, 43 AD3d 685, 686 [1st Dept 2007], *quoting Four Seasons Hotels v Vinnik*, 127 AD2d 310, 320 [1st Dept 1987]; *see also Island Intellectual Property LLC v Reich & Tan Deposit Solutions, LLC*, 155 AD3d 542, 542 [1st Dept 2017]). As plaintiff agreed at oral argument, the insured versus insured exclusion which is the subject of the counterclaim (and also the subject of plaintiff's motion to dismiss), raises a pure issue of law not requiring fact discovery. By its motion plaintiff has unequivocally charted course for summary judgment as to the first counterclaim.

Dismissal Standard

In determining a motion to dismiss pursuant to CPLR 3211, "the court must accept the facts as alleged in the complaint as true, accord [them] the benefit of every possible favorable inference, and determine . . . whether the facts as alleged fit within any cognizable legal theory" (*Goldman v Metropolitan Life Ins. Co.*, 5 NY3d 561, 570-571 [2005] [internal quotation marks and citation omitted]; *Goshen v Mutual Life Ins. Co. of N.Y.*, 98 NY2d 314, 326 [2002]). Dismissal based upon documentary evidence is appropriate only where the "documentary evidence submitted conclusively establishes a defense to the asserted claims as a matter of law" (*Leon v Martinez*, 84 NY2d 83, 88 [1994]). However, allegations that are bare legal conclusions or are inherently incredible or that are flatly contradicted by the documentary evidence are not accorded such favorable inferences and need not be accepted as true (*Biondi v Beekman Hill House Apt. Corp.*, 257 AD2d 76, 81 [1st Dept 1999], *affd* 94 NY2d 659 [2000]). Also, "[w]hether a plaintiff can ultimately establish its allegations is not part of the calculus in determining a motion to dismiss" (*EBC I, Inc. v Goldman, Sachs & Co.*, 5 NY3d 11, 19 [2005]).

Summary Judgment Standard

A party seeking summary judgment must make a prima facie case showing that it is entitled to judgment as a matter of law by proffering sufficient evidence to demonstrate the absence of any material issue of fact (*Alvarez v Prospect Hosp.*, 68 NY2d 320, 324 [1986]). If the movant fails to make this showing, the motion must be denied (*id.*). Once the movant meets its burden, then

the opposing party must produce evidentiary proof in admissible form sufficient to raise a triable issue of material fact (*Zuckerman v City of New York*, 49 NY2d 557, 562 [1980]).

In deciding the motion, the court must draw all reasonable inferences in favor of the nonmoving party and deny summary judgment if there is any doubt as to the existence of a material issue of fact (*Vega v Restani Constr. Corp.*, 18 NY3d 499, 503 [2012]; *Branham v Loews Orpheum Cinemas, Inc.*, 8 NY3d 931, 932 [2007]). "Where different conclusions can reasonably be drawn from the evidence, the motion should be denied" (*Sommer v Federal Signal Corp.*, 79 NY2d 540, 555 [1992]). "[I]ssues as to witness credibility are not appropriately resolved on a motion for summary judgment" (*Santos v Temco Serv. Indus.*, 295 AD2d 218, 218-219 [1st Dept 2002]; *see also Santana v 3410 Kingsbridge LLC*, 110 AD3d 435, 435 [1st Dept 2013]).

Contract Interpretation

An insurance policy is a contract and, where provisions of a policy are "clear and unambiguous", they should be "given their plain and ordinary meaning" (*United States Fid. & Guar. Co. v Annunziata*, 67 NY2d 229, 232 [1986]; *see also Matter of Viking Pump, Inc.*, 27 NY3d 244, 257 [2016]). Additionally, ambiguity in an insurance policy will be construed in favor of the insured, particularly when the ambiguity is in an exclusionary clause (*Cragg v Allstate Indem. Corp.*, 17 NY3d 118, 122 [2011]). Generally, the insurer has the burden of showing that coverage does not exist or that an exclusion applies (*County of Columbia v Continental Ins. Co.*, 83 NY2d 618, 627 [1994]; *Seaboard Sur. Co. v Gillette Co.*, 64 NY2d 304, 311 [1984]). However, while ambiguities are construed against the insurer, the court should not disregard the plain meaning of the policy to create an ambiguity, since this improperly rewrites the parties' agreement (*United States Fid.*, 67 NY2d at 232; *Gilbane Bldg. Co./TDX Constr. Corp. v St. Paul Fire & Mar. Ins. Co.*, 31 NY3d 131, 135 [2018]; *Catucci v Greenwich Ins. Co.*, 37 AD3d 513, 514 [2d Dept 2007]).

"[T]he party claiming insurance coverage bears the burden of proving entitlement [to coverage], and ... a party that is not named an insured or an additional insured on the face of the policy is not entitled to coverage" (*Tribeca Broadway Assoc. v Mount Vernon Fire Ins. Co.*, 5 AD3d 198, 200 [1st Dept 2004]). Also, "absent unambiguous contractual language to the

contrary, an additional insured 'enjoy[s] the same protection as the named insured'" (*BP A.C. Corp. v One Beacon Ins. Group*, 33 AD3d 116, 126 [1st Dept 2006] [internal citation omitted], *mod* 8 NY3d 708 [2007]; *see also Kassis v Ohio Cas. Ins. Co.*, 12 NY3d 595, 599-600 [2009]).

The duty to defend is "'exceedingly broad' ... [and it applies] whenever the four corners of the complaint suggest--or the insurer has actual knowledge of facts establishing--a reasonable possibility of coverage" (*Continental Cas. Co. v Rapid-American Corp.*, 80 NY2d 640, 648 [1993][internal citation omitted]; *see also Regal Constr. Corp. v National Union Fire Ins. Co. of Pittsburgh, PA*, 15 NY3d 34, 37 [2010]; *Fitzpatrick v American Honda Motor Co.*, 78 NY2d 61, 66 [1991]). If an insurer "establishes as a matter of law that there is no possible factual or legal basis upon which it might ultimately be obligated to indemnify under any policy provision, the insurer is relieved of [its] duty [to defend]" (*Great N. Ins. Co. v Kobrand Corp.*, 40 AD3d 462, 463 [1st Dept 2007], *lv dismissed* 10 NY3d 781 [2008]).

Attorneys' Fees in a Declaratory Judgment Action

"[A]n insured who is 'cast in a defensive posture by the legal steps an insurer takes in an effort to free itself from its policy obligations,' and who prevails on the merits, may recover attorneys' fees incurred in defending against the insurer's action" (*U.S. Underwriters Ins. Co. v City Club Hotel, LLC*, 3 NY3d 592, 597 [2004] quoting *Mighty Midgets, Inc. v Centennial* Ins. Co., 47 NY2d 12, 21 [1979]). This is so because the "insurer's duty to defend an insured extends to the defense of any action arising out the occurrence, including a defense against an insurer's declaratory judgment action" (*U.S. Underwriters*, 3 NY3d at 597-598; *see also Chase Manhattan Bank v Each Individual Underwriter Bound to Lloyd's Policy No. 790/004A89005*, 258 AD2d 1, 4-5 [1st Dept 1999]).

A "follow form" policy is a policy that conforms to the endorsements of the underlying policy (*see Federal Ins. Co. v International Bus. Machs. Corp.*, 18 NY3d 642, 646 [2012]; *Jefferson Ins. Co of N.Y. v Travelers Indem. Co.*, 92 NY2d 363, 369 [1998]).

Discussion

Plaintiff has asserted that the Individual Defendants' motion should be denied, since plaintiff has not joined issue with the Individual Defendants' counterclaims. However, these counterclaims contend that plaintiff breached its obligation under the Policy, breached its duty of

good faith, and makes an application for a declaration of the parties' rights. These counterclaims are, in substance, intertwined with plaintiff's claims. Moreover, the dispute involves the interpretation of the parties' obligations under the Policy and the Primary Policy and, consequently, are matters of contract interpretation. Finally, the parties have charted a course for summary judgment as plaintiff's motion to dismiss is aimed at defendants' first counterclaim (*see Primedia*, 43 AD3d at 686).

The Individual Defendants state that the lower level insurers on the Primary Policy and the other excess insurers have agreed to defense and coverage of the Delaware Action. However, the actions of other parties lack any relevance to plaintiff and RSUI's obligations under their respective policies.

The Denial Letter and plaintiff's and RSUI's claims are based upon the insured versus insured exclusion. This exclusion is intended to prevent a company from recovering business losses that it was in a position to avoid by more carefully supervising its own officers and directors. The 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. Plaintiff has asserted that the Creditor Trust is not a bankruptcy trustee, examiner, receiver, liquidator or a creditor committee. However, the Primary Policy uses the phrase "comparable authority" which phrase is not defined. The phrase is ambiguous and therefore must be construed against the insurer, particularly since it is being invoked to exclude coverage (*see Federal Ins.*, 18 NY3d at 646; *Cragg*, 17 NY3d at 122). Plaintiff and RSUI have not shown that the exclusion prevents defense and coverage under their respective policies.

The branch of the motions that seeks to dismiss the Individual Defendants first counterclaim for breach of contract shall be denied.[1] The public policy exception does not bar coverage for the Individual Defendants. The contention that there is other coverage and no need

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[1] In motion sequence number 009, Block too moves for partial summary judgment (NYSCEF Doc. No. 208) and adopts the arguments of the Individual Defendants in motion sequence number 002). At oral argument his counsel adopted their arguments (see also NYSCEF Doc. No. 176, adopting Individual Defendants' arguments in opposition to motion sequence number 001). Accordingly, this Decision and Order also decides motion sequence 009.

for the claim to reach plaintiff's coverage is belied by plaintiff's allegation in its complaint that exhaustion of the other coverage is imminent.

The second counterclaim for breach of the covenant of good faith and fair dealing must be dismissed as it does not allege conduct that is separate and distinct from that on which the breach of contract claim is based (see N.Y.U. v Contl Ins. Co., 87 NY 2d 308, 316 [1995]). The third counterclaim for a declaratory judgment shall be dismissed as duplicative of the breach of contract claim and in the court's discretion.

Because the insured versus insured exclusion does not apply, the Individual Defendants and Block are entitled to their attorneys' fees in defending themselves in this declaratory action (*see U.S. Underwriters*, 5 NY3d at 597-598). The court having rejected plaintiff's claim that the insured versus insured exclusion applies, the Individual Defendants' mirror image counterclaim for breach of contract must be granted.

It is, therefore,

ORDERED that plaintiff's motion to dismiss (motion sequence number 001) is granted to the extent that the second and third counterclaims are hereby dismissed and is otherwise denied; and it is further

ORDERED that RSUI Indemnity Company's motion to dismiss (motion sequence number 008) is granted to the extent that the second and third counterclaims are hereby dismissed and is otherwise denied; and it is further

ORDERED that the motions of Nicholas S. Schorsch, Edward M. Weil, Jr., William Cohen and Peter Budko (motion sequence number 002) and of Brian S. Block (motion sequence number 009) for partial summary judgment are granted to the extent of granting summary judgment as to the first counterclaims alleging breach of contract regarding defense, coverage, attorneys' fees and costs of defense; and it is further

ADJUDGED and DECLARED that upon triggering the attachments of Westchester policy, policy number G27447594001, and RSUI policy, policy number NHS657034, Westchester Fire Insurance Company and RSUI Indemnity Company respectively are obligated to pay for all defense and indemnity costs incurred in the pending action in Delaware Chancery Court entitled *RCS Creditor Trust v Nicholas S. Schorsch et. al*, case number 2017-0178, up to the limits of said policies, and it is further

ORDERED that upon service of a copy of this order with notice of entry on the Office of the Special Referee, 60 Centre Street, Room 119, the clerk shall place the matter on the calendar for assignment to a referee to hear and report with recommendations the amount of expenses incurred in defending this action including reasonable attorneys' fees.

This constitutes the decision and order of the court.

DATED: **April 25, 2019**

E N T E R,

O. PETER SHERWOOD J.S.C.