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NO. 68478-7

IN THE COURT OF APPEALS OF THE STATE OF WASHINGTON
DIVISION I

QUELLOS GROUP LLC, *Appellant/Cross-Respondent*,

v.

FEDERAL INSURANCE COMPANY and INDIAN HARBOR
INSURANCE COMPANY, *Respondents/Cross-Appellants*

BRIEF OF APPELLANT/CROSS-RESPONDENT

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TABLE OF CONTENTS

	Page
INTRODUCTION	1
ASSIGNMENTS OF ERROR	2
ISSUES PERTAINING TO ASSIGNMENTS OF ERROR	4
STATEMENT OF THE CASE.....	5
I. QUELLOS' 2000-05 INVESTMENT MANAGEMENT INSURANCE POLICIES	6
II. QUELLOS' COVERAGE DISPUTE WITH ITS EXCESS CARRIERS REGARDING THE POINT CLAIMS	8
III. THE SUMMARY JUDGMENT PROCEEDINGS	10
A. The Parties' Summary Judgment Motions.....	10
B. The Trial Court's Summary Judgment Ruling.....	10
STANDARD OF REVIEW	14
SUMMARY OF ARGUMENT	14
ARGUMENT.....	16
I. THE TRIAL COURT ERRED IN RULING THAT QUELLOS' SETTLEMENT WITH ITS PRIMARY CARRIER ELIMINATED THE EXCESS CARRIERS' COVERAGE OBLIGATIONS.....	16
A. The Attachment Point Provisions At Issue Are Conditions to Coverage.....	16
B. The Excess Carriers Waived Any Right To Demand Compliance With The Attachment Point Conditions.....	22

C.	The Excess Carriers Failed to Meet Their Burden of Proving that Quellos' Claimed Breach Was Material.....	25
D.	The Excess Carriers Failed to Meet Their Burden of Proving that Quellos' Claimed Breach Was Substantially Prejudicial.	27
1.	The Trial Court Erred in Ruling that Such Proof Was Not Required	27
2.	The Trial Court Erred in Alternatively Ruling that the Excess Carriers Established Substantial Prejudice.....	30
II.	THE TRIAL COURT ERRED IN ACCEPTING THE EXCESS CARRIERS' LITERAL INTERPRETATION BECAUSE IT PRODUCES ABSURD RESULTS.....	36
A.	This Literal Interpretation Impermissibly Nullifies Excess Coverage.....	36
B.	The Excess Carriers' Literal Interpretation Also Contravenes Paramount Principles Favoring Settlement.....	41
III.	THE TRIAL COURT ERRED IN RULING THAT THE ATTACHMENT POINT CONDITIONS WERE NEGOTIATED.....	48
IV.	REQUEST FOR ATTORNEYS' FEES AND EXPENSES.....	49
	CONCLUSION.....	50

TABLE OF AUTHORITIES

Cases

<i>Allstate Ins. Co. v. Riverside Ins. of Am.</i> , 509 F. Supp. 43 (E.D. Mich. 1981).....	34, 47
<i>Am. Safety Ins. Co. v. City of Olympia</i> , 162 Wn.2d 762, 174 P.3d 54 (2007).....	41
<i>Am. Star Ins. Co. v. Grice</i> , 121 Wn.2d 869, 854 P.2d 622 (1993).....	21
<i>B & L Trucking & Constr. Co.</i> , 134 Wn.2d 413, 951 P.2d 250 (1998).....	20
<i>Bailie Comm., Ltd. v. Trend Bus. Sys.</i> , 53 Wn. App. 77, 765 P.2d 339 (1988).....	26
<i>Boeing Co. v. Aetna Casualty and Surety Co.</i> , 113 Wn.2d 869, 784 P.2d 507 (1990).....	48
<i>Canron, Inc., v. Fed. Ins. Co.</i> , 82 Wn. App. 480, 918 P.2d 937 (1996).....	27, 31
<i>City of Seattle v. Blume</i> , 134 Wn.2d 243, 947 P.2d 223 (1997).....	41
<i>Colorado Structures, Inc. v. Ins. Co. of the West</i> , 161 Wn.2d 577, 167 P.3d 1125 (2007).....	25
<i>Comerica, Inc. v. Zurich Am. Ins. Co.</i> , 498 F. Supp. 2d 1019 (E.D. Mich. 2007).....	21
<i>D & S Realty, Inc. v. Markel Ins. Co.</i> , 789 N.W.2d 1 (Neb. 2010).....	20
<i>Devese v. Transguard Ins. Co.</i> , 798 N.W.2d 614 (Neb. 2011).....	20
<i>Drake v. Ryan</i> , 514 N.W.2d 785 (Minn. 1994).....	33

<i>Dunlap v. State Farm & Cas. Co.</i> , 878 A.2d 434 (Del. Super. 2005).....	27
<i>Elliott Co. v. Liberty Mut. Ins. Co.</i> , 434 F. Supp. 2d 483 (N.D. Ohio 2006).....	34, 47
<i>Federal Ins. Co. v. Pacific Sheet Metal, Inc.</i> , 54 Wn. App. 514, 774 P.2d 538 (1989).....	19
<i>Fremont Indem. Co. v. New England Reinsurance Co.</i> , 815 P.2d 403 (Ariz. 1991).....	20
<i>Goodyear Tire & Rubber Co. v. Nat’l Union Ins. Co. of Pittsburgh</i> , 2011 WL 5024823 (N.D. Ohio Sept. 19, 2011).....	21
<i>Haller v. Wallis</i> , 89 Wn.2d 539, 573 P.2d 1302 (1978).....	42
<i>HLTH Corp. v. Agricultural Excess & Surplus Ins. Co.</i> , 2008 WL 3413327 (Del. Sup. Ct. July 31, 2008)	45, 46
<i>Home Ins. Co. v. St. Paul Fire & Marine Ins. Co.</i> , 229 F.3d 56 (1st Cir. 2000).....	20
<i>Kalama Chemical, Inc. v. Allianz Ins. Co.</i> , 1995 WL 17015061 (Wash. Super. Aug. 14, 1995) ...	26, 32, 43, 44
<i>Kaplan v. Nw Mut. Life Ins. Co.</i> , 115 Wn. App. 791, 65 P.3d 16 (2003).....	22
<i>Koppers Co., Inc. v. Aetna Cas. & Surety Co.</i> , 98 F.3d 1440 (3d Cir. 1996).....	47
<i>Leingang v. Pierce Cnty. Med. Bureau, Inc.</i> , 131 Wn.2d 133, 930 P.2d 288 (1997).....	50
<i>Maynor v. Vosburg</i> , 648 So. 2d 411 (La. Ct. App. 1994).....	37
<i>McGreevy v. Oregon Mut. Ins. Co.</i> , 128 Wn.2d 26, 904 P.2d 731 (1995).....	50

<i>Med. Mut. Ins. Co. of NC v. Am. Cas. Co. of Reading, PA</i> , 721 F.Supp.2d 447 (E.D.N.C. 2010).....	20
<i>Morgan v. Prudential</i> , 86 Wn.2d 432, 545 P.2d 1193 (1976).....	37, 38, 41
<i>Mut. of Enumclaw Ins. Co. v. USF Ins. Co.</i> , 164 Wn.2d 411, 191 P.3d 866 (2008).....	31
<i>Nw. Steel Rolling Mills, Inc. v. Fireman's Fund Ins. Co.</i> , No. C86-376WD (W.D. Wash. Jan. 16, 1991).....	32, 43
<i>Olympic Steamship Co., Inc. v. Centennial Ins. Co.</i> , 117 Wn.2d 37, 811 P.2d 673 (1991).....	50
<i>Oregon Auto. Ins. Co. v. Salzberg</i> , 85 Wn.2d 372, 535 P.2d 816 (1975).....	<i>passim</i>
<i>Pereira v. Nat'l Union Fire Ins. Co. of Pittsburgh, Pa</i> , 2006 WL 1982789 (S.D.N.Y. July 12, 2006).....	22, 46
<i>Pilgrim v. State Farm & Cas. Ins. Co.</i> , 89 Wn. App. 712, 950 P.2d 479 (1997).....	29
<i>Pub. Util. Dist. No. 1 of Klickitat County v. Int'l Ins. Co.</i> , 124 Wn.2d 789, 881 P.2d 1020 (1994).....	<i>passim</i>
<i>Qualcomm, Inc. v. Certain Underwriters at Lloyd's, London</i> , 161 Cal. App. 4th 184, 73 Cal Rptr. 3d 770 (Cal. Ct. App. 2008).....	48
<i>Reliance Ins. Co. v. Transamerica Ins. Co.</i> , 826 So. 2d 998 (Fla. Dist. Ct. App. 2001).....	34, 47
<i>Ross v. Harding</i> , 64 Wn.2d 231, 391 P.2d 526 (1964).....	17, 18
<i>Safeco Title Ins. Co. v. Gannon</i> , 54 Wn. App. 330, 774 P.2d 30 (1989).....	29, 30
<i>Seafirst Ctr. Ltd. P'ship v. Erickson</i> , 127 Wn.2d 355, 898 P.2d 299 (1995).....	41, 42

<i>Seafirst Ctr. Ltd. P'ship v. Kargianis, Austin & Erickson</i> , 73 Wn. App. 471, 866 P.2d 60 (1994).....	42
<i>Seaway Port Authority of Duluth v. Midland Ins. Co.</i> , 430 N.W.2d 242 (Minn. Ct. App. 1988).....	19
<i>Seiber v. Poulsbo Marine Ctr., Inc.</i> , 136 Wn. App. 731, 150 P.3d 633 (2007).....	14
<i>Siligato v. Welch</i> , 607 F. Supp. 743 (D. Conn. 1985).....	34, 47
<i>Stargatt v. Fid. & Cas. of N.Y.</i> , 67 F.R.D. 689 (D. Del. 1975)	34, 43, 47
<i>State Farm Fire & Cas. Co. v. Nationwide Mut. Ins. Co.</i> , 596 F. Supp. 2d 940 (E.D. Va. 2009)	40
<i>Teigen v. Jelco of Wis. Inc.</i> , 367 N.W.2d 806 (Wis. 1985).....	34, 47
<i>Trinity Homes LLC v. Ohio Cas. Ins. Co.</i> , 629 F.3d 653 (7th Cir. 2010)	34, 47
<i>Vision One, LLC v. Philadelphia Indem. Ins. Co.</i> , 158 Wn. App. 91, 241 P.3d 429 (2010).....	22, 23
<i>Zeig v. Mass. Bonding & Ins. Co.</i> , 23 F.2d 665 (2d Cir. 1928).....	34, 43, 47
Rules	
CR 56(c).....	14
Other Authorities	
13 Richard A. Lord, <i>Williston on Contracts</i> § 38.1 (4th ed. 2000)	17, 28
15 Lee R. Russ, <i>Couch on Insurance</i> § 220:32 (3d ed. 2011)	37
2 Allan D. Windt, <i>Insurance Claims & Disputes</i> § 6:2 (5th ed. 2011 Supp.).....	39
2 Allan D. Windt, <i>Insurance Claims & Disputes</i> § 6:45 (5th ed. 2011 Supp.).....	39, 40

Franklin D. Cordell, 3 *New Appleman On Insurance Law* § 20 (2011) ... 17

Restatement (Second) of Contracts § 241(a)-(e) (1981)..... 26

INTRODUCTION

The central question presented by this appeal brought by Quellos Group LLC (“Quellos”) is whether Federal Insurance Company (“Federal”) and Indian Harbor Insurance Company (“Indian Harbor”) (collectively, the “Excess Carriers”) may repudiate \$30 million in excess insurance sold to Quellos merely because it settled with its primary insurer, American International Specialty Lines Insurance Company (“AISLIC”), for less than full primary policy limits. In erroneously resolving this question in the Excess Carriers’ favor, the trial court sanctioned a forfeiture of coverage based on a literal reading of standardized policy conditions drafted by the insurance industry, which appear in a wide variety of insurance policies sold in this State. The court sanctioned this result despite the fact that the Excess Carriers had denied coverage years before Quellos settled with its primary insurer, that Quellos paid the difference between the settlement amount and AISLIC’s policy limits, and that the Excess Carriers failed to establish that Quellos’ claimed breach of the condition was material or substantially prejudicial.

If permitted to stand, the trial court’s reading of this standardized policy condition would have far-reaching consequences for policyholders in this State. Under this reading, Washington policyholders will forfeit all excess coverage whenever they settle with their primary insurers for even

one penny less than 100 percent of policy limits. Policyholders will suffer this forfeiture even when they request only that their excess insurers honor their promise to pay for losses greater than the specified attachment point for excess coverage. The trial court's reading, therefore, is bound to have a stifling effect on the settlement of coverage disputes, as well as having the potential to produce many other adverse results when policyholders in this State are unable to collect full limits from their primary insurers.

For the reasons discussed below, the court erred in granting summary judgment to the Excess Carriers. Because Washington law does not permit them to disavow coverage in the circumstances presented here, this Court should reverse and remand this case with instructions to grant summary judgment to Quellos instead.

ASSIGNMENTS OF ERROR

1. The court erred in granting summary judgment to the Excess Carriers based solely on Quellos' claimed breach of standardized attachment point provisions that, under a literal reading, conditions their payment of covered losses on the primary insurer's payment of its full policy limits. RP 99:9-108:8 (Ex. A)¹; CP 322-24.
2. The court erred in ruling that these standardized provisions are not

¹ For the Court's convenience, Quellos has appended the Report of Proceedings and certain other documents as Exhibits to this brief. Citations to these documents include a reference to both the record ("RP ____" or "CP ____") and the Exhibit ("Ex. ____") appended to this brief.

conditions to coverage that the Excess Carriers may invoke as grounds for denying coverage only in certain circumstances. RP 104:17-106:5 (Ex. A).

3. The court erred in ruling that these standardized provisions are not conditions to coverage that the Excess Carriers waived by denying coverage years before Quellos settled its coverage dispute with AISLIC for less than the policy limits. RP 103:16-104:16 (Ex. A).

4. The court erred in ruling that these standardized provisions are not conditions to coverage that may serve to relieve the Excess Carriers of their contractual obligations only if they can prove that Quellos' claimed breach was a material and substantially prejudicial breach. RP 104:17-106:10 (Ex. A).

5. The court erred in alternatively ruling that the Excess Carriers had met any burden they had of proving a material and substantially prejudicial breach. RP 106:11-108:4 (Ex. A).

6. The court erred in accepting a literal interpretation of the standardized attachment point provisions producing absurd and unjust results, including nullifying Quellos' excess insurance and relieving the Excess Carriers of the obligation to pay policy benefits in exactly the situation this insurance is most needed. RP 99:9-103:15 (Ex. A).

7. The court erred in accepting a literal interpretation of these standardized provisions that conflicts irreconcilably with the paramount

principles of Washington law favoring settlement over litigation of disputes. RP 99:9-103:15 (Ex. A).

8. The court erred in finding that the standardized attachment point provisions in the Excess Carriers' policies represent negotiated terms, contrary to the evidence that Quellos was given no opportunity to negotiate different policy wording. RP 100:5-12 (Ex. A).

ISSUES PERTAINING TO ASSIGNMENTS OF ERROR

1. When a policyholder, suffering insured losses in excess of the primary policy limits, settles with the primary insurer for less than those limits and itself pays the difference, may the excess insurers disavow their contractual obligations based solely on standardized attachment point provisions that, under a literal reading, condition coverage on the primary insurer's payment of its full policy limits? (Assignments of Error 1 to 8)
2. Do such standardized attachment point provisions function as conditions to coverage, which excess insurers may properly invoke as grounds for avoiding coverage only in certain circumstances? (Assignment of Error 2)
3. Do excess insurers waive any right to demand compliance with such standardized provisions by denying coverage years before the policyholder settles its coverage dispute with the primary insurer for less than the primary policy limits? (Assignment of Error 3)

4. Are excess insurers seeking to disavow coverage based on the policyholder's claimed breach of such standardized provisions required to prove that this breach was material and substantially prejudicial?
(Assignment of Error 4)
5. Did the Excess Carriers alternatively meet the burden of proving as a matter of law that Quellos' claimed breach of these standardized provisions was material and substantially prejudicial? (Assignment of Error 5)
6. Does Washington law permit a literal interpretation of such standardized provisions when that interpretation produces the absurd and unjust result of nullifying excess coverage and relieving the excess insurers of the obligation to pay policy benefits when excess coverage is most needed? (Assignments of Error 6, 7, 8)
7. Does Washington law permit a literal interpretation of such standardized provisions when that interpretation frustrates paramount principles favoring settlement over litigation of disputes? (Assignment of Error 6, 7, 8)

STATEMENT OF THE CASE

Quellos is an investment management company providing financial services to its clients, including tax planning and investment management advice. CP 116, 148, 174. Among other things, Quellos provided certain clients with such services regarding portfolio optimized investment

transactions (“POINT”). CP 210, ¶ 4 (Ex. B). Quellos has incurred defense costs and other losses as a result of a number of government investigations, lawsuits and other claims arising out of POINT (the “POINT Claims”), and has sought insurance coverage from its various investment management insurers for those costs in this action. CP 211, ¶¶ 12-13 (Ex. B).

Quellos timely appeals the trial court’s grant of summary judgment to the Excess Carriers relieving them of any obligation to reimburse Quellos for defense costs and other losses arising out of the POINT Claims. RP 99:9-108:8; CP 322-40, 348-58.

I. QUELLOS’ 2000-05 INVESTMENT MANAGEMENT INSURANCE POLICIES

Quellos has assisted its clients with managing many millions of dollars in investments. CP 117. To ensure adequate protection in the event of claims relating to these professional services, Quellos purchased multiple layers of coverage, including a primary policy and several excess policies, in successive policy periods from 2000 through 2007. CP 210, ¶ 5 (Ex. B).

During the policy period of September 21, 2004 to September 21, 2005², AISLIC sold Quellos a primary investment management insurance

² Quellos also purchased investment management insurance policies that provide coverage from September 21, 2000 to September 21, 2004. CP 117, fn. 2. Because Quellos

policy providing coverage of \$10 million for claims against Quellos or its insured directors and officers made during this policy period involving Quellos' investment management services (the "AISLIC primary policy"). CP 47-95 (Ex. C). Federal sold Quellos the first layer excess insurance covering the same risks, which provides an additional \$10 million in coverage for claims made during this same policy period (the "Federal policy"). CP 97-108 (Ex. D). Indian Harbor sold Quellos the second layer of excess insurance also covering the same risks, and providing an additional \$20 million in coverage for this policy period (the "Indian Harbor policy"). CP 110-112 (Ex. E), CP 211, ¶ 10 (Ex. B). Like AISLIC's primary policy, Quellos' excess policies contain standardized terms drafted by the insurance industry. CP 99 (Form 14-02-2272 (Ed. 5/97)) (Ex. D), CP 110 (Form EX 71 01 09 99) (Ex. E), CP 300, ¶ 3 (Ex. F).

The Insuring Clause in Federal's first layer excess policy provides coverage "in conformance with the terms and conditions of the Primary Policy." CP 99, § 1 (Ex. D). The Clause also contains a standardized policy condition stating that the coverage "shall attach only after the insurers of the Underlying Insurance shall have paid in legal currency the

currently is seeking coverage for losses arising from POINT Claims only from its 2004-05 policies, however, this appeal does not address the coverage provided under the other policies. *Id.*

full amount of the Underlying Limit for such Policy Period.” *Id.* The Federal policy contains a separate “depletion of underlying limits” provision that reiterates this policy condition. CP 99, § 3 (Ex. D).

The Insuring Agreement in Indian Harbor’s policy provides coverage “in conformance with the terms, conditions, endorsements and warranties of the Primary Policy together with the terms, conditions, endorsements and warranties of any other Underlying Insurance.” CP 110, § 1 (Ex. E). The Insuring Agreement also contains a standardized policy condition stating that coverage “will attach only after all of the Underlying Insurance has been exhausted by the actual payment of loss by the applicable insurers thereunder” *Id.* Like the Federal policy, the Indian Harbor policy contains a separate “depletion of underlying limits” section that reiterates this policy condition. CP 110, § 3 (Ex. E).

II. QUELLOS’ COVERAGE DISPUTE WITH ITS EXCESS CARRIERS REGARDING THE POINT CLAIMS

During the 2004-05 policy period, Quellos began giving notice to its primary insurer, AISLIC, and the Excess Carriers of various POINT Claims as these claims began to be asserted against Quellos and other insureds. CP 211, ¶ 12 (Ex. B). By October 2007, Quellos had incurred substantial defense costs and other losses in connection with the POINT Claims, which exceeded the policy limits of both AISLIC’s primary policy,

and Federal's excess policy, and exceeded the attachment point of Indian Harbor's excess policy. CP 211-12, ¶¶ 16-17 (Ex. B). The Excess Carriers nonetheless both denied coverage for these POINT Claims. *Id.*

Approximately two years later, on August 26, 2009, after it denied coverage for certain of the POINT Claims and the Excess Carriers also had denied coverage for these Claims, AISLIC provided Quellos with a payment in the amount of \$4,982,973.58 for various defense and other costs related to the POINT Claims. CP 212, ¶ 18 (Ex. B). AISLIC made this payment after Quellos' former CEO, Jeff Greenstein, and one other director, Charles Wilk, were indicted. CP 1109, ¶ 18. In September 2010, these two individuals subsequently entered guilty pleas. CP 941-64. Although none of Quellos' other directors or officers or the company itself were accused of any wrongdoing (CP 1109, ¶¶ 17-18), AISLIC declined to make any further payment for defense costs or other losses Quellos incurred in connection with the POINT Claims. CP 212, at ¶¶ 18-19 (Ex. B).

On December 1, 2010, after being met with all of its insurers' denials of coverage for the POINT Claims (and certain other matters), Quellos brought suit against its insurers, including AISLIC, and the Excess Carriers. CP 116, 146-172.

On June 27, 2011, some seven months after Quellos filed suit and

long after the Excess Carriers had issued their first denials of coverage for the POINT Claims in 2007, Quellos and AISLIC entered into a \$15 million global settlement (“AISLIC Settlement Agreement”). CP 212, ¶ 19 (Ex. B). This Agreement resolved Quellos’ coverage dispute with AISLIC regarding the POINT (and all other) Claims, and released AISLIC from further liability under all of AISLIC’s primary policies, including the 2004-05 AISLIC primary policy. *Id.* The AISLIC settlement agreement did not allocate any of the settlement payment to the POINT Claims or the 2004-05 primary policy. *Id.* at ¶ 20.

III. THE SUMMARY JUDGMENT PROCEEDINGS

A. The Parties’ Summary Judgment Motions

In October 2011, the parties filed cross-motions for summary judgment as to the Excess Carriers’ affirmative defense seeking to repudiate \$30 million in excess coverage sold to Quellos based on its settlement with AISLIC for less than the full primary policy limits. CP 7-21, CP 113-42. Federal also filed a separate summary judgment motion, joined by Indian Harbor, arguing that the guilty pleas of two former directors of Quellos should serve to deprive all of the insureds of any coverage for the POINT Claims. CP 1019-59.

B. The Trial Court’s Summary Judgment Ruling

At the conclusion of the hearing held on December 16, 2011, the

trial court granted summary judgment to the Excess Carriers on the exhaustion issue in a ruling from the bench. RP 99:9-108:8 (Ex. A). The court began by holding that the Excess Carriers' policies unambiguously require AISLIC's primary policy to be exhausted by its full payment of the \$10 million policy limits. RP 100:5-21 (Ex. A).

The trial court declined to consider the precedent on which *Quellos* relied establishing that Washington law forbids literal readings of policy provisions that produce absurd results rendering coverage ineffective or illusory. RP 99:12-100:4 (Ex. A). The court also declined to consider the precedent on which *Quellos* relied establishing that a literal reading of the attachment point provisions contravenes paramount principles of Washington law favoring settlements. *Id.*

The court discounted this precedent on grounds that the policies at issue ostensibly are "not just ... boilerplate or standard form policies," and that, "when parties sit down and have particular policy language, you need to give effect to that ... policy language." RP 100:9-12 (Ex. A). The court so ruled notwithstanding the absence of any evidence that the terms of the attachment point provisions actually were negotiated, and that the evidence instead showed that both of the Excess Carriers' policies contain standardized terms drafted by the insurance industry. CP 99 (Form 14-02-2272 (Ed. 5/97)) (Ex. D), CP 110 (Form EX 71 01 09 99) (Ex. E), CP 300,

¶ 3 (Ex. F). The court also so ruled even though it correctly recognized that Washington has “never adopted a sophisticated insured standard.” RP 100:5-6 (Ex. A).

The court next ruled that the Excess Carriers were entitled to demand compliance with the attachment point provisions, notwithstanding having denied coverage for the POINT Claims years before Quellos settled with its primary carrier for less than full policy limits. RP 103:16-104:16 (Ex. A). The court rejected Quellos’ argument that the Excess Carriers had waived any right to demand compliance with this requirement by denying coverage years before Quellos settled with its primary carrier, and though it was undisputed that the POINT losses for which Quellos sought coverage exceeded the limits of the underlying policies at the time the Excess Carriers first denied coverage. CP 211, ¶ 15 (Ex. B).

The court also discounted the precedent on which Quellos relied establishing that, regardless of where the provision in question appears in the policy, a policy term that predicates coverage on the policyholder’s compliance with procedural requirements functions as a condition to coverage. RP 104:22-105:6 (Ex. A). The court concluded that the attachment point provisions are not “mere” conditions to coverage on the ground that they ostensibly defined the scope of coverage. RP 104:17-106:5 (Ex. A). The court ruled that Quellos’ claimed breach excused the

insurers' performance, even if the breach was immaterial and did not substantially prejudice the insurers. RP 104:17-106:5, RP 106:2-10 (Ex. A).

In the alternative, the court concluded that Quellos' claimed breach was material and substantially prejudicial. RP 106:11-108:4 (Ex. A). The Excess Carriers presented no evidence to support a finding of materiality or prejudice (CP 7-21, 242-45, 308-311), and it was undisputed that they had engaged coverage counsel to represent their interests at the outset. CP 211-212, ¶¶ 12-15, 19 (Ex. B). The court nonetheless ruled that the Excess Carriers had relied on AISLIC to expend the resources necessary to make the initial determination of whether Quellos had suffered covered losses that exhausted its primary limits of \$10 million. RP 106:11-108:4 (Ex. A).

On Federal's separate summary judgment motion, the court granted summary judgment with respect to losses on the POINT Claims incurred by the two insured individuals who had entered guilty pleas. RP 97:7-12, 98:4-14 (Ex. A). However, the court rejected the argument that the conduct-based exclusions could serve, as a matter of law, to bar coverage to all insureds, including other directors and officers of Quellos, that were not accused of any intentional misconduct but nonetheless incurred liability as a result of the POINT Claims. RP 93:14-99:8 (Ex. A). With respect to these other insureds, the court concluded that "there is a genuine issue of

material fact as to which costs are covered, [and] which costs are not.” RP 97:18-19; *see* RP 96:4-98 (Ex. A).

STANDARD OF REVIEW

This Court reviews summary judgment orders *de novo*, considering all facts and reasonable inferences in the light most favorable to the nonmoving party *Seiber v. Poulsbo Marine Ctr., Inc.*, 136 Wn. App. 731, 736-37, 150 P.3d 633 (2007). Summary judgment is proper where there is no genuine issue of material fact and the moving party is entitled to judgment as a matter of law. *Id.*; *see also* CR 56(c).

SUMMARY OF ARGUMENT

The trial court erred in ruling that the Excess Carriers were entitled to repudiate \$30 million in excess coverage sold to Quellos simply because Quellos settled with AISLIC, its primary insurer, for less than full policy limits. For three reasons, this Court should reverse the trial court’s decision granting summary judgment to the Excess Carriers, and remand this case with instructions that summary judgment should be granted to Quellos instead.

First, the attachment point language constitutes a condition to coverage, and the Excess Carriers waived any right to demand compliance with this condition when they denied coverage years before Quellos settled its coverage dispute with AISLIC for less than primary policy limits.

Second, the Excess Carriers cannot repudiate coverage based on Quellos' claimed noncompliance with this condition because they failed to meet their burden of proving that the asserted breach was either material or substantially prejudicial. The Excess Carriers did not and cannot meet their burden here because Quellos paid the difference between the settlement and AISLIC's primary policy limits and requests only that the Excess Carriers pay for losses greater than their policies' respective attachment points, and because the Excess Carriers denied coverage years before the AISLIC settlement and have been actively involved in this coverage dispute at all times before and since the settlement.

Third, Washington law precludes acceptance of the Excess Carriers' literal reading of the standardized conditions because that reading produces absurd results, including nullifying Quellos' excess coverage and giving these carriers an unfair windfall in the very situation in which the insurance they sold Quellos for substantial premiums was written to apply, for extraordinary losses far exceeding primary policy limits. Moreover, acceptance of the Excess Carriers' literal interpretation would frustrate the paramount principles favoring settlement over litigation of disputes by compelling policyholders to litigate their coverage disputes with primary and other underlying insurers to judgment.

ARGUMENT

I. THE TRIAL COURT ERRED IN RULING THAT QUELLOS' SETTLEMENT WITH ITS PRIMARY CARRIER ELIMINATED THE EXCESS CARRIERS' COVERAGE OBLIGATIONS.

In granting the Excess Carriers summary judgment, the trial court erroneously ruled that the attachment point provisions at issue were not “mere” conditions to coverage. RP 106:2-5 (Ex. A). Owing to that error, the court disregarded the controlling precedent dictating that an insurer that has previously denied coverage waives the right to invoke a policyholder’s noncompliance with a policy condition as grounds for avoiding its own contractual obligations. *E.g., Pub. Util. Dist. No. 1 of Klickitat County v. Int’l Ins. Co. (“Klickitat County”)*, 124 Wn.2d 789, 804, 881 P.2d 1020 (1994) (*en banc*). The court compounded its error by also disregarding the controlling precedent dictating that, to avoid coverage based on a policyholder’s breach of a condition, an insurer must prove both that the claimed breach was material and substantially prejudicial. *E.g., Oregon Auto. Ins. Co. v. Salzberg*, 85 Wn.2d 372, 377, 535 P.2d 816 (1975). Because this precedent entitled Quellos to summary judgment, the trial court’s decision should be reversed.

A. The Attachment Point Provisions At Issue Are Conditions to Coverage.

The trial court erroneously concluded that the attachment point provisions are not conditions to coverage but are instead the “essential” and

“defining aspect” of the Excess Carriers’ policies. RP 104:17-106:5 (Ex. A). This conclusion conflicts with the plain language of both excess policies and settled principles for determining when policy language functions as a condition.

In an *en banc* decision, the Washington Supreme Court instructed that, in contrast to coverage-granting provisions and exclusions, which define the scope of coverage, conditions “designate the manner in which claims covered by the policy are to be handled once a claim has been made or events giving rise to a claim have occurred.” *Klickitat County*, 85 Wn.2d at 803. Conditions thus impose procedural steps that a policyholder is to undertake to perfect the right to coverage defined by the coverage grant and exclusions. See Franklin D. Cordell, 3 *New Appleman On Insurance Law* § 20 (2011) (conditions do not “define the scope of coverage,” but instead “impose ‘procedural’ duties on the contracting parties”); 13 Richard A. Lord, *Williston on Contracts* § 38.1 (4th ed. 2000) (explaining that a contract condition does not create rights or duties in and of itself, but only limits or modifies rights or duties). Because they are procedural, contractual conditions often employ phrases and words such as “after” to convey that performance depends upon the specified event. *Ross v. Harding*, 64 Wn.2d 231, 237, 391 P.2d 526 (1964) (holding that “[a]ny words which express, when properly interpreted, the idea that the

performance of a promise is dependent on some other event will create a condition”).

The attachment point provisions at issue here are not, as the trial court mischaracterized them, the “essential” and “defining aspect” of the Excess Carriers’ policies. RP 105:15-106:5 (Ex. A). The essential and defining aspects of these policies are the coverage-granting provisions, together with the terms establishing *the amount* of underlying loss that must be incurred before these policies will begin to pay. CP 99-101, CP 110-112. Requirements as to what entity is to pay the specified underlying amount are merely procedural. The Excess Carriers’ policies thus prescribe that their insurance attaches “only after” and “in the event” of payment of the underlying loss. CP 99, § 1 (Ex. D), CP 110, § 1 (Ex. E); *see Ross*, 64 Wn.2d at 237.

Washington cases rejecting requests for the so-called “drop-down” of excess coverage confirm that the essential consideration here is that the specified underlying amount is paid and not what entities pay this amount. In cases where an underlying carrier cannot pay its limits because of insolvency, for example, policyholders have argued that the excess insurer’s policy should “drop down” and begin to pay covered losses before the specified attachment point for excess coverage. Washington courts have rejected that argument because the amount of underlying coverage is

considered an essential aspect of the excess policy. *E.g.*, *Federal Ins. Co. v. Pacific Sheet Metal, Inc.*, 54 Wn. App. 514, 520-21, 774 P.2d 538 (1989); *see also Seaway Port Authority of Duluth v. Midland Ins. Co.*, 430 N.W.2d 242, 247-48 (Minn. Ct. App. 1988) (rejecting argument that the excess policy should drop down because “excess insurers are generally liable only for the amount of loss or damage in excess of coverage provided by other insurance policies.”).

In contrast here, *Quellos* is not seeking to change an essential aspect of excess insurance by demanding that the Excess Carriers’ policies “drop down” to a lower level of coverage. *Quellos* simply seeks to obtain payment for losses at the level at which the Excess Carriers contracted to begin payment. It is the Excess Carriers instead that have sought to change an essential aspect of their policies by demanding *Quellos*’ forfeiture of coverage on the procedural basis that AISLIC did not pay every penny of its underlying limits. The trial court committed reversible error by ruling that the Excess Carriers were entitled to this windfall.

Contrary to the arguments made by the Excess Carriers below, the fact that the attachment point language appears in the insuring agreements, as well as in other sections of these policies, does not establish that the attachment point provisions are not conditions. Washington law mandates that policy provisions must be read in the context of the policy as a whole,

and in terms of the function they serve. *E.g.*, *B & L Trucking & Constr. Co.*, 134 Wn.2d 413, 427-28, 951 P.2d 250 (1998). The section in which a particular provision is placed in a policy, therefore, is not determinative.

As the First Circuit reasoned in applying these same principles and ruling that the construction and effect of an insurance provision does not depend on its location within a policy, coverage is determined by construing the policy as a whole, and not by engaging in “semantic microscopy” focusing on policy provisions read in isolation. *Home Ins. Co. v. St. Paul Fire & Marine Ins. Co.*, 229 F.3d 56, 62-63 (1st Cir. 2000). Numerous other cases³ applying the same settled principle of policy interpretation also hold that an insurer’s “labeling” or placement of a term in a policy is not controlling. *D & S Realty, Inc. v. Markel Ins. Co.*, 789 N.W.2d 1, 13 (Neb. 2010) (“We conclude that regardless of an insurer’s labeling, a clause that requires an insured to avoid an increased hazard is a condition subsequent for coverage.”).

Reconfirming that the attachment point language in the insuring

³ *E.g.*, *Medical Mut. Ins. Co. of NC v. Am. Cas. Co. of Reading, PA*, 721 F. Supp. 2d 447, 459 n. 3 (E.D.N.C. 2010) (language of policy provision controls, not where insurer decides to place provision within policy); *Devese v. Transguard Ins. Co.*, 798 N.W.2d 614, 619 (Neb. 2011) (concluding that a clause in an occupational accident policy requiring the driver to maintain a commercial driver’s license was a condition to coverage despite the clause appearing under the “general exclusions and limitations” section of the policy); *Fremont Indem. Co. v. New England Reinsurance Co.*, 815 P.2d 403, 406 (Ariz. 1991) (escape clause stating that policy affords no coverage if there is other insurance available is not transformed into exception merely because of location in policy, insurer cannot gain an advantage merely by rearranging provisions in policy).

agreements of the Excess Carriers' policies functions as a condition to coverage, both policies reiterate the same requirement in other sections of the contracts. These additional provisions again state that excess coverage applies "in the event of exhaustion" of the underlying policy limits. CP 110 § III(B) (Ex. E); *see* CP 99, § III (Ex. D). Also supporting the conclusion that this attachment point language constitutes a condition, the out-of-state cases on which the Excess Carriers themselves most heavily relied below hold that functionally identical policy language serves as a condition precedent to coverage.⁴ *See, e.g., Comerica, Inc. v. Zurich Am. Ins. Co.*, 498 F. Supp. 2d 1019, 1022, 1028 (E.D. Mich. 2007); *Goodyear Tire & Rubber Co. v. Nat'l Union Ins. Co. of Pittsburgh*, 2011 WL 5024823, at *1, 3 (N.D. Ohio Sept. 19, 2011).

At the very least, Quellos' interpretation that the policy language at issue serves as a condition is plainly reasonable. It was error for the trial court to accept the Excess Carriers' contrary interpretation because Washington law mandates that it is a policyholder's reasonable interpretation that governs. *See Am. Star Ins. Co. v. Grice*, 121 Wn.2d 869, 874-75, 854 P.2d 622 (1993) (if the policy language at issue is fairly susceptible to two or more reasonable interpretations, the policy is

⁴ These decisions conflict with Washington law, however, in holding that a showing of prejudice is not required when a policyholder is claimed to have breached a condition precedent to coverage. *E.g., Klickitat Cnty.*, 124 Wn.2d at 804; *Salzberg*, 85 Wn.2d at 376.

ambiguous and must be construed against the insurer and in the policyholder's favor); accord *Kaplan v. Nw. Mut. Life Ins. Co.*, 115 Wn. App. 791, 808, 65 P.3d 16 (2003) (“[The policyholder] does not need to show that his list of possible interpretations, or any one of them, is more reasonable than that espoused by [the insurer], but only that there is more than one reasonable interpretation.”).⁵

B. The Excess Carriers Waived Any Right To Demand Compliance With The Attachment Point Conditions.

In granting the Excess Carriers summary judgment, the trial court erroneously disregarded controlling precedent mandating that a policyholder is relieved from its obligation to comply with policy conditions once an insurer has denied coverage. In *Vision One, LLC v. Philadelphia Indemnity Insurance Co.*, 158 Wn. App. 91, 241 P.3d 429 (2010), for example, this Court held that a policyholder was not obligated to comply with a consent-to-settlement condition because the policyholder had settled its underlying legal dispute after the insurer had denied coverage. *Id.* at 100-01. This Court explained that an insurer should not be allowed, “on the one hand, to deny liability and thus, in the eyes of the insured, breach his contract and, at the same time, on the other hand, be

⁵ Indeed, even leaving aside whether the attachment point language at issue can reasonably be viewed as a condition to coverage, some courts have declined to enforce such language on grounds of ambiguity. *E.g.*, *Pereira v. Nat'l Union Fire Ins. Co. of Pittsburgh, Pa.*, 2006 WL 1982789, at *7 (S.D.N.Y. July 12, 2006)

allowed to insist that the insured honor all his contractual commitments.” *Id.* at 101. The Court concluded that a denial of coverage “is a breach of contract on the part of the insurer and its breach should, by rights, relieve the insured of the punitive effects of his failure to comply” with other conditions in the policy. *Id.*

For the same reason, the trial court should have ruled that Quellos had no obligation to comply with the attachment point conditions in the Excess Carriers’ policies. It is undisputed that the Excess Carriers both denied coverage for the POINT Claims in 2007, at a time when the dollar amount of Quellos’ losses already exceeded underlying policy limits. CP 211, ¶¶ 16-17 (Ex. B). These 2007 denials of coverage, moreover, predated by nearly four years the settlement that Quellos later reached with AISLIC in June 2011. *Id.* at ¶ 19. Having denied coverage years before the AISLIC settlement (*Id.* at ¶¶ 16-17), the Excess Carriers cannot now “insist” that Quellos instead should have collected full policy limits from AISLIC, even if their policies properly could be read to impose such a requirement. *Vision One*, 158 Wn. App. at 101.

The Excess Carriers could not have invoked Quellos’ settlement with AISLIC at the time they first denied coverage because Quellos did not settle with AISLIC until years later. In rejecting Quellos’ argument that the Excess Carriers had waived the right to invoke the attachment point

language, the trial court nonetheless ruled that their present denial of coverage owing to Quellos' settlement with AISLIC was "completely consistent with the position" the Excess Carriers previously took in denying coverage. RP 104:1-3 (Ex. A). This reasoning underscores the trial court's confusion of two distinct requirements: 1) the substantive requirement that excess insurance exists only for losses exceeding underlying policy limits; and 2) the procedural requirement as to who pays the underlying amount. With respect to the second procedural requirement, *Vision One* demonstrates that the Excess Carriers waived the right to insist on Quellos' compliance by choosing to deny coverage and abandon Quellos four years before Quellos settled with AISLIC.

The Excess Carriers sought to sidestep *Vision One* by contending that a finding of waiver supposedly would improperly create coverage "because coverage under the excess policies has not attached, and cannot attach unless and until AISLIC pays the full limit of its liability" CP 245. Contrary to that contention, Quellos is seeking to recover only the insurance the Excess Carriers contracted to provide at the specified attachment points of their policies. It is the Excess Carriers that are seeking to change the bargain and gain a windfall by disavowing coverage simply because Quellos has paid some of the amount of loss within AISLIC's primary policy limits. No expansion of coverage is involved,

Vision One applies, and the trial court's failure to follow this precedent necessitates reversal of its summary judgment ruling.

C. The Excess Carriers Failed to Meet Their Burden of Proving that Quellos' Claimed Breach Was Material.

The trial court also erred in relieving the Excess Carriers of any obligation to prove that Quellos' claimed breach of the attachment point conditions was material. The Washington Supreme Court unequivocally has instructed that a policyholder's breach of a condition of coverage can justify a forfeiture of coverage only where the breach is material. *See Colorado Structures, Inc. v. Ins. Co. of the West*, 161 Wn.2d 577, 588-89, 167 P.3d 1125 (2007) (holding that a nonbreaching party may avoid further performance only if the other party has materially breached the insurance contract). That Court also has unequivocally instructed that the insurer bears the burden of proving materiality regardless of whether the policy condition at issue is a condition precedent or a condition subsequent to coverage. *E.g., Salzburg*, 85 Wn.2d at 377.

To determine if a breach of any such condition is material, Washington courts consider a number of factors. These factors include: (1) whether "the breach deprive[d] the injured party of a benefit which he reasonably expected," (2) whether "the breaching party will suffer a forfeiture by the injured party's withholding performance," and (3) whether

the breach did not “comport[]with good faith and fair dealing.” *Bailie Comm., Ltd. v. Trend Business Systems*, 53 Wn. App. 77, 83, 765 P.2d 339 (1988) (citing Restatement (Second) of Contracts § 241(a)-(e) (1981)).

Each of these factors confirms that Quellos’ alleged breach cannot be deemed material. With respect to the first factor, Washington law dictates that the Excess Carriers cannot legitimately claim that Quellos’ settlement with AISLIC for less than full policy limits deprives them of contractual benefits because Quellos has paid the difference between the settlement and AISLIC’s policy limits and seeks only the insurance the Excess Carriers’ contracted to provide for losses exceeding the respective attachment points of their policies. As one Washington court ruled in reaching a conclusion that has been echoed by courts throughout the country, “as long as the insured ... pays an amount equivalent to the retained limit,” the excess insurer “is not prejudiced” because the excess insurer is only being asked to provide coverage for loss that exceeds its policy’s attachment point. *Kalama Chemical, Inc. v. Allianz Ins. Co.*, 1995 WL 17015061, at *5 (Wash. Super. Aug. 14, 1995); *see, infra*, § I(D)(2) (collecting cases also reaching this conclusion).

With respect to the second factor, Quellos would forfeit the excess insurance for which it paid nearly \$2 million in premiums (CP 210-211, ¶¶ 9, 11 (Ex. B)) if AISLIC’s full payment of its primary policy limits were

required to obtain excess coverage. Scores of cases throughout the country confirm the manifest unfairness of that result. *See, infra*, § I(D)(2), § II.

Finally, with respect to the third requirement, it is fully consistent with principles of good faith and fair dealing for the Excess Carriers to pay for losses exceeding the attachment points of their policies, which are the same amounts they would be liable for if AISLIC had paid full primary policy limits. *See, e.g., Dunlap v. State Farm & Cas. Co.*, 878 A.2d 434, 444 (Del. Super. 2005) (good faith and fair dealing imposes “the obligation to preserve the *spirit* of the bargain rather than the letter, the adherence to substances rather than form”) (citation omitted).

Rather than undertaking the required analysis, the trial court merely stated in passing that the attachment point provisions were “obviously a material condition” RP 106:13-14. That too was reversible error.

D. The Excess Carriers Failed to Meet Their Burden of Proving that Quellos’ Claimed Breach Was Substantially Prejudicial.

1. The Trial Court Erred in Ruling that Such Proof Was Not Required.

Washington law is equally clear that, in order to deny benefits based on a policyholder’s alleged breach of a condition to coverage, an insurer bears the heavy burden of proving that it was substantially prejudiced. *E.g., Cannon, Inc., v. Fed. Ins. Co.*, 82 Wn. App. 480, 485, 918 P.2d 937 (1996) (noncompliance with a policy provision does not deprive

the insured of the benefits of the policy unless the insurer demonstrates actual prejudice resulting from the insured's noncompliance). Indeed, the Washington Supreme Court has unequivocally instructed that, because “an undue emphasis on traditional, technical contract principles has dubious application in cases involving insurance coverage disputes,” a carrier must satisfy this burden whether the policy condition allegedly breached “could be said to be a covenant or *an express condition precedent*.” *Salzberg*, 85 Wn.2d at 376 (emphasis added).

In *Salzberg*, the Supreme Court considered the circumstances under which an insurer may be relieved of liability as a result of a policyholder’s breach of a cooperation clause in an insurance policy. *Id.* at 374. The insurer argued that the cooperation clause was a condition precedent to coverage and that, accordingly, it need only show that the policyholder had breached the clause in order to avoid its coverage obligations. *Id.* The Court rejected this argument, finding “it no longer appropriate to adhere to the view that the release of an insurer from its obligations without a showing of prejudice to it should depend upon the legalistic conundrum” of whether the particular provision represents a “condition precedent or only a covenant.” *Id.* at 376.

The Washington Supreme Court reaffirmed these principles in its *en banc* decision in *Klickitat County*, ruling that “an insurer cannot deprive an

insured of the benefit of purchased coverage absent a showing that the insurer was actually prejudiced by the insured's noncompliance with *conditions precedent* such as those at issue in this case." 124 Wn.2d at 804 (emphasis added). The Court reasoned that, like cooperation clauses and notice clauses, a no-settlement clause is "a condition the insured must fulfill to create the insurer's obligation to pay under the policy." *Id.* at 803. Because the purpose of such clauses is "to prevent the insurer from being prejudiced by the insured's actions," a showing of actual prejudice is required to release the insurer from its coverage obligation to prevent a "possible windfall for the insurers." *Id. Accord Pilgrim v. State Farm & Cas. Ins. Co.*, 89 Wn. App. 712, 724, 950 P.2d 479 (1997).

The Washington cases relied upon by the Excess Carriers below, holding that an insurer need not prove prejudice to avoid coverage in the event that a policyholder fails to report a claim within the policy period of a claims-made policy, are inapposite. These cases hold that, because claims-made and reporting policies "are essentially *reporting* policies," "no liability attaches" when "the claim is not reported during the policy period," and the carrier has no obligation to pay. *Safeco Title Ins. Co. v. Gannon*, 54 Wn. App. 330, 338, 774 P.2d 30 (1989). The rationale for this result is that "allow[ing] an extension of reporting time after the end of the policy period" would entail "an extension of coverage to the insured gratis,

something for which the insurer has not bargained.” *Id.*

This rationale has no application here. It is undisputed that Quellos properly reported the POINT Claims to the Excess Carriers during the policy periods of their 2004-05 excess policies. Unlike the situation in which the policyholder has not satisfied a claims-made reporting requirement, Quellos is not seeking to expand the excess coverage it purchased for losses exceeding the specified attachment points of the Excess Carriers’ policies one iota. Whether these attachment points were reached by the primary insurers actual payment of its limits or by losses paid for in part by Quellos, the Excess Carriers’ coverage obligations are the same. In contrast to the claims-reporting requirement, which Quellos satisfied, the attachment point language functions like the cooperation and consent-to-settlement clauses in insurance policies, “which have the effect of excluding already existing coverage” (in this case, losses exceeding the attachment points). *Safeco*, 54 Wn. App. at 337. The trial court erred in ruling that the Excess Carriers were not required to prove prejudice because Washington law mandates that all such provisions are governed by a prejudice standard to safeguard the special protective purpose of insurance by “preserving, not curtailing, coverage.” *Gannon*, 54 Wn. App. at 339; *see Klickitat Cnty.*, 124 Wn.2d at 803.

2. The Trial Court Erred in Alternatively Ruling that the

Excess Carriers Established Substantial Prejudice.

The trial court also erred in alternatively ruling that the Excess Carriers had satisfied their burden of proving substantial prejudice. To make the requisite showing, the Excess Carriers were required to establish “not an abstract right, but some concrete detriment, some specific advantage lost or disadvantage created which has an identifiable prejudicial effect on the insurer.” *Canron*, 82 Wn. App. at 486; *see also Mut. of Enumclaw Ins. Co. v. USF Ins. Co.*, 164 Wn.2d 411, 430, 191 P.3d 866 (2008) (“We hold that in order to show prejudice, the insurer must prove that an insured’s breach of [the condition] had an identifiable and material detrimental effect on its ability to defend its interests.”). The Excess Carriers fell far short of satisfying this burden.

Notwithstanding that Quellos paid the difference between AISLIC’s settlement payment and AISLIC’s \$10 million policy limit, the trial court concluded that the Excess Carriers suffered prejudice because of AISLIC’s refusal to pay the entire \$10 million limit itself. The trial court appears to have concluded that the Excess Carriers had been prejudiced on the ground that they had relied upon AISLIC to determine which of the many costs incurred by Quellos as a result of the POINT Claims were covered losses serving to exhaust AISLIC’s \$10 million policy limit. The trial court stated that “there is a lot that goes into the primary carrier defending or paying or

making coverage determinations as to these 10 million dollars of covered losses that protects the excess insurer and allows the excess insurer to price their policies accordingly and act accordingly and they would be acting in reliance upon that payment being made.” RP 107:13-19 (Ex. A). These factual findings are wholly unsupported by the record below, and certainly do not support the trial court’s ruling that the Excess Carriers had satisfied their burden as a matter of law. Indeed, the Excess Carriers submitted no evidence at all showing that they relied on AISLIC’s coverage determinations and determined the price of their policies on this basis. RP 37:5-39:22, 44:4-45:5.

Nor would such evidence have sufficed to establish the substantial prejudice required for the Excess Carriers to disavow coverage. Washington courts have recognized that, “as long as the insured ... pays an amount equivalent to the retained limit,” the excess insurer “is not prejudiced” because the excess insurer is only being asked to provide coverage for loss that exceeds its policy’s attachment point. *Kalama*, 1995 WL 17015061, at *5; *see id.* at *4 (“[T]here is no prejudice to the insurer in finding exhaustion as long as the full amount of the retained limits is credited against the insured.”); *accord Nw. Steel Rolling Mills, Inc. v. Fireman’s Fund Ins. Co.*, No. C86-376WD, Order at 2:11-15 (W.D. Wash. Jan. 16, 1991) (“[The excess insurers] failed to show any prejudice to them

if the insured settles with the policy carrier for an amount below the policy limits, and absorbs the difference, in a disputed coverage case. Whether the entire \$2,150,000 is paid by the primary carrier, or \$1,900,000 by that carrier and \$250,000 by the insured, the result for the excess carrier is identical.”).

Numerous other courts have reached the same conclusion mandated by Washington law. The Supreme Court of Minnesota’s decision in *Drake v. Ryan*, 514 N.W.2d 785 (Minn. 1994), is instructive. There, the court soundly rejected the argument that a policyholder’s less-than-underlying-limits settlement caused the excess insurer to suffer any prejudice. *Id.* at 789. The Court concluded that the excess carrier was not prejudiced “because it is only being asked to fulfill its obligations to its insured - to provide coverage in excess of that provided by the primary ... policy.” *Id.* The Court found no merit in the contention that its holding would incentivize “token settlements” with the primary insurer, reasoning that this concern was not well-founded when the settling party agrees to “swallow the gap” between the settlement amount and the primary policy limits because the settling party’s “own self-interest generally will prevent them from reaching a token settlement.” *Id.*

In ruling in favor of the policyholder on this issue, scores of other

courts⁶ similarly have emphasized that the excess insurer suffers no prejudice from a policyholder's less-than-limits settlement with an underlying insurer. As the Second Circuit ruled in a decision that has been relied upon by many other courts, "the [excess insurer] had no rational interest in whether the insured collected the full amount of the primary policies, so long as it was only called upon to pay such portion of the loss as was in excess of the limits of those policies." *Zeig v. Mass. Bonding & Ins. Co.*, 23 F.2d 665, 666 (2d Cir. 1928).

The undisputed facts presented to the trial court plainly support the same conclusion. Both the Excess Carriers were timely notified of the POINT Claims beginning in 2005, at the same time as was Quellos' primary insurer, AISLIC. CP 211, ¶ 12 (Ex. B). Both Excess Carriers have been actively involved in investigating the POINT Claims ever since. *Id.*, ¶

⁶ See, e.g., *Stargatt v. Fid. & Cas. of N.Y.*, 67 F.R.D. 689, 691 (D. Del. 1975) (same); *Reliance Ins. Co. v. Transamerica Ins. Co.*, 826 So. 2d 998, 999 (Fla. Dist. Ct. App. 2001) (same); *Elliott Co. v. Liberty Mut. Ins. Co.*, 434 F. Supp. 2d 483, 500 (N.D. Ohio 2006) ("[T]he excess insurers are not harmed, since they only pay for losses exceeding the full limit of the primary policy."); *Siligato v. Welch*, 607 F. Supp. 743, 747 (D. Conn. 1985) (less-than-limits underlying settlement is not "prejudicing the excess insurer, which is left in the same position after a settlement by the primary insurer as before"); *Teigen v. Jelco of Wis. Inc.*, 367 N.W.2d 806, 809-10 (Wis. 1985) (finding no merit to insurer's argument that it was prejudiced because it set excess premium with expectation that cost of defending the lawsuit would be borne by primary insurer); *Trinity Homes LLC v. Ohio Cas. Ins. Co.*, 629 F.3d 653, 659 (7th Cir. 2010) ("[T]his construction of the policy neither has a punitive effect on [the excess insurer] nor does it alter its underwriting considerations."). As one court concluded, the excess carrier cannot legitimately claim prejudice in such circumstances because the policyholder's settlement with the underlying insurer for less than full limits does "not enlarge[] the excess carrier's liability" and because the excess carriers can "defend[] exactly as it would have been defended had there been no settlement." *Allstate Ins. Co. v. Riverside Ins. of Am.*, 509 F. Supp. 43, 47 (E.D. Mich. 1981).

14. Indeed, outside counsel for the Excess Carriers, who are among those representing these carriers in the instant litigation, have represented these carriers in the process of responding to Quellos' requests for coverage for the POINT Claims since as early as 2007. *Id.* Because Quellos' losses on the POINT Claims far exceeded AISLIC's policy limits, Quellos also named the Excess Carriers as defendants at the outset in its complaint. CP 116, 211, ¶ 15 (Ex. B). Over the seven months before AISLIC and Quellos reached a settlement of their coverage dispute in June 2011, these carriers' outside counsel actively litigated issues relating to coverage for the POINT Claims, just as they have been since that time. CP 144, ¶ 5, CP 212, ¶¶ 14, 19 (Ex. B).

Far from being warranted by any substantial prejudice resulting from Quellos' settlement with AISLIC in June 2011, some four years after the Excess Carriers retained outside counsel to represent them in their coverage dispute with Quellos (CP 211, ¶ 14 (Ex. B)), the trial court's grant of summary judgment to the Excess Carriers provides an unwarranted windfall unfairly eliminating the excess insurance for which Quellos paid nearly \$2 million in premiums (CP 210-211, ¶¶ 9, 11 (Ex. B)). This Court should reverse, and remand the case with instructions to grant summary judgment to Quellos instead.

II. THE TRIAL COURT ERRED IN ACCEPTING THE EXCESS CARRIERS' LITERAL INTERPRETATION BECAUSE IT PRODUCES ABSURD RESULTS.

A. This Literal Interpretation Impermissibly Nullifies Excess Coverage.

In holding that Quellos forfeited \$30 million in excess insurance purchased from the Excess Carriers merely because AISLIC refused to pay 100 percent of its policy limits, the trial court also erroneously ignored the special considerations governing the interpretation of insurance policies. Washington law mandates that insurance policies serve essential protective and risk-spreading functions rendering them “simply unlike traditional contracts.” *Salzberg*, 85 Wn.2d at 376-77. Because of these essential functions, the Washington Supreme Court has directed that insurance policies are to be given a reasonable and practicable interpretation, and are not to be construed literally in a fashion that would lead to “absurd” results, rendering insurance coverage altogether “ineffective.” *Id.*

The trial court’s interpretation of the standardized attachment point provisions in the Excess Carriers’ policies contravenes this directive by sanctioning an excess insurer’s repudiation of coverage any time that a policyholder settles a dispute with an underlying primary insurer for even a cent less than full policy limits. Such a reading impermissibly would work a forfeiture of the excess coverage for which Quellos paid substantial premiums, notwithstanding that the very purpose of excess coverage is to

protect against potentially catastrophic losses exceeding primary policy limits, such as these Quellos incurred as a result of the POINT Claims. *E.g.*, *Maynor v. Vosburg*, 648 So. 2d 411, 423 (La. Ct. App. 1994) (“An insured purchases excess insurance coverage to provide supplemental coverage that picks up where his primary coverage ends and thus provide protection against catastrophic losses.”); 15 Lee R. Russ, *Couch on Insurance* § 220:32 (3d ed. 2011) (stating that the purpose of excess coverage is to “protect the insured in the event of a catastrophic loss in which liability exceeds the available primary coverage”).

The Washington Supreme Court’s decision in *Morgan* is instructive. There, the policyholder had purchased life insurance policies that provided coverage for, among other things, “loss by severance of both hands at or above the wrists.” *Morgan v. Prudential*, 86 Wn.2d 432, 433-34, 545 P.2d 1193 (1976). After suffering a serious accident in which two of his fingers and significant portions of his thumbs were severed from his hands, the policyholder submitted a claim to his insurers. *Id.* The appellate court agreed with the insurers that the plain and ordinary meaning of the policy terms required complete physical detachment of the policyholder’s entire hands “at or above the wrist,” and accordingly ruled in favor of the insurers. *Id.* at 434. The Washington Supreme Court reversed, ruling that the appellate court had erred in accepting such a literal interpretation of the

policy language. Applying the settled principle that insurance policies must be given “practical and reasonable interpretations” that do not produce “absurd” results or “render the coverage nonsensical or ineffective” (*id.* at 434-35), the court observed that “[t]he substance of what [the policyholder] sought was insurance against the possible loss of [the policyholder’s] hand as a useful member of his body.” *Id.* at 436-37. Given that purpose, the court concluded that the policyholder’s interpretation that the policy provided coverage “if [his] hands cannot function as useful members of the body . . . as much as though actually completely severed from the body” was reasonable. *Id.* at 437. The court accordingly construed the provision in favor of coverage and against the insurers. *Id.*

These same principles call for rejection of the trial court’s ruling that the terms of the Excess Carriers’ policies can be read to preclude coverage unless Quellos is able to obtain payment of every dollar of the underlying insurance from the underlying insurers through settlement or judgment. As one preeminent authority on insurance law has explained:

An excess insurer should not be able to escape liability simply because the primary carrier was released for less than its policy limit. . . . [W]hen the literal terms of a policy lead to an absurd result, the policy should not be applied literally. It would be an absurd result if an excess insurer were absolved from liability if, for example, . . . the insured compromised a disputed coverage claim by accepting less than the primary’s entire limit

in settlement The excess insurer is entitled to a credit for all of the benefits that should have been paid under the terms of the primary policy; it is not entitled to a windfall, which would result under any of the foregoing scenarios if the excess insurer were simply released from any liability.

2 Allan D. Windt, *Insurance Claims & Disputes* § 6:45, at 99 (5th ed. 2011 Supp.) (emphasis added); *accord id.* § 6:2, at 6-22 to 6-23. Here, too, it produces an “absurd result” to read the attachment point provisions of the Excess Carriers’ policies as nullifying the coverage Quellos reasonably expected for losses far exceeding primary policy limits simply because Quellos settled with the primary insurer for less than full policy limits.

The absurdity of the literal reading that the Excess Carriers persuaded the trial court to accept is underscored by the fact that Quellos is rendered worse off for having purchased the primary policy from AISLIC than Quellos would have been had it not bought primary coverage at all. The Excess Carriers’ policies both contain provisions stating that Quellos is to “maintain []” the “Underlying Insurance” during the policy periods of their policies. CP 99, § 2 (Ex. D), CP 111, § 4 (Ex. E). But, if Quellos had chosen not to purchase primary coverage, rather than paying AISLIC \$1,200,000 in premiums for this primary coverage (CP 210, ¶ 7 (Ex. B)), Quellos still would have been entitled to recover from the Excess Carriers after giving them a credit for the policy limits that were to be provided by the missing primary policy. *State Farm Fire & Cas. Co. v. Nationwide*

Mut. Ins. Co., 596 F. Supp. 2d 940, 947-48 (E.D. Va. 2009) ("If the insured does not maintain the underlying minimum policy limits specified in the Declarations, State Farm will only pay the amount of loss in excess of that minimum limit."); 2 Allan D. Windt, *supra*, § 6:45, at 6-365 ("In the event an insured breaches its obligation under an excess policy to maintain primary insurance, the excess insurer's duty to indemnify should encompass those damages in excess of what the primary limits were supposed to have been."). It is an absurd result to construe the attachment point language in the Excess Carriers' policies to preclude Quellos from collecting any excess insurance when Quellos *did* purchase a primary policy, as the Excess Carriers' policies require.

There are numerous other situations, in addition to settling with the policyholder for less than full policy limits, in which a primary insurer will not pay out its policy limits to its policyholder. Coverage under the primary policy may, for example, be lost because the policy is cancelled or because the policyholder committed a material and substantially prejudicial breach of a primary policy requirement not imposed by the terms of the excess policies. Having contracted with the policyholder and set a premium based on the existence of the underlying insurance, the excess insurer may properly argue that its obligation is limited to losses that would have been paid by the primary policy limits if those limits had been

collectible. But it is absurd to read the standardized attachment point provisions at issue to nullify excess coverage in the myriad circumstances in which the policyholder may be unable to collect from its primary carrier. Because Washington law forbids “literal” readings of policy language that produce such “absurd” results, *Morgan*, 86 Wn.2d at 434-35, this Court should reject the Excess Carriers’ interpretation, and rule that the attachment point language in their policies obligates them to provide coverage as long as Quellos makes up any difference between the settlement amount paid by the underlying insurers and underlying policy limits.

B. The Excess Carriers’ Literal Interpretation Also Contravenes Paramount Principles Favoring Settlement.

In addition to sanctioning other absurd results, the trial court ignored the deleterious impact of the Excess Carriers’ literal interpretation on the ability of policyholders to fashion reasonable settlements of insurance disputes. The Washington Supreme Court’s decision in *Seafirst Ctr. Ltd. P’ship v. Erickson*, 127 Wn.2d 355, 366, 898 P.2d 299 (1995) highlights “Washington’s strong public policy of encouraging settlements,”⁷ and reconfirms that it was error for the trial court to accept

⁷ The Washington Supreme has also ruled in numerous other cases that Washington law strongly favors the public policy of settlement over litigation. *Am. Safety Ins. Co. v. City of Olympia*, 162 Wn.2d 762, 772, 174 P.3d 54 (2007) (citing, as examples, *City of Seattle v. Blume*, 134 Wn.2d 243, 258, 947 P.2d 223 (1997) (“[T]he express public policy of this state ... strongly encourages settlement.”); *Seafirst Ctr. Ltd. P’ship v. Erickson*, 127 Wn.2d

the Excess Carriers' literal interpretation in the circumstances presented here.

In *Seafirst*, the Court invoked this strong public policy in abrogating in part the common-law "rule of discharge," under which releasing one joint obligor to a contract through means such as settlement had the effect of releasing all other joint or joint-and-several obligors. See 127 Wn.2d at 364. In so ruling, the Court emphasized that "[a]llowing the obligee to accept partial satisfaction promotes settlement, which the law strongly favors." *Id.* at 365. The Court also emphasized that, "if [the opposing] view is correct, one recalcitrant obligor could force a trial regardless of the desires of the other parties." *Id.* (quoting *Seafirst Ctr. Ltd. P'ship v. Kargianis, Austin & Erickson*, 73 Wn. App. 471, 476, 866 P.2d 60 (1994)).

The draconian effect the trial court ascribed to the standardized policy language at issue at the Excess Carriers' urging presents precisely the same concern the Washington Supreme Court confronted in *Seafirst*. If this standardized language is read to permit a forfeiture of excess coverage unless the policyholder collects every dollar of underlying policy limits from the underlying insurer or insurers, then policyholders very often will

355, 366, 898 P.2d 299 (1995) (referring to "Washington's strong public policy of encouraging settlements"); *Haller v. Wallis*, 89 Wn.2d 539, 545, 573 P.2d 1302 (1978) ("[T]he law favors amicable settlement of disputes . . .").

have no choice but to litigate their disputes with the underlying insurers to judgment because insurers generally demand some discount off full policy limits as a condition of settlement. The trial court's application of the attachment point provisions thus plainly would enable "recalcitrant" excess insurers to "force a trial regardless of the desires" of the primary insurer and or policyholder, contrary to the teaching of *Seafirst*, which dictates that all settlements of coverage disputes are to be promoted. The impact of this ruling on policyholders of limited means, who may lack the resources to engage in protracted litigation with each of the insurers providing successive layers of insurance, would be particularly harsh.

Courts in Washington have rejected the interpretation accepted by the trial court here precisely because Washington law promotes a policyholder to have the right to settle with its underlying insurer for less than full policy limits without forfeiting its excess coverage. *See Kalama*, 1995 WL 17015061, at *3 & n.5; *accord Nw. Steel Rolling Mills*, No. C86-376WD, at 2:16-3:3 (citing favorably to *Zeig*, 23 F.2d 665 and *Stargatt*, 67 F.R.D. 689 and holding that allowing a policyholder to settle for less than full limits with an underlying insurer supports "the desirability of settlement, which would be made more difficult by a contrary holding").

In *Kalama*, the court enumerated four considerations establishing why excess coverage should not depend upon whether a policyholder is

able to settle with its primary insurer for full policy limits. 1995 WL 17015061 at *3 & n.5. First, “[i]t would be a waste of judicial resources and an unnecessary risk to the insured to expose itself to the unknowns of a trial, if the insured were required, for example, to go to trial in order to access its excess coverage, even if it had an offer to settle for one penny or one dollar short of full primary limits.” *Id.* Second, “if the damages were ten million dollars, the primary limits were \$100,000 and the excess limits were twenty million, it might be a good business decision to forego the expense associated with pursuing the primary carrier altogether.” Third, “it may be economically sound for the insured to take a percentage of its primary insurance, pay the difference itself to the retained limit of its excess carrier and then proceed under its excess.” *Id.* Fourth and finally, “if the insured had a small primary policy, it may be economically sensible to pay the primary limits and then proceed under the excess.” *Id.*

Consistent with the Washington courts’ reasoning in *Seafirst* and *Kalama*, the great weight of authority from other jurisdictions also supports rejection of the contention that an excess carrier may avoid coverage because the policyholder settles with an underlying insurer for less than full policy limits. This authority holds that a policyholder’s less-than-limits settlement with an underlying insurer serves to exhaust the underlying coverage when the policyholder covers the resulting gap between the

settlement amount and the attachment point of the overlying excess policy.

HLTH Corp. v. Agricultural Excess & Surplus Ins. Co., 2008 WL 3413327 (Del. Sup. Ct. July 31, 2008), is particularly instructive. In this case, the court rejected the argument made by Federal and other excess insurers that attachment point language very similar to that at issue here served to nullify excess coverage because the policyholder had settled with the underlying insurer for less than its policy limits. The policy language at issue stated that coverage attached “[o]nly in the event of exhaustion of the Underlying limit by reason of the insurers of the Underlying Insurance, or the insureds in the event of financial impairment or insolvency of an insurer of the Underlying Insurance, paying in legal currency loss which, except for the amount thereof, would have been covered hereunder.” *Id.* at *14. In rejecting the excess insurers’ argument, the court was guided by the same concerns cited by the Washington Supreme Court in *Seafirst*:

Settlements avoid costly and needless delays and are desirable alternatives to litigation where both parties can agree to payment and leave other separately underwritten risks unchanged. The Court sees unfairness in allowing the excess insurance companies in the instant case to avoid payment on an otherwise undisputedly legitimate claim.

Id. at *15. To promote, rather than stifle, settlement of coverage disputes, and recognizing the fundamental unfairness of penalizing a policyholder for settling such disputes with its primary or lower level excess insurers,

the court ruled that defense costs incurred by plaintiffs exceeding “any loss they may have imposed on themselves by accepting settlements with underlying insurers for less than the policy limit” would serve to “exhaust[] *those underlying policies . . . as a matter of law.*” *Id.* (emphasis added).

Pereira v. National Union Fire Insurance Co. of Pittsburgh, Pa., 2006 WL 1982789 (S.D.N.Y. 2006), also is instructive. In this case, the court employed the same principles of policy interpretation as are applied under Washington law in ruling that nearly identical policy language did not entitle an excess carrier to disavow coverage based on a policyholder’s settlement with an underlying insurer for less than full policy limits. The policy at issue contained a provision stating that exhaustion occurs “solely as the result of actual payment of claims or losses thereunder by the applicable insurers.” *Id.* While recognizing that the excess insurer’s interpretation that underlying coverage can be exhausted only if the underlying insurers in fact pay the limits of their policies “may be reasonable,” the *Pereira* court ruled in favor of coverage because a contrary ruling would “provide a windfall to the excess insurers” to the policyholder’s substantial prejudice,” and because it could not be “said that the excess insurers’ interpretation of the policy is the only reasonable one.” *Id.*

The overwhelming majority of other cases addressing the issue also

have invoked the public policy favoring settlements in adopting the “widely-followed rule that the policyholder may recover on the excess policy for a proven loss to the extent it exceeds the primary policy’s limits.” *Koppers Co., Inc. v. Aetna Cas. & Surety Co.*, 98 F.3d 1440 (3d Cir. 1996).⁸ Because these decisions are rooted in the same fundamental policy of promoting settlements that underpins Washington law, they also support a ruling as a matter of law that the Excess Carriers cannot repudiate coverage based on Quellos’ settlement with AISLIC.

The trial court discounted this voluminous precedent on the ground that the attachment point language in many of these cases was not the same as that at issue here. RP 100:13-101:24. But the concerns expressed in all of these cases, which also guided the Washington Supreme Court’s decision in *Seafirst*, are no less applicable to the Excess Carriers’

⁸ See, e.g., *Zeig*, 23 F.2d at 666 (“To require an absolute collection of the primary insurance to its full limit would in many, if not most, cases involve delay, promote litigation, and prevent an adjustment of disputes which is both convenient and commendable.”); *Stargatt*, 67 F.R.D. at 691 (same); *Reliance Ins. Co.*, 826 So. 2d at 999 (same); *Teigen*, 367 N.W.2d at 809-810 (finding that less than limits settlement exhausted primary policy and triggered excess policy, in part, because allowing partial settlements “foster[s] effective and expeditious resolution of lawsuits.”); *Drake*, 514 N.W.2d at 789 (“[E]nforcement of policy exhaustion clauses would serve to force an insured to litigate the claim to final judgment in order to exhaust the policy claim limits . . . and unnecessarily burden the court system.” (internal citations and quotation marks omitted)); *Elliott Co.*, 434 F. Supp. 2d at 500 (holding in favor of coverage because “to hold otherwise discourages reasonable settlement between the insured and the primary insurer”); *Siligato*, 607 F. Supp. at 747 (“A primary insurer is permitted, and should be encouraged, to settle a claim.”); *Allstate Ins. Co.*, 509 F. Supp. at 48 (“There is no question but that the public policy of the state of Michigan is to encourage settlements.”); *Trinity Homes*, 629 F.3d at 659 (“[Excess insurer’s] reading of the policy would deter parties . . . from settling with their [underlying] insurers. . . . Indiana public policy favors an interpretation that encourages-not discourages-settlement.”).

standardized attachment point provisions. In stark contrast, the out-of-state cases upon which the Excess Carriers relied below accepted a literal reading of these provisions, despite the “conflicting social and economic considerations,” including the public policy of promoting settlement. *E.g.*, *Qualcomm, Inc. v. Certain Underwriters at Lloyd’s, London*, 161 Cal. App. 4th 184, 73 Cal Rptr. 3d 770 (Cal. Ct. App. 2008) (citation omitted). Such cases do not support the trial court’s ruling because Washington law forbids such a literal reading of policy language in the circumstances presented here.

III. THE TRIAL COURT ERRED IN RULING THAT THE ATTACHMENT POINT CONDITIONS WERE NEGOTIATED.

It appears that the trial court failed to apply the settled principles of policy interpretation governing the interpretation of the attachment point conditions in the Excess Carriers’ policies at least in part because of its erroneous belief that these conditions somehow had been the subject of negotiation. In this regard, the trial court stated:

[A]lthough, we have never adopted a sophisticated insured standard here in Washington, when individuals do negotiate different forms of policies - and clearly these two policies differ. They’re not just quote/unquote, boilerplate or standard form policies - when parties sit down and have particular policy language, you need to give effect to that ... policy language.

RP 100:5-12. The trial court correctly concluded that the Washington Supreme Court has rejected the “sophisticated insured” standard for

construing insurance policies. *E.g.*, *Boeing Co. v. Aetna Casualty and Surety Co.*, 113 Wn.2d 869, 784 P.2d 507 (1990). But there is no basis in the record for the trial court's finding that Quellos had the privilege of "sitting down" and negotiating the policy wording with the Excess Carriers.

Quellos purchased standard-form policies from both of the Excess Carriers,⁹ and the Excess Carriers have presented no evidence at all that Quellos either negotiated the attachment point language at issue or was offered and rejected alternative available language, or that the parties intended for any specialized or technical meaning to apply. While Indian Harbor submitted an endorsement to the trial court containing alternative attachment point language (*see* CP 218), sworn testimony presented by Quellos showed that it was not informed of the availability of that language. *See* CP 300, ¶ 3 (Ex. F). The mere fact that Indian Harbor may have had some specialized alternative language in its "back pocket" did not entitle the Excess Carriers to summary judgment, and the trial court's ruling in their favor should be reversed for the numerous reasons discussed above.

IV. REQUEST FOR ATTORNEYS' FEES AND EXPENSES.

In the event that this Court overturns the trial court's ruling and finds in favor of coverage, Quellos requests an award of its attorneys' fees

⁹ *See* CP 99 (Form 14-02-2272 (Ed. 5/97)) (Ex. D), CP 110 (Form EX 71 01 09 99) (Ex. E), CP 210-11, ¶¶ 9, 11 (Ex. B).

and costs. The Washington Supreme Court has held that an award of such expenses is required when a policyholder prevails in an action to obtain the benefit of its insurance policy. *E.g., Olympic Steamship Co., Inc. v. Centennial Ins. Co.*, 117 Wn.2d 37, 53, 811 P.2d 673 (1991); *McGreevy v. Oregon Mut. Ins. Co.*, 128 Wn.2d 26, 32-33, 904 P.2d 731 (1995). This policyholder is entitled to such an award regardless of whether the insurance policy provides for such an award. *Klickitat Cnty.*, 124 Wn.2d at 813; *see also Leingang v. Pierce Cnty. Medical Bureau, Inc.*, 131 Wn.2d 133, 930 P.2d 288 (1997).

CONCLUSION

For the foregoing reasons, Quellos respectfully requests that this Court reverse the trial court's February 20, 2012 Order Granting Defendants' Motions for Summary Judgment regarding the exhaustion of underlying limits of insurance (CP 322-26), vacate the trial court's entry of judgment in favor of the Excess Carriers, and award Quellos its reasonable attorneys' fees and costs.

Respectfully submitted,
KILPATRICK, TOWNSEND &
STOCKTON, LLP

DEARMIN FOGARTY
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CERTIFICATE OF SERVICE

I hereby certify that on June 20, 2012, I filed with the Court of Appeals of the State of Washington, Division 1, the foregoing, **Brief of Appellant/Cross-Respondent**, and served a copy on the following counsel of record:

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NO. 68478-7

IN THE COURT OF APPEALS OF THE STATE OF WASHINGTON
DIVISION I

QUELLOS GROUP LLC, *Appellant/Cross-Respondent*,

v.

FEDERAL INSURANCE COMPANY and INDIAN HARBOR
INSURANCE COMPANY, *Respondents/Cross-Appellants*

**APPENDIX TO BRIEF OF APPELLANT/CROSS-RESPONDENT
EXHIBITS A - F**

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COURT OF APPEALS
STATE OF WASHINGTON
DIVISION I

EXHIBIT A

1 SUPERIOR COURT OF WASHINGTON IN AND FOR KING COUNTY

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3 QUELLOS GROUP LLC,)
4 Plaintiff,)
5 vs.) 10-2-41637-4 SEA
6 FEDERAL INSURANCE COMPANY;)
7 INDIAN HARBOR INSURANCE COMPANY;))
8 STEADFAST INSURANCE COMPANY;)
9 and NUTMEG INSURANCE COMPANY,)
10 Defendants.)

11 _____
12 TRANSCRIPT OF PROCEEDINGS
13 BEFORE THE HONORABLE DEAN LUM

14 _____
15 DECEMBER 16, 2011

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24 RECORDING TRANSCRIBED BY:
25 CHERYL J. HAMMER, RPR, CCR 2512

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3 (BEGINNING OF TRANSCRIPTION)

4 THE COURT: Thank you. Please be
5 seated. Good morning.

6 NUMEROUS VOICES: Good morning, Your
7 Honor.

8 THE COURT: Counsel, we're being
9 recorded on a DVD. So let's see. Could you enter
10 your appearances for the record, starting this way and
11 going this way.

12 MR. STANDISH: Daniel Standish on
13 behalf of Federal Insurance Company.

14 MR. WILSON: Good morning, Your Honor.
15 John Wilson also on behalf of Federal.

16 MS. RICHEIMER: Good morning, Your
17 Honor. Gabriela Richeimer on behalf of Indian Harbor
18 Insurance Company.

19 MR. BENTSON: Good morning. Dan
20 Bentson on behalf of Indian Harbor.

21 MR. FOGARTY: Good morning, Your
22 Honor. Paul Fogarty, local counsel for the plaintiff.
23 And I'm joined by my cocounsel Barry Fleishman and
24 Helen Michaels, who will be making argument. Also
25 we're joined by Mary Przekop, who recently joined our

1 firm.

2 THE COURT: Great. Thank you.

3 MR. FOGARTY: From Seattle U.

4 THE COURT: All right. You can sit at
5 the table if you want. All right. Thank you.

6 Counsel, thank you very much. I very
7 much appreciate your briefing in this matter, and I
8 guarantee you I've read it all. I took some time with
9 the case.

10 One challenge, of course, for my
11 bailiff has to make has been to make sure that she's
12 received, as working copies, everything that's been
13 filed. And so I believe she has confirmed that I have
14 received and read everything that you've filed. I
15 have a list here, and so to -- and so regardless of
16 what happens here, the final order should reflect all
17 of the documents that were considered.

18 Now, I have a list here, and I don't
19 know if she shared that with you, but I think what I'd
20 like you to do is just confirm at some point that my
21 list is the same as your list.

22 MR. FLEISHMAN: We did see that list,
23 Your Honor. We sent it over earlier this week to
24 confirm.

25 THE COURT: Is that right?

1 MS. RICHEIMER: Yes, Your Honor.

2 THE COURT: Thanks. So obviously, you
3 know, on this, to the extent the court grants any
4 summary judgment to anyone, it's a standard review on
5 a matter of law is de novo, but it's very important
6 that we incorporate in that final order all the
7 documents that or pleadings that the court reviewed.

8 So Counsel, let's -- I did spend
9 probably until about 2:00 last night taking a look at
10 this. And I take my notes on my iPad now, so if you
11 see me looking down during your argument, I'm not
12 checking my email. I'm checking my notes. All right.

13 So all right. We have until 11:00.
14 11:00 is when somebody else is coming here arguing
15 their summary judgment motion. So I'm happy to divide
16 it up. Have you discussed how you want to organize
17 argument or is there a disagreement about that?

18 MR. FLEISHMAN: Good morning, Your
19 Honor. Barry Fleishman again. We've discussed it and
20 there are two summary judgement motions. One deals
21 with the issue of exhaustion; the other deals with the
22 issue of bad acts exclusion. We've talked it over
23 with counsel for the insurance companies, and we're
24 going to -- if it's all right with Your Honor, I'll do
25 sort of a brief overview of the facts to put the case

1 in context and then go into the exhaustion argument.

2 And counsel will respond on the
3 exhaustion argument and we'll take the first hour or
4 as much time as you'd like on the exhaustion and then
5 move on. Ms. Michaels is going to argue our side of
6 the bad acts exclusion argument.

7 THE COURT: That sounds fine. So
8 essentially we can divide it in half, shall we? Shall
9 we agree we're going to divide in half and maybe take
10 a five minute recess, five or 10 minute recess
11 between, you know?

12 MR. FLEISHMAN: That's fine, Your
13 Honor.

14 THE COURT: Is that okay?

15 MS. RICHEIMER: That's fine, Your
16 Honor. I would say we can -- I certainly think on the
17 exhaustion we wouldn't need to spend more than an
18 hour, and I would like to make sure there was an hour
19 to spend on the other issues, so...

20 THE COURT: Right. I think what we'd
21 like to do is let's go ahead and take a recess at
22 10:00, okay? Then take a 10 minute recess at 10:00
23 and that's a logical stopping point, unless everybody
24 agrees that, you know, we need to stop earlier if you
25 want to spend more time on the other one.

1 But let's go ahead and it's -- so
2 basically, give each of you -- or not each of you, but
3 I'll treat you as one side here.

4 So you guys get half an hour to talk
5 about this exhaustion issue. Whether it's a form of
6 your motion or response to their motion, you get a
7 half an hour to chat about, you know, the exhaustion,
8 whether it's your motion or opposition to theirs,
9 essentially.

10 MR. FLEISHMAN: Very good, Your Honor.

11 THE COURT: So let's go ahead and
12 start there. Counsel, let me ask you. I have a
13 couple questions for you and just I probably won't be
14 able to help myself by jumping in and asking questions
15 during your argument.

16 MR. FLEISHMAN: That always makes it
17 easier for us, Your Honor.

18 THE COURT: I don't know. When I was
19 in practice, the worst thing would be if a judge
20 didn't say anything at all, like that. That was like
21 the worst case scenario, you know, because I didn't
22 have a chance to talk to him or her out of something
23 if it wasn't going my way or I didn't have a chance to
24 talk them into, you know, something if they were going
25 my way.

1 So these policies are not
2 occurrence-based policies, are they, or are they?

3 MR. FLEISHMAN: They are claims-made
4 policies.

5 THE COURT: Claims-made policies.

6 MR. FLEISHMAN: And that's why we're
7 dealing with one particular year for these
8 transactions that are at issue, the POINT
9 transactions.

10 THE COURT: And the primary policy at
11 issue did not distinguish between or did it
12 distinguish between defense cost and indemnity costs?
13 Did it?

14 MR. FLEISHMAN: In terms of the
15 settlement, Your Honor, or in terms of --

16 THE COURT: Well, anything.

17 MR. FLEISHMAN: The background on the
18 case, Your Honor, is that there were different types
19 of transactions.

20 THE COURT: Understood.

21 MR. FLEISHMAN: There's CDS,
22 FLIP/OPIS, GRAT, and then there's POINT.

23 THE COURT: Right.

24 MR. FLEISHMAN: On everything other
25 than POINT, the insurance companies were paying

1 defense costs and they were contributing to the
2 settlements on an agreed basis between Quellos and the
3 insurance companies.

4 THE COURT: Right.

5 MR. FLEISHMAN: On POINT, the carriers
6 deny as to everything. The primary carrier made some
7 payments in spite of its denial but stopped and then
8 said we're paying no more. We deny coverage.

9 THE COURT: In some CGL pol -- okay.
10 Go ahead. Go ahead and read the note. That's okay.

11 In some CGL policies there's a
12 distinction, and in many of the cases both of you cite
13 there are different, different kinds of policies. And
14 it appears these are different kinds of claims-made
15 policies and occurrence-based CGL policies, which, you
16 know, a whole bunch of these cases that both parties
17 cite are not claims-made policies. They're, you know,
18 CGL policies.

19 The Kalama Chemical case was a CGL
20 policy, primary and excess. Same thing in the
21 Northwest Rolling Mills case and the Boeing v. Aetna
22 case as well. All of those cases that Washington
23 practitioners are intimately familiar with, but, but
24 these -- in those cases there was this distinction
25 between defense and indemnity costs and the defense

1 costs didn't come off the retained limit.

2 MR. FLEISHMAN: That's correct, Your
3 Honor.

4 THE COURT: So is that not the case in
5 this case?

6 MR. FLEISHMAN: No. In this case the
7 defense -- there is a duty to defend and there is a
8 duty to indemnify in these claims-made policies. The
9 difference on the limits and exhaustion is that the
10 defense costs exhaust the limits just as the indemnity
11 does. The usual type of CGL defense is outside
12 limits.

13 THE COURT: Right. So yeah. All
14 right. So in a normal CGL case, you wouldn't --
15 somebody could -- a primary carrier could offer up
16 limits, and that -- but that wouldn't be all that they
17 were giving up if they were claiming exhaustion,
18 because they still had, arguably, an unlimited amount
19 of defense costs that they may have to incur. Is that
20 correct?

21 MR. FLEISHMAN: That's right. In an
22 ordinary case a policy holder could say we're not
23 accepting you to put up just your limits, because then
24 you're removing your duty to defense, which is outside
25 your limits.

1 THE COURT: Right. So you believe
2 that that issue is -- that they agree with you on that
3 limit, or is there a disagreement about that issue?
4 In other words, that classic defense costs also count
5 against the limit?

6 MR. FLEISHMAN: No. I think there's
7 basic agreement on that fact, Your Honor. The
8 disagreement comes as to whether the primary carrier,
9 in this case AISLIC, needed actually to give us that
10 money in order to trigger the excess policies.

11 THE COURT: Right. So if -- is any
12 amount of money that your client paid necessarily,
13 does it necessarily count against that limit? There
14 clearly was a cover -- is a coverage dispute, and the
15 primary carrier clearly compromised, did not pay
16 limits.

17 If they had paid limits, arguably,
18 there would be pretty good argument that all of the
19 stuff that they paid, all the money they paid, went
20 toward covered claims. But there clearly is a huge
21 coverage dispute going on here. And arguably, they're
22 saying that, you know, due to the fraud exclusion
23 primarily, that none of this or a significant portion
24 of this is not covered.

25 So do you -- in order to get to them

1 first on the exhaustion issue, don't you have to first
2 prove that those were covered costs as opposed to
3 uncovered costs?

4 MR. FLEISHMAN: I think what the
5 carriers are arguing is actually the reverse. That we
6 don't even get to the issue of whether it's covered or
7 not covered, because there hasn't been exhaustion as a
8 matter of law.

9 THE COURT: Right. That's their
10 motion. How about your motion?

11 MR. FLEISHMAN: We don't necessarily
12 disagree with that. We believe that the exhaustion
13 requirements under their policies have been met, and
14 so you go directly now to the issues of actual
15 coverage under the policy.

16 THE COURT: Okay.

17 MR. FLEISHMAN: To put it briefly and
18 concisely, Your Honor, if you rule that the insurance
19 companies are correct, that the condition of
20 exhaustion has not been met, we're done. We go up to
21 the appellate court to see if that's correct.

22 If you agree with *Quellos*, that the
23 exhaustion requirements under the policies have been
24 met or don't need to be met because of Washington law,
25 then we go on to the coverage issues on determining

1 whether in fact there's coverage under policies.

2 THE COURT: All right. So in terms of
3 the exhaustion cases, both sides cite numerous cases.
4 There's a -- the primary distinction being the
5 particular policy language at issue differs slightly
6 from case to case, from reported case to reported
7 case.

8 So in terms of the cases you cite,
9 does it matter how specific those -- I mean, are a lot
10 of your cases distinguishable because they have
11 different policy language? I mean, that's what they
12 say. They say your cases are distinguishable and if
13 they don't clearly define, with specificity, arguably
14 the way they find in their policy, then of course it's
15 ambiguous.

16 And so of course if it's ambiguous
17 then you go into policy considerations, world of
18 construction, all those, you know, the policy of
19 promoting settlements, all the, you know, the typical
20 kind of of course line of reasoning.

21 But if how -- how many cases do you
22 have which actually construe their policy language?
23 It appears that we have one out of the Federal
24 District Court in New York and then we have one other
25 one, which they criticize as being actually dicta.

1 So is that right, that those were the
2 only two that you cited with exactly the same policy
3 language? I note that you --

4 MR. FLEISHMAN: That's correct, Your
5 Honor.

6 THE COURT: As a fine matter, I notice
7 that a couple times you say functionally equivalent.
8 Hats off to you and your counsel. You say
9 functionally equivalent language and a bunch of other
10 things, but, you know, in terms of actual same
11 language, are those the only two ones that you cite?

12 MR. FLEISHMAN: Yes, the HLTH case out
13 of Delaware and the Pereira case out of New York.

14 THE COURT: I mean, how material is
15 that, that the language?

16 MR. FLEISHMAN: We don't think they
17 get there, Your Honor. We make three arguments why
18 the insurance companies are wrong and why summary
19 judgment needs to be granted on behalf of Quellos.

20 THE COURT: So I'll leave you alone on
21 that right now.

22 MR. FLEISHMAN: If you are -- if you
23 agree with us on the first argument, you don't get to
24 the ambiguity issue, you don't get to the materiality
25 issues, you don't get to the prejudice issue. It ends

1 if you agree with us on this first issue. And that
2 is, in light of the denial of coverage that the
3 insurance company has made in this case, do they have
4 the right to assert that the condition should apply.

5 Now, the background to the case, the
6 factual background, is very important to understand so
7 that you fully comprehend how important it was that
8 they deny coverage.

9 These cases arise from claims made in
10 2005. They fall into the 2004/2005 policy period.
11 Very soon after the claims were made on POINT, they
12 were denied by all of the insurance companies.
13 Primary and then Federal sits on top of the primary
14 and Indian Harbor sits on top of Federal. They all
15 denied.

16 My client was on its own at that
17 point. We paid all the defense costs. We pay the
18 settlement amounts. More than 40 million dollars in
19 total with defense costs and settlement amounts. We
20 didn't have any protection from any of the insurance
21 companies during that period of time.

22 It's only now, after the settlement
23 with AISLIC, which took place last year, that the
24 insurance companies say, well, because AISLIC didn't
25 pay you every single penny of their primary limits,

1 that was a precondition to coverage and you can't
2 claim under our policies. AISLIC breached.

3 If AISLIC is wrong, which means they
4 are wrong, which means there is actual coverage, the
5 insurance companies are saying they can profit by the
6 breach by the primary carrier. Primary carrier said
7 we're not paying. They might -- they may be wrong.
8 They may be right. We'll determine that when we get
9 to the coverage side of the case.

10 Primary carrier said we're not paying.
11 My client had to do all the payments. They had no
12 choice. And even if my client is right and AISLIC is
13 wrong and there's coverage, the insurance companies
14 are saying, well, we don't pay, because AISLIC didn't
15 pay the full amount to their limits.

16 They're getting a free ride. They
17 would be getting a free ride based upon the bad act
18 and the breach of contract by the insurance company
19 that sits underneath that. They'd be getting a
20 windfall.

21 THE COURT: Was one of the bases for
22 denial failure to exhaust underlying limits?

23 MR. FLEISHMAN: I believe they mention
24 that in their -- well, they couldn't have used it as a
25 basis for denial, because it didn't happen until four

1 years later when the settlement was reached.

2 They say in their policy -- they say
3 in their letters that in order to get us, you have to
4 exhaust, but that actually didn't take place until
5 AISLIC made the settlement four years later.

6 If you look at the case law, the case
7 law is absolutely clear on the point. You start with
8 Vision One, and Vision One says with respect to a
9 consent to settle situation, where the policy says you
10 need the insurance company's consent in order to
11 settle the case, and the consent was not gotten.

12 But the insurance company had denied,
13 Vision One, which is 158 Wash Ap 91 241 P 3rd 429, it
14 says, straight out, that when an insurer denies
15 liability and the insured settles with the tort
16 feator, the insurer is estopped from claiming that the
17 insured breached the policy by impairing, recognizing
18 that you can't deny and then seek to enforce a
19 condition under the policy.

20 It goes on to quote from a Fifth
21 Circuit opinion that says, it's difficult to see why
22 an insurer should be allowed on the one hand to deny
23 liability, and thus in the eyes of the insured breach
24 its contract, at the same time, on the other hand, be
25 allowed to insist that the insured honor all his

1 contractual commitments.

2 Clearly stating Washington law, that
3 if you choose to deny coverage, you are estopped. You
4 cannot raise a condition to coverage as a reason for
5 denial.

6 Now, the carriers say this doesn't
7 apply because it's not a condition. First they say,
8 you know, the provision in the policy that sets forth
9 the exhaustion requirements is not a condition. They
10 say it's part of the actual insurance coverage grant.

11 If you look at the language, that's
12 not what the language of the policy says. Take a look
13 at the Chubb policy. The Chubb policy starts off with
14 one sentence. The company shall provide the insureds
15 with insurance during the policy period excess of the
16 underlying limit. That's the coverage grant.

17 Then it says, coverage hereunder shall
18 attach only after the insurers of the underlying
19 insureds shall have paid in legal currency the full
20 amount of the underlying limit. That's the condition.
21 It uses the condition words. Shall attach only after.
22 That is a condition proceeding.

23 THE COURT: Well, aren't all coverage
24 grants in a general sense conditions? I mean, you
25 could call every provision of a policy a condition.

1 Something has to happen before, you know, you get
2 coverage, right? So in a broad sense, if we define
3 condition broadly, then everything in the policy is a
4 condition.

5 Is that really what the court meant
6 when they were defining condition?

7 MR. FLEISHMAN: Well, there's a
8 difference between whether you meet the substance of
9 the policy, whether the wrongful act under the policy
10 meets the definition of wrongful act, whether the
11 coverage actually fits the terms of the coverage
12 grant. This provision isn't about that.

13 This is saying, even if you meet the
14 coverage provisions of the policy, even if your claim
15 is covered under the policy, we only pay after certain
16 action takes place. And the Washington courts in this
17 type of situation have said that that's conditional
18 language.

19 If you take a look at the Kalama case,
20 which is 1995 17015061 Westlaw, it says it straight
21 out, key policy language makes clear that exhaustion
22 of underlying limits is a condition precedent to
23 coverage under the 2, the Roman numeral 2, excess
24 policy.

25 You can't get much more clear than

1 that. Superior Court of Washington saying exhaustion
2 of underlying limits is a condition proceeding.

3 THE COURT: Actually, that actually
4 raises an issue. That's a trial court decision, is it
5 not?

6 MR. FLEISHMAN: It is.

7 THE COURT: So are we, I guess, are we
8 allowed to cite trial court decisions?

9 MR. FLEISHMAN: You take a look at the
10 Colorado Structures case.

11 THE COURT: All right. That's
12 published.

13 MR. FLEISHMAN: Colorado Structures
14 case. A condition is an event that must occur or a
15 circumstance that must exist in order for the promisor
16 to have a duty to perform.

17 Here we're saying even if coverage is
18 there, coverage under the policy is there, their duty
19 to perform does not take place until only after --
20 using the word from the policy -- there has been
21 exhaustion. A condition -- this is back from the
22 decision. A condition is classified according to its
23 origin and effect. It can be expressed, implied in
24 fact or constructed. It is precedent. It's a
25 condition precedent if its occurrence triggers a duty

1 of performance that has not arisen previously.

2 That's exactly what they're saying
3 here. Exhaustion did not take place; therefore the
4 obligation to provide coverage has not been triggered.
5 These words in their provision meet exactly what the
6 conditions words are in the cases.

7 Now, they're also saying that
8 Washington does not allow a condition -- this argument
9 to result in coverage that was never there to begin
10 with. We don't take issue with that.

11 If there was an exclusion in the
12 policy that said you don't have coverage for X, and
13 then you're arguing, well, you can't assert that
14 because you're already denied coverage, that would be
15 creating coverage from a denial of the policy, a
16 denial of the claim. We're not arguing that.

17 What we're saying is there's been no
18 expansion of the coverage whatsoever. They are still
19 sitting on top of the primary limits. Quellos is not
20 asking any of the insurance companies to come below
21 the policy limits.

22 We're not changing the scope of the
23 coverage. We're not changing the definition of the
24 claim. We're not changing anything about whether the
25 acts that were alleged in the underlying actions fit

1 within the policy.

2 So there's no possible argument that
3 there is an expansion of coverage here. We're only
4 saying the triggering event that's a condition to the
5 obligation of the carriers to pay under the policy has
6 not taken place, and if they assert that, if they
7 denied coverage, they can't assert that condition.

8 Your Honor, if --

9 THE COURT: Why don't you take another
10 10 minutes and then we'll shift.

11 MR. FLEISHMAN: Sure. If you agree
12 with Quellos on this point -- and we think the law is
13 absolutely clear -- then you don't go any further.
14 All the other arguments are done.

15 We believe they are wrong on two other
16 points. The first one is on the ambiguity point,
17 where, Your Honor, you're correct, there are cases
18 that are out there that go against our position, that
19 say when you have the language that the insurance
20 companies have in their policies. In this situation
21 policy language is clear. It's going to be enforced
22 and they enforce it.

23 You have at least two cases, the HLTH
24 case and the Pereira case, that go the opposite way.
25 And the reason they go the opposite way is because

1 they interpret that language to mean that if there's
2 exhaustion by payment of the insurance company or on
3 behalf of the insurance company, it's the same thing.
4 There's no difference. There's no impact on anything.

5 And because there's a public policy in
6 favor of settlements, because there's public policy in
7 Washington against forfeiting insurance, because
8 there's public policy to try to look at the entire
9 coverage, Washington law insurance interpretation
10 principles require you not just to look at a little
11 narrow provision of a policy, but look at the entire
12 policy in context.

13 That's what they did in the Morgan
14 case. If you look at the Morgan case, Morgan says the
15 hands have to be severed above the wrist, otherwise
16 you don't get coverage. And the court said in terms
17 of the overall intent of what that policy was supposed
18 to provide, that would wipe out the coverage there was
19 supposed to be. So we're going to add the word
20 substantially severed in order to effect the intent of
21 the policy.

22 It was clear. If you look at that
23 language, it says severed, cut off, but the court said
24 that doesn't make sense in terms of the overall scope
25 of the policy. That's what we're seeing here. This

1 was an excess policy that was designed to provide
2 coverage for covered events that resulted in covered
3 losses above 10 million dollars.

4 The insurance companies are saying, we
5 don't care if it's a covered event that's more than 10
6 million dollars. For purposes of this argument, they
7 don't -- they concede that we had losses in excess of
8 10 million dollars, and in Indian Harbor's case in
9 excess of 20 million dollars.

10 They argue that there's coverage
11 issues, and we'll get to that later, but they concede
12 the losses were way above their attachment points.
13 They're saying it doesn't matter. The fact that the
14 primary carrier did not pay every single dollar on its
15 own makes everything else irrelevant.

16 I'd note that the Federal policy
17 language actually creates an impossibility if you look
18 at the language.

19 THE COURT: Hold on. Let me turn to
20 that.

21 MR. FLEISHMAN: It's on page 3 of 6.

22 THE COURT: Yeah. I wrote it out too,
23 so... Okay. Go ahead.

24 MR. FLEISHMAN: So that the Federal
25 policy, if you look at the second sentence, it says,

1 coverage hereunder shall attach only after the
2 insurers of the underlying insurance, a defined term,
3 shall have paid in legal currency the full amount of
4 the underlying limit to such policy period.

5 Underlying limit is a defined term.
6 Underlying limit, if you look at the definition, says,
7 underlying limit means the amount equal to the
8 aggregate of all limits of liability as set forth in
9 the declarations for all underlying insurance plus the
10 applicable uninsured retention.

11 There's about two and a half million
12 dollars self-insured retention on these policies that
13 has to be paid by Quellos. So the Federal policy
14 creates an impossibility. The Federal language says
15 the underlying insurance company has to pay the entire
16 underlying limit, which would include the self-insured
17 retention. That never happens. So if you actually --

18 THE COURT: Wait, wait, wait. Run
19 that by me again. The language says the self-insured
20 retention plus the retained limit, correct?

21 MR. FLEISHMAN: The definition of
22 underlying limit is the underlying coverage plus the
23 Quellos retention.

24 THE COURT: Right. Okay.

25 MR. FLEISHMAN: The language that

1 Federal is relying on says the underlying carriers,
2 the insurers, have to pay both. They have to pay the
3 entire underlying limit, which means they have to pay
4 the insurer's part of it as well as the self-insured
5 retention.

6 It's an error, arguably, in the
7 language, or it creates an ambiguity in the language,
8 because it can't be enforced the way it's written. If
9 it's enforced the way it's written, the insurance --
10 the policy holder never gets anything.

11 But that just goes to show the
12 absurdity of the language and the windfall that it
13 creates for the insurance company. That was never the
14 intent of this policy.

15 So what we're saying the second
16 portion of our argument is, under the law of
17 Washington, you can read their language to say needs
18 to be exhausted by payments by the insurers or on
19 their behalf. That fits the public policy of
20 Washington. That fits the interpretation laws within
21 the state of Washington, and you can rule that that
22 has been met, because the loss is above the limit.

23 I'll take two minutes, Your Honor,
24 because I realize it's 9:32.

25 THE COURT: I'm going to give you a

1 little bit of a rebuttal time too, so go ahead.

2 MR. FLEISHMAN: Thank you, Your Honor.

3 The last point I'd make, Your Honor,
4 is if you rule against us on the consent on the
5 condition that they can't raise this as a condition
6 after denying, you rule against us on what the
7 language actually means. Even then they still have to
8 show that there was a material breach by which they
9 were prejudiced.

10 There's nothing in their papers, Your
11 Honor, that shows that the lack of AISLIC paying every
12 single dollar was material. There's nothing in their
13 papers that demonstrates any actual prejudice. The
14 law in Washington requires that prejudice can't be
15 assumed. There has to be actual prejudice under the
16 policy.

17 Washington law has applied it in the
18 Salzberg case with respect to the cooperation clause.
19 They've applied it in the public utilities case with
20 respect to settlement without consent. They've
21 applied it in Canron and other cases with respect to
22 notice.

23 Clear as crystal under Washington law
24 that if they seek to enforce a condition, they have to
25 show that there was a material breach and that there

1 was some actual prejudice that they suffered. They
2 can't do that here, because the coverage is the same.
3 Their requirements are the same. The triggering
4 attachment point is the same. Nothing has happened
5 that actually prejudiced these carriers.

6 They denied. The primary carrier
7 denied. Quellos was on its own to defend from the
8 beginning. They can't meet the standard under
9 Washington law. So on any -- you can take your
10 choice, Your Honor.

11 You can choose they can't raise the
12 condition at all, you can choose that the language is
13 ambiguous and can't be interpreted in their favor, or
14 you can choose that there's no material breach and
15 they haven't shown any prejudice. Quellos can win on
16 any of those three points.

17 Thank you, Your Honor.

18 THE COURT: Thank you very much.
19 Counsel, who wants to start?

20 MS. RICHEIMER: Gabriela Richeimer for
21 Indian Harbor. But I will leave, since the Federal
22 policy was directly addressed, I'll leave, Dan, if you
23 want, I'll leave a few minutes for Federal.

24 THE COURT: So you're representing
25 Indian Harbor, correct?

1 MS. RICHEIMER: Indian Harbor. That's
2 right, Your Honor.

3 THE COURT: So tell me about -- so is
4 this a condition or not?

5 MS. RICHEIMER: Well, one thing I
6 agree with counsel on, Your Honor, is that it is
7 important to read the entire policy, or at least the
8 coverage form. And you'll note, Your Honor, from the
9 stipulation, the coverage form for Indian Harbor is,
10 you know, a mere three pages.

11 It's not a dense form, but we think
12 it's a very clear form. And the language appears
13 first of all in the insuring agreement. And I think
14 it is important, Your Honor, to understand that this
15 is an excess policy. It's not triggered merely by the
16 assertion of wrongful acts against the insured.

17 There's a very specific requirement in
18 the insuring agreement that says the coverage
19 hereunder will attach only after all of the underlying
20 insurance has been exhausted by the actual payment of
21 loss by the applicable insurers thereunder.

22 Your Honor, and then it's reinforced
23 elsewhere in the policy, and we provided full quotes
24 for you in our briefing to show that, you know, about
25 half of this policy consists of various ways for

1 Indian Harbor to express to its insured that this is
2 not a mere condition of coverage; this is a principle
3 of attachment of this excess policy.

4 This is why, Your Honor, we talked
5 about the case from the appellate case in Safeco
6 versus Gannon, and the same principle was also --
7 that's 54 Washington Ap 330, and the same principle
8 was applied recently by the US District Court in Moody
9 versus American Guarantee. And that cite was 2011 US
10 District Lexis 38024.

11 And this goes to the point that you
12 were alluding to with Mr. Fleishman's presentation,
13 Your Honor, that, yeah, I mean, just about anything in
14 this insurance policy is a condition. The quote that
15 counsel made from Colorado Structures was an event
16 that has to occur or a circumstance that must exist, a
17 triggering event. And that's true in the Gannon case
18 and in this Moody case. Those were notice cases.

19 Those were cases where the insurance
20 companies had denied coverage based upon failure to
21 give notice. And in those cases the court said,
22 because it was a claims -- these were claims-made
23 policies, that you cannot treat notice as a mere
24 condition. That's the quote, mere condition of
25 coverage.

1 If you read it out of the policy, you
2 change the basic insuring agreement between the
3 insurer and the insured. And Your Honor, that's what
4 we say is exactly what happens here. When you take a
5 policy --

6 THE COURT: So in other words, you're
7 saying not all conditions are conditions. Not all
8 conditions are mere conditions. There are mere
9 conditions and other conditions, right?

10 MS. RICHEIMER: Well, yes, Your Honor.
11 I mean, in the context of insurance, I mean, I think
12 where this whole condition of precedent comes up, and
13 that's the Ross versus Harding case and other types of
14 contracts, is you're picking them apart and you're
15 saying, well, this is a condition precedent to
16 coverage. We're going to treat it in a particular way
17 versus, you know, a mere covenant.

18 Well, when you're talking about
19 insurance, there's a number of events that have to
20 occur before coverage is triggered. And that was the
21 point that you made earlier this morning, Your Honor.

22 THE COURT: I don't make points. I'm
23 not making points.

24 MS. RICHEIMER: I'm sorry, Your Honor.

25 THE COURT: I'm just asking questions.

1 MS. RICHEIMER: That was the question
2 you asked earlier, Your Honor, is that isn't
3 everything in this policy more or less a condition.
4 And I think that's basically true if you take the
5 Colorado Structures definition, a circumstance that
6 must exist.

7 But where courts -- but when you have
8 a triggering event that defines the scope of coverage,
9 and here, Your Honor, you're talking about an excess
10 policy. It's exhaustion that defines the scope of
11 coverage. It would fundamentally rewrite the contract
12 between the insurer and the insured to strip it out of
13 a policy. And if you strip the exhaustion language
14 out of the Indian Harbor policy, there's really not
15 much left.

16 There's not -- the contract that's
17 left is not the contract that Quellos purchased. And
18 that's exactly the point that was made in the Gannon
19 case, was that if you take away in that case it was
20 notice. If you strip notice out of the policy, which
21 is effectively what you do when you talk about
22 imposing a prejudice requirement on it, it
23 fundamentally changes the nature of the contract
24 between the insured and the insurer.

25 And we believe, Your Honor, when you

1 read this insurance contract as a whole and the
2 specific exhaustion language that it's clear that it's
3 not a mere condition of coverage.

4 I think, Your Honor, the way that we
5 look at it is that you don't -- you begin with the
6 policy, you begin with the language of the policy,
7 which we believe is unambiguous. You can also look at
8 the context in which this policy was agreed to and
9 written.

10 And it is a fairly specialized form of
11 coverage. You're not talking about an automobile
12 policy or any sort of mandatory insurance. You're
13 talking about two sophisticated businesses, Quellos,
14 which designs and manages investments and tax
15 strategies, ably is assisted in purchasing this
16 coverage by a sophisticated insurance broker, and then
17 on the other side of the table you have the insurance
18 companies, who carefully drafted language defining the
19 scope of the excess coverage and when they attach.

20 THE COURT: Well, let me ask you about
21 that. There is certainly language in a number of
22 cases that talk about sophisticated insurers and
23 sophisticated brokers, but is there not also a line of
24 Washington cases which also reject the sophisticated
25 insured exception or doctrine that exists in other

1 states, and don't we still have a construction, a
2 policy construction, which says that policy language
3 be construed as an ordinary policy holder would
4 construe it?

5 I mean, there is language in a number
6 of cases you cite which talks about sophisticated
7 insureds, but has Washington Supreme Court ever
8 adopted the sophisticated insured exception, like in
9 other states?

10 MS. RICHEIMER: Here's what -- I'm
11 sorry, Your Honor. Here is what I would say. It's
12 not a special rule of construction. It's part of the
13 context in which these policies were negotiated. And
14 I think it's permissible under Washington law to look
15 at the context, the full context of the policy and the
16 entire policy as a whole.

17 So I don't think it creates any
18 special rules for Quellos, but it's part of the
19 amalgam of considerations that go into reviewing a
20 policy.

21 So for example, talking about the
22 Morgan case, the insurer, which was discussed
23 extensively in the briefing and in argument, the
24 insurer wanted the court to interpret loss by
25 severance -- and that was the key triggering language

1 there -- as a total severance. And in that case the
2 insurer wanted the court to imply a limitation into
3 the policy that was not stated in the language.

4 And so in that respect Morgan was not
5 unlike Zeig and numerous other exhaustion cases, where
6 the policy did not define exhaustion. It was excess,
7 in fact sometimes it's not even excess policies, but
8 there was no specific exhaustion requirement.

9 And the court in Morgan, like the
10 courts in these more generic exhaustion cases, was
11 unwilling to limit the grant of coverage and imply a
12 restriction on coverage which is not stated in the
13 policy.

14 So but Washington law does permit
15 insurance companies to put clear limitations on
16 coverage, and Washington law enforces those
17 limitations as long as they're clearly stated in the
18 policy. And so it is the specific policy language,
19 Your Honor, that does distinguish Zeig and its progeny
20 from the more recent cases that we cited and provided
21 to Your Honor with our reply brief that look at these
22 very specific exhaustion language and say you don't
23 read it out of a policy.

24 We also point out in our reply brief,
25 Your Honor, and I'll say briefly here again,

1 Washington law is not unlike the law in these other
2 states. If you talk about Vision One, Vision One
3 apply -- the Vision One case specifically discusses a
4 nearly universal rule that insurance companies cannot
5 deny coverage and then insist that the insured come
6 back to them to get consent to settle.

7 So let's put that concept in the
8 context of this case, Your Honor. This was a request
9 made to the insurance companies in connection with the
10 settlement, the Saban settlement, and there was -- the
11 request of Quellos to the insurance companies is we
12 want to negotiate a settlement with Saban. We want
13 your authority to go forward and negotiate that
14 settlement.

15 And it was in that context, Your
16 Honor, that my client did deny coverage for that
17 settlement. And so what did Quellos do? They went
18 out and settled the Saban case, and they were, at
19 least from the perspective of our client -- and this
20 is the universal rule. It's not unique to Washington
21 -- Quellos was free to go out and negotiate a
22 settlement with Saban and they did not have to come
23 back to Indian Harbor and get our consent to settle.

24 It's not the same thing at all, it's
25 not remotely the same thing as saying they could then,

1 several years later, settle with the excess carrier.
2 And the settlement -- I'm sorry -- settle with the
3 primary carrier.

4 Your Honor, the settlement with the
5 primary carrier was the primary carrier didn't pay
6 anything, anything more than they'd already paid. And
7 so it's just a very different situation. It's a
8 universal rule followed in many states, including the
9 states that have enforced the strict exhaustion
10 requirement.

11 And it's the same thing with breach of
12 cooperation, Your Honor. Breach of cooperation
13 requires prejudice, because their coverage has
14 attached and the insurance company says to the
15 insured, you've failed to cooperate with us and so the
16 law implies prejudice and that's the Salzberg case.

17 In an occurrence policy notice is
18 another example where the courts will apply a
19 prejudice rule on an occurrence-based policy, because
20 again, the happening of the occurrence is the event
21 that triggers coverage and so if the insured happens
22 to be a little late in providing notice to the
23 insurance company, the courts say, well, you have to
24 show prejudice.

25 But again, we circle back, Your Honor,

1 to what is the principle at work here. What is -- the
2 principle is exhaustion. It's integral to the very
3 grant of coverage. And so it is to rewrite the
4 contract if you impose a prejudice requirement.

5 THE COURT: Okay. I know this is not
6 your position, but let's just assume for the sake of
7 argument that this is a condition, and let's assume
8 for the sake of argument that it's not a mere
9 condition.

10 Let's also assume that it's -- that
11 the prejudice requirement is not limited to a breach
12 of the cooperation clause, not limited to
13 occurrence-based policies and not limited to -- you
14 know, and is extended to a claims-made policy such as
15 the one we have here.

16 What is your prejudice? And I know
17 you're arguing that we don't even get there, right?
18 But assuming just for the sake of argument that we
19 have satisfied, touched first, second and third base
20 on those particular issues, what's your prejudice?

21 MS. RICHEIMER: Your Honor, we talk a
22 little bit about this in our opposition brief and
23 these aren't just arbitrary requirements that are
24 placed in the policy so that excess carriers can deny
25 coverage in these situations.

1 The excess policies assume that
2 there's a primary carrier in place that will make the
3 coverage determinations and will make a coverage
4 determination in good faith. And Your Honor alluded
5 to this earlier this morning, that the primary -- when
6 the primary carrier -- if the primary carrier here,
7 for example, had paid 10 million dollars in coverage,
8 it would -- and then turned it over to the excess
9 carriers and said you're up, we would be in a very
10 different situation here.

11 In that circumstance the primary
12 carrier has made a determination of coverage. Is it
13 binding on the excess carriers. Well, not literally,
14 but it's the excess carriers have a right and it's
15 written into its policies to have the primary carrier
16 be the party that makes the determination as to
17 whether there's been 10 million dollars in covered
18 losses, not the insured. There's a big distinction
19 there.

20 The other piece of it is here AISLIC
21 did deny coverage and from the excess carrier's
22 perspective, again, when there's a dispute about
23 coverage, the excess carriers have a right to rely on
24 the primary carriers to, you know, carry the water in
25 terms of that dispute.

1 So we point out in our brief, Your
2 Honor, that the premiums paid for the primary policies
3 are significantly low -- I'm sorry -- the premiums
4 paid for the excess policies are significantly lower
5 than the premiums paid for the primary policy and
6 baked into that premium is the notion that it's going
7 to be the primary carrier that makes the tough
8 decisions about coverage and if need be litigates
9 those coverage disputes.

10 This is also discussed to some extent
11 in the Qualcomm case, which is the California case,
12 that says, hey, the insured has a duty to try to
13 negotiate with the underlying carriers or all the
14 carriers, and if they can't do that, then they have a
15 choice.

16 They can proceed in coverage
17 litigation with all the carriers, but if they -- if
18 the choice they make is to settle below limits of the
19 primary policy, well, that's on the insured; that's
20 not on the insurance company. It goes against --
21 coverage is never going to be triggered under those
22 excess policies.

23 How much time are you going to reserve
24 on their rebuttal?

25 THE COURT: Just under five minutes.

1 So why don't you take another 15.

2 MS. RICHEIMER: I won't take that. I
3 want to leave some time for Mr. Standish.

4 THE COURT: I mean, there's a total of
5 15, so you have some time.

6 MS. RICHEIMER: Okay. I want to talk
7 a little bit about the common law here, and I want to
8 point out a few points about the cases that they cite.
9 And the point we make, Your Honor, is that it's
10 understandable for the Washington Supreme Court to
11 step in and abrogate common law principles that can
12 chill settlements or mitigation strategies, but it's
13 not rewriting the contract at all.

14 And so one of the cases on which they
15 principally rely, the Seafirst case, that was the
16 Washington Supreme Court limiting an ancient rule of
17 discharge, where discharge of one of several joint
18 obligors to a contract or a partnership, and the point
19 of that, of limiting that rule of discharge is to give
20 effect to the intent of the release that was entered
21 into between the plaintiff and one of the joint
22 obligors.

23 So again, so the point of that
24 limiting principle in Seafirst was to give -- was
25 actually to give effect to an agreement. The excess

1 carriers were not joint obligors with AISLIC, so it's
2 irrelevant that -- the case is basically irrelevant.
3 It certainly is not rewriting a contract.

4 And in the American Safety versus
5 Olympia case, Your Honor, that was another case cited
6 for a Washington public policy. Well, in that case,
7 Your Honor, the court -- and that's 162 Washington 2nd
8 762.

9 In that case, Your Honor, that was a
10 case where the court enforced the contract between the
11 parties. You had Assurity standing in for the
12 contractor, who said that the city had waived its
13 rights under the contract by attempting to resolve a
14 dispute with Assurity and not demanding strict
15 compliance with the contract until some point later.
16 And the court said, well, no, I'm going to enforce
17 that contract.

18 So there again, public policy does not
19 -- there's no public policy in Washington that would
20 allow the court to rewrite unambiguous language in the
21 contract. And I think it's useful to talk about one
22 of the cases that we cite in our briefs, Your Honor,
23 from another jurisdiction, the Wisconsin case in
24 Danbeck, and they talk specifically about -- this is
25 629 Northwest 2nd 150 at 198, and the court says,

1 although the public policy supporting partial
2 settlements still figures prominently in our
3 jurisprudence, it does not supplant the plain language
4 of the insurance contract.

5 To choose an interpretation that
6 furthers the public policy of encouraging settlements
7 but contradicts the clear language of the contract
8 would be to substitute our policy preferences
9 regarding UIM insurance coverage for the agreement of
10 the parties.

11 And Your Honor, that's exactly what's
12 going on here. You've got a clear and unambiguous
13 contract, you've got a specific exhaustion requirement
14 that takes up about half the provisions of this
15 contract, and Quellos is saying, is asking you, Your
16 Honor, asking this court to step in between the two
17 contracting parties and give Quellos a new insurance
18 policy, rewrite the basic insurance agreement between
19 Quellos and the excess carriers.

20 We don't believe that that is
21 supported by either interpretative principles of
22 Washington law or public policy.

23 THE COURT: Let me ask you just before
24 we turn the floor over to counsel. Let me ask you
25 about this windfall argument, okay? So the underlying

1 limit or attachment was 10 million dollars of covered
2 losses, right?

3 MS. RICHEIMER: That's the primary
4 limit.

5 THE COURT: Right. Part of your
6 argument is that if the primary carrier was one who
7 had paid this, the presumption would have been -- if
8 they weren't going to pay for uncovered losses.

9 So if they had paid 10 million dollars
10 of covered losses and they would have carried the
11 water for you and you would have -- that would have
12 been the benefit that you would have had and therefore
13 the prejudice you incurred because they weren't there.

14 Part, I think part of your heartburn
15 is that the policy holder is claiming all kinds of
16 losses as making up the difference between the
17 settlement amount and the limit, whether or not they
18 were covered. If the policy holder could prove that
19 that difference was in covered losses as opposed to
20 just costs they incurred in general which may not have
21 been covered would we have a different situation?

22 MS. RICHEIMER: I'm not -- I mean,
23 Your Honor, if the issue is -- I don't think I
24 completely follow the question, but you started with
25 windfall, so I think I know that what you're referring

1 to --

2 THE COURT: I'm talking about the
3 windfall argument.

4 MS. RICHEIMER: And actually it
5 relates to the prejudice argument, I do understand,
6 which is that, well, hey, let's just litigate
7 coverage, and what's the difference to you.

8 Well, the difference to us is that,
9 from Indian Harbor's perspective, they took the time
10 to write this policy that has the specific attachment
11 language in it. They priced the policy accordingly.
12 It was freely negotiated between Quellos and Indian
13 Harbor and they had a right to insist on strict
14 compliance with that provision.

15 So I understand the windfall argument,
16 Your Honor, but it's not a -- the purpose of talking
17 about why we have the primary carrier carrying the
18 water and all of that is to say that there's a
19 rational basis for having this in the policy, for
20 making this an essential term of the excess policy,
21 and we have a right -- and our company having put that
22 in the policy, there's nothing that's unconscionable
23 or extraordinary about enforcing it.

24 And to simply take -- windfall is just
25 another way of saying public policy. You want to take

1 public policy, you want to take this, quote/unquote,
2 windfall argument and substitute it for this contract.
3 And Your Honor, from our client's perspective, it is
4 inherently prejudicial, as it were, to have to extract
5 significant portions of the language from this policy.

6 THE COURT: Thank you. Thank you very
7 much. Counsel, good morning.

8 MR. STANDISH: Good morning, Your
9 Honor. Just very briefly. Federal will join in
10 Indian Harbor's motion, so I won't repeat all of the
11 arguments. I'll just point out a couple of things
12 with respect to the Federal policy.

13 First of all, counsel for Quellos
14 suggested there would be (unintelligible) based on the
15 definition based on underlying limit, because it
16 referenced the retention. And I think if one looks at
17 the definition, which is on page 6 of the Federal
18 policy, it's actually very clear. There's no
19 suggestion that the underlying insurers have to pay
20 the retained limit.

21 It says the underlying limit means the
22 amount equal to the aggregate of all limits of
23 liability as set forth in the declarations for all
24 underlying insurance, subject to any sublimits plus
25 the applicable uninsured retention.

1 Obviously if there is a retention,
2 it's going to be uninsured and borne by the policy
3 holder itself. This isn't suggesting that somehow the
4 underlying insurer has to pay the uninsured retention.
5 So I think that language is not ambiguous at all.

6 Secondly, the Federal policy actually
7 does expressly address the one circumstance in which
8 Quellos is allowed to fill the gap, as it were, and
9 that's in the section entitled completion of
10 underlying limit.

11 THE COURT: I saw that, but their
12 policy doesn't have that.

13 MR. STANDISH: It does not have it.
14 So that's another strike against Quellos with respect
15 to a circumstance in which the primary carrier becomes
16 insolvent or financially impaired.

17 But the one circumstance with respect
18 to the Federal policy where Quellos can fill the gap
19 is when the underlying insurance is uncollectible and
20 it expressly references financial impairment or --

21 THE COURT: Of course it doesn't say
22 only, that that's the only circumstance in which a
23 policy holder could pay. Although your implication is
24 that because it was singled out, that's the only time,
25 but there's no express language that says that is the

1 only time they can pay that. Right?

2 MR. STANDISH: Not in those words,
3 Your Honor, but with respect to in the coverage grant,
4 it says expressly the coverage shall attach only after
5 the insurers of the underlying insurance have paid in
6 legal currency the full amount of the underlying limit
7 for such policy period.

8 So there's really no reason to address
9 other circumstances until given the express
10 requirement in the coverage grant of the Federal
11 policy that AISLIC paid in legal currency the full
12 amount of its limit.

13 THE COURT: That was interesting you
14 put that in a footnote and it was kind of like I
15 almost missed that.

16 MR. STANDISH: That's why I like to
17 highlight things in oral argument.

18 THE COURT: Okay. Go ahead.

19 MR. STANDISH: Otherwise, we will
20 stand on the argument of Indian Harbor and adopt those
21 as well for our own, Your Honor.

22 THE COURT: Thank you very much.
23 Counsel, about five minutes?

24 MR. FLEISHMAN: Very quickly. Four
25 points, Your Honor. Point number one, the insurance

1 companies are trying to resurrect an argument that's
2 been rejected by the Washington courts since 1975, by
3 the Supreme Court in Salzberg, and that's to say that
4 there's some difference between conditions and real
5 conditions and covenants and, you know, I'm just going
6 to read from the decision in Salzberg. This is 1975,
7 Your Honor.

8 In like manner, we deem it no longer
9 appropriate to adhere to the view that the release of
10 an insurer from its obligations without a showing of
11 prejudice to it should depend upon the legalistic
12 conundrum of whether the cooperation clause is an
13 expressed condition precedent or only a covenant.

14 Such an approach places an undue
15 emphasis on traditional technical contract principles
16 and their duteous application in cases of this nature.

17 In addition, insurance policies in
18 fact are simply unlike traditional contracts. They go
19 on to say that this issue of what's a condition and
20 does it have to be a special condition in order to --
21 it's been rejected by the Washington Supreme Court for
22 35 years.

23 Number two, the issue of whether
24 anybody -- and also, actually, Your Honor, the Boeing
25 case says the same thing by distinguishing when you

1 can have waiver -- waiver and estoppel cannot apply to
2 expand coverage. Boeing case. Now in a different
3 category are such matters as failure to pay a premium
4 on time, failure to cooperate with the carriers as to
5 a claim, failure to give timely notice of a claim and
6 so on. Defenses of that nature can be loss depending
7 upon the facts and circumstances.

8 And then you go back to the Kalama
9 case, which Superior Court clearly says the language
10 is exhaustion, is a condition precedent.

11 Sophisticated insured. Washington
12 courts ejected that. If Weyerhaeuser and Boeing are
13 not sophisticated insureds, then my client's not a
14 sophisticated insured, Your Honor.

15 THE COURT: Counsel, I was one of
16 counsel in the Boeing case, so I'm fully aware of
17 that.

18 MR. FLEISHMAN: Thank you, Your Honor.

19 Very quickly, Your Honor. You
20 pressed, where's the prejudice. You gave counsel
21 every opportunity to say, we were actually prejudiced
22 by this, this, and this. Not a hint of actual
23 prejudice. In fact, the primary carrier denied there
24 was no underlying carrier to, quote, carry the water
25 for the excess carriers.

1 The primary carrier was gone. Quellos
2 was defending all by itself. Quellos had every much
3 the incentive to defend those cases strongly as any
4 insurance company would have, because it was Quellos's
5 own money that was on the line.

6 The excess carrier, since they are
7 denying on top of the AISLIC's denial, they're going
8 to be in this courtroom whether there's a settlement
9 with AISLIC or not. If AISLIC didn't settle with
10 Quellos, they'd be sitting in the same chairs, because
11 our losses exceeded AISLIC's limits and got into their
12 policies. They have to have been sued.

13 THE COURT: Well, yes, you would have
14 sued -- okay. The procedure and posture would have
15 been, okay, you would have sued them, but you would
16 have had to prove 10 million dollars of covered
17 losses, right, not just losses?

18 MR. FLEISHMAN: As we still do. As we
19 still do. There is no difference. We still have to
20 show that there are more than 10 million dollars of
21 covered losses in order to get to their policies.
22 Absolutely no difference in the proving and they'd
23 still be in this courtroom.

24 So there's no change in the coverage.
25 There's no change at all in what the posture would be

1 whether the primary carrier has an extra chair sitting
2 in that corner and you can see them or they're not.

3 Finally, Your Honor, the issue of
4 condition resolves this matter in two ways. If you
5 agree that the exhaustion language is a condition,
6 which we think you're compelled to under the law,
7 number one, the excess carriers can't even raise it,
8 so it's over.

9 Number two, the carriers have to show
10 materiality and prejudice. They haven't done it, so
11 it's over. Your Honor, you never have to reach a
12 decision on the issue of ambiguity and the issue of
13 whether the LHTH case applies or whether other cases
14 apply and get to the difficulty of whether Morgan
15 establishes an ambiguity or not.

16 You never have to get there, because
17 there's a condition in the policy. They can't raise
18 it, they never showed prejudice, and the issue is
19 over. Thank you, Your Honor.

20 THE COURT: Thank you very much.
21 Okay. Counsel, we'll take a few minutes. Counsel, I
22 know it says employees only, but you may use the rest
23 rooms back here, okay? Thank you very much. We'll
24 see you in about 10 minutes. Thank you.

25 (Break in recording.)

1 MR. FLEISHMAN: Your Honor, my
2 colleague just used the rest room.

3 THE COURT: Okay. There she is.
4 Sorry. It's not your fault. I think I got out here
5 early. Thank you.

6 So let's go ahead and let's just kind
7 of divide up the time. So you're going to be spending
8 most of the time for defendants on this one?

9 MS. RICHEIMER: That's right.

10 THE COURT: So she's essentially
11 joined on yours.

12 MS. RICHEIMER: Correct, Your Honor.
13 I'm a potted plant at this point.

14 THE COURT: So we'll go to a little
15 past 11:00 then for total, so you have just a little
16 time for rebuttal, so we'll divide up the time kind of
17 accordingly. So Counsel, about half an hour or so at
18 the most and so let's see.

19 So I gave them a real hard time on
20 that motion, so let me press you a little bit on this
21 one, okay? So are there questions of fact here, in
22 terms of the -- okay.

23 So you have a guilty plea by two of
24 the officers directors. The policy was issued to the
25 company, right? So the company, arguably, it would

1 entail the alleged criminal and civil liability for
2 both -- for the officers, the directors, the company
3 itself, and multiple employees were under suspicion,
4 right? Isn't that right?

5 MR. STANDISH: That's correct, Your
6 Honor.

7 THE COURT: So there were a number of
8 employees who were under suspension who are not
9 charged, correct? So and you concede that their costs
10 -- you know, they were never indicted of anything and
11 they may or may not have known about this activity,
12 but so are their costs covered or not covered or
13 potentially covered?

14 THE STANDISH: The short answer is no,
15 and the answer in the analysis varies depending on
16 which of the four conduct base exclusions I talk
17 about.

18 THE COURT: Right.

19 MR. STANDISH: When I talk about the
20 prior knowledge exclusion contained in the
21 application, that would wipe out coverage for
22 everybody including those individuals, because there's
23 no severability component to that exclusion.

24 If we're talking about the dishonest
25 conduct exclusion, which does have a severability

1 clause that protects insured individuals from the
2 imputation of conduct as to other insured individuals,
3 then they'd be able to invoke that, but the undisputed
4 record evidence and their answers to interrogatories
5 show that those individuals only incurred 1.2 million
6 dollars in defense fees and costs.

7 So it never even breaches the famous
8 gap between what AISLIC paid and where the Federal
9 policy attaches, even if you give them that 1.2
10 million dollars in defense fees and costs for those
11 individuals.

12 THE COURT: Several of these
13 exclusions go toward objective whether to
14 reasonableness and objective as opposed to subjective.
15 Any time a judge sees objective and reasonableness,
16 they kind of question of fact, clacks and bells start
17 going off. What am I to make of that language in
18 there?

19 MR. STANDISH: I think what Your Honor
20 will find is in the mountain of cases that talk about
21 the application of the objective standard or conduct
22 or prior knowledge type exclusions, they are routinely
23 disposed of on summary judgment because the court is
24 perfectly capable of reaching conclusion that an
25 objective person in the standpoint of Mr. Greenstein

1 and Mr. Wilk, admitted felons, would know that what
2 they were doing, based on the conduct they admitted
3 to, was facts or circumstances that might give rise to
4 a claim. They've in essence admitted to having
5 engaged in the conspiracy to defraud the United States
6 of America.

7 THE COURT: That goes to coverage for
8 them. How about for the company?

9 MR. STANDISH: The exclusionary
10 language refers to any insured. And this sort of goes
11 into the line of cases in Washington that talks about
12 you have to focus on whether it says the insured or
13 any insured. If it says if any insured engaged in
14 this conduct, if any insured had this knowledge, then
15 the exclusion applies.

16 There's a savings clause for
17 individuals as to dishonest conduct exclusion, but
18 that severability clause doesn't apply to the prior
19 knowledge exclusion that's in the application.

20 THE COURT: Well, would you agree that
21 it is slightly different, albeit different, set of
22 facts going to prove the fraud exclusion than the --
23 let's see. Well, the wrongful, knowing wrongful act
24 exclusion and the prior knowledge exclusion, those are
25 -- I could imagine different scenarios where one would

1 be satisfied and one wouldn't be. Aren't those fairly
2 fact intensive inquiries?

3 MR. STANDISH: I can walk Your Honor
4 through each prong of those exclusions. I think the
5 essential facts that were admitted by Mr. Greenstein
6 and Mr. Wilk when they pled guilty to the two federal
7 crimes that are at issue here allow us to check off
8 the box of every element that we need to do to trigger
9 each of those exclusions.

10 THE COURT: All right. Well, yeah.
11 Prima fascia case wise, yeah. Okay. Let's grant you
12 that. That, you know, certainly you have a basis, you
13 know, to -- a good faith basis to put forward an
14 argument for the applicability of the exclusion.

15 Counsel may or may not want to say
16 this openly, but, you know, it's pretty clear that
17 you've at least set forth a basis for setting -- a
18 good faith basis for setting forth these exclusions,
19 but the question is whether you get that as a matter
20 of law now. Right? I mean, isn't that the big issue?

21 Not whether, you know, you've checked
22 off the boxes, but do you get it as a matter of law
23 now?

24 MR. STANDISH: I have not seen any
25 argument by Quellos taking the position that these

1 crimes did not occur. I would be highly surprised if
2 Quellos were to walk into this court and suggest to
3 Your Honor that the crimes did not occur.

4 I don't think we have an issue of
5 fact. I think we have undisputed criminal conduct
6 that's embodied in the guilty pleas of these two
7 individuals that gets us all the way there.

8 Now, if there's other evidence they're
9 going to come in and submit that suggests that there
10 really is an issue of fact as to whether or not these
11 crimes occurred, I would like to see it.

12 THE COURT: Go ahead. But I think you
13 know what my concerns are.

14 MR. STANDISH: Yes, Your Honor. And
15 I'll start by addressing those concerns, because I
16 think it's important. Quellos has thrown up a number
17 of evidentiary objections to materials that we've
18 submitted, but the one thing they can't really object
19 to, because it's clearly admissible under the
20 Washington hearsay rule, is the guilty plea itself of
21 Mr. Greenstein and Mr. Wilk.

22 And if one looks at those guilty
23 pleas, which are attached as Exhibits I and J to the
24 Seligman declaration submitted with our motion, you
25 will see all of the elements of each of the exclusions

1 that we need to apply here.

2 Just to highlight. The elements of
3 each offense is laid out on page 2 of the guilty plea
4 that each of these individuals signed. Both the
5 conspiracy to defraud the United States as well as the
6 aiding and abetting the violation of the filing of
7 false tax returns require knowledge. They require
8 deliberate, willful conduct, and that's embodied in
9 the plea agreement that they filed.

10 Both plea agreements recite the core
11 facts surrounding the fraud. The core facts show
12 indisputably that this fraud goes back to 1999, which
13 is important for purposes of some of the exclusions
14 that we're talking about here this morning.

15 Those facts also show the sham nature
16 of the transaction that underlied POINT. It
17 emphasizes there was no actual stock at issue in these
18 transactions. There was no purchase and sale of
19 actual stock. There was no payment for actual stock.
20 No basis in stock. This was a total sham transaction
21 between two Isle of Maine companies that facilitated
22 this fraud.

23 These two individuals not only signed
24 the plea agreements, but at the plea hearing, which is
25 also part of the record before Your Honor, the

1 district judge read the statement of facts to them and
2 both of these individuals acknowledged, under oath,
3 that the recitation of the statement of facts was
4 correct.

5 So we think on that basis alone, Your
6 Honor, regardless of whether Your Honor considers the
7 secretly recorded telephone call in the United Kingdom
8 or the senate report that concluded that these
9 transactions were highly suspect as well, or the
10 California franchise tax assessment that concluded
11 that these transactions were inappropriate, Your Honor
12 doesn't need to go there. Your Honor can look solely
13 at this document and reach the conclusion that the
14 four exclusions apply.

15 Let me walk through each of these
16 exclusions and show how we checked the boxes that were
17 with respect to each requirement to reach the
18 exclusion. The first one is the so-called deliberate
19 or criminal wrongful act exclusion.

20 The policy does not apply to any claim
21 arising out of, based upon, or attributable to the
22 committing in fact of any criminal or deliberate
23 fraudulent act by any insured or knowing or willful
24 violation of any statute by the insured.

25 Obviously we have the plea agreements.

1 Greenstein and Wilk's conduct is both criminal and
2 deliberately fraudulent. That's evidenced by the
3 elements of the offense to which they pled guilty to.
4 The conduct occurred in fact. They admitted that
5 these facts occurred when they pled guilty to these
6 crimes.

7 In the Virginia Mason Medical Center
8 case, which Judge Pechman decided in the Western
9 District of Washington, she looked at the term in fact
10 and just said it has to be something that can be
11 objectively verified. Here we have objective
12 verification of facts through the guilty pleas of
13 these two individuals.

14 We also have the case Farkas versus
15 National Union, which is an Eastern District of
16 Virginia case, but that also finds that a conviction
17 satisfies the in-fact requirement.

18 The exclusion has broad, leading
19 language. It applies to any, arising out of, based
20 upon or attributable to the excluded conduct.
21 Numerous Washington cases hold that arising out of is
22 unambiguous and it's been given a broad meaning. And
23 I'll just cite Munn versus Mutual Enumclaw to Your
24 Honor as one example. And there are a number of other
25 such cases cited on page 2 of our brief.

1 So fraud arising out of leading
2 language is sufficiently broad to capture both
3 negligent as well as criminal conduct related to the
4 crimes that occurred. We've talked about
5 severability, Your Honor, and why it applies only as
6 between individuals and not with respect to the
7 entities.

8 The exclusion bars coverage for claims
9 based on the conduct by, quote, any insured, unquote.
10 And under cases like Farmers Insurance versus Hembree,
11 that's sufficient to impute this conduct to Quellos
12 itself. So for those reasons, we submit the criminal
13 and deliberate acts exclusion applies.

14 Second, the policy does not apply to
15 any actual or alleged wrongful act committed with the
16 knowledge that it was a wrongful act. Here, once
17 again, we have Greenstein and Wilk conceding in their
18 plea agreements, which the elements of the crime that
19 we were convicted, that they engaged in knowing,
20 willful, conscious, criminal violations of federal
21 law.

22 So we think that exclusion applies as well.

23 Now, the only counterargument that
24 Quellos has made to attack that exclusion is to
25 suggest that it's overly broad and if you deny

1 coverage every time somebody commits a wrongful act,
2 acknowledge it's a wrongful act, it somehow creates
3 illusory coverage.

4 We're not suggesting that this
5 exclusion knocks out every claim under the policy
6 every time there's an alleged wrongful act. To the
7 contrary. We're saying under the facts of this case,
8 where you have admitted criminal conduct, it's clear,
9 given the elements of each offense, that these were
10 wrongful acts committed with knowledge that they were
11 wrongful acts.

12 THE COURT: So are all these costs,
13 all of the costs incurred by Quellos criminal defense
14 costs?

15 MR. STANDISH: Let me direct Your
16 Honor, if I might, to --

17 THE COURT: Well, they're not, right?
18 They're not?

19 MR. STANDISH: No. There are
20 settlement costs as well with respect to individual
21 investors.

22 THE COURT: Right. Right. And civil
23 defense costs as well?

24 MR. STANDISH: Yes.

25 THE COURT: So okay. Well, there's an

1 overlap, is there not? I mean, arguably, you could be
2 paying civil investors in settlement for your criminal
3 conduct, right?

4 MR. STANDISH: Correct.

5 THE COURT: So which, under your
6 scenario, would not be covered?

7 MR. STANDISH: That's correct.

8 THE COURT: And under your scenario,
9 the individual criminal defense costs would also not
10 be covered, under your scenario, right?

11 MR. STANDISH: That's correct.

12 THE COURT: What about civil defense
13 costs and civil settlements that arose out of
14 negligence separate and apart from -- separate and
15 apart from the criminal conduct itself?

16 MR. STANDISH: Well, we're focused on
17 the criminal and deliberate wrongful acts exclusion.

18 THE COURT: Right. I understand.
19 Understood.

20 MR. STANDISH: That's where the
21 arising out of language is extraordinarily important.

22 THE COURT: Right.

23 MR. STANDISH: That's where the case
24 law that I cited to you was that talks about it
25 sweeping within all of the conduct associated with the

1 underlying crime to bar coverage.

2 THE COURT: Right. Okay. So that's
3 what saves you. You concede that, you know, in a
4 criminal conduct you could have a range of conduct
5 which was criminal and then other conduct which in and
6 of itself was not criminal or fraudulent, citing to
7 the other exclusion, but you would still have to incur
8 it, right? I mean, so you're arguing that you're
9 saved by this arising out of language?

10 MR. STANDISH: That's correct.

11 THE COURT: All right. Go ahead.

12 MR. STANDISH: The third exclusion
13 that we think applies here is an exclusion for any
14 actual or alleged wrongful act occurring prior to the
15 continuity date, which is September 20, 2000, if on or
16 before such continuity date any insured knew of such
17 wrongful act or could have reasonably foreseen that
18 such wrongful act could lead to a claim.

19 Now, here, the continuity date for
20 Quellos Group LLC, the plaintiff in this case,
21 September 20, 2000, is after the fraud began, again,
22 based on the undisputed facts that are contained in
23 the plea agreement as well as Mr. Bontje's
24 declaration.

25 Mr. Bontje is the CFO of Quellos, and

1 he submitted a declaration in this case. Even he says
2 the illegal POINT transaction was created in the
3 summer of 1999. Based on that continuity date, there
4 is no coverage for the wrongful acts that arise out of
5 this conduct before September 20, 2000.

6 Now, Quellos has taken issue with
7 that. They say there was other entities involved with
8 the creation of POINT, and the continuity date on the
9 policy for those entities predates September 20, 2000.
10 But we submit that's irrelevant, Your Honor, because
11 those parties are not before the court. It's Quellos
12 Group LLC who is making the claim for coverage here.

13 It's Quellos that -- the ability of
14 Quellos Group LLC to recover for these claims that's
15 at issue and so whether or not other entities that
16 might have been involved who aren't parties to this
17 case are beside the point.

18 The fourth exclusion, and this is the
19 one that's contained in the application for the
20 predecessor policies to the policy before this court,
21 is also (unintelligible) coverage here and it's a
22 broad exclusion. It's incorporated by reference into
23 our policy in a way that I will describe to Your
24 Honor. But it asks the following question.

25 Does any applicant or any of its

1 partners, directors, officers, employees, or trustees
2 have any knowledge of any fact or circumstance which
3 might give rise to a claim under the proposed policy.
4 It then contains an exclusion. It is agreed that if
5 such knowledge exists, any claim arising from such
6 fact or circumstances will not be covered by the
7 policy.

8 The question focuses on the knowledge
9 on the part of any insured -- again, that very
10 important any of the following list of people, of
11 facts or circumstances.

12 THE COURT: So which might.

13 MR. STANDISH: Which might give rise
14 to a claim.

15 THE COURT: That is a really
16 expansive, I mean, it's a really expansive exclusion,
17 isn't it? I mean, it's you have knowledge of
18 something that might happen, not probable to happen,
19 not substantial likelihood like some occurrence-based
20 policies under which, you know, which there's federal
21 authority on that. Might. Pretty broad that one.

22 MR. STANDISH: A couple things on
23 that, Your Honor. It is broad, but it's also a fairly
24 common term in the insurance industry, particularly
25 when an insured is asking for coverage of a particular

1 kind for the first time. The insurer wants to know
2 about everything that's out there and doesn't want to
3 pick up ongoing risks that are likely to expose its
4 policy.

5 So if the insured knows about some
6 fact or circumstance that might give rise to a claim,
7 this exclusion takes care of that.

8 THE COURT: I can't remember in the
9 blizzard of stuff we were reading, but are there a lot
10 of cases construing this exclusion?

11 MR. STANDISH: There are various cases
12 construing language of this guild. There's a few
13 cases, one of the issues and one of the arguments that
14 you'll hear from my opposing counsel is the which
15 might give rise to a claim gives rise to a subjective
16 as opposed to an objective standard.

17 And there is a body of case law out
18 there that generally says an insured must be
19 subjectively aware of the facts and then whether those
20 facts might give rise to a claim is measured by the
21 reasonable person standard, an objective standard.
22 And that's the objective standard that Your Honor was
23 referring to.

24 THE COURT: So any insured, meaning
25 the people who were indicted or --

1 MR. STANDISH: Precisely.

2 THE COURT: -- or someone else or the
3 person who actually filled out the application?

4 MR. STANDISH: No. The question, the
5 exact language of the question, is the -- is posed to
6 the applicant, which is Quellos Group, or any of its
7 partners, directors, officers, employees or trustees.

8 THE COURT: Yeah. See what my concern
9 about that is, I mean, that's kind of like with 20/20
10 hindsight you're looking back and then you're saying,
11 okay, something might, you know, because if something
12 might have -- because one of many officers or
13 directors had some information that might lead to a
14 claim and then it actually ended up leading to a
15 claim, even if it was unlikely, the exclusion applies.
16 I mean, that's...

17 MR. STANDISH: I understand Your
18 Honor's concern. So let's focus about the facts of
19 this particular case. In this particular case, it's
20 undisputed that by 1999, before the inception of this
21 policy, Greenstein and Wilk were engaged in violations
22 of criminal federal law.

23 The element was the existence of an
24 agreement by two or more persons to defraud an agency
25 of the United States, the defendants' knowing and

1 voluntary participation in the conspiracy, an overact
2 in furtherance of a conspiracy, the knowing and
3 voluntary participation in the conspiracy.

4 I mean, these are facts that took
5 place according to this plea agreement starting as of
6 1999. These guys were violating federal law at the
7 time this insurance was applied for, so this isn't a
8 closed case.

9 I would submit to Your Honor that even
10 if one applies a subjective standard to the question
11 of whether or not these facts and circumstances might
12 give rise to a claim, these guys knew it.

13 And whether Your Honor admits the
14 secretly recorded telephone conversation in London or
15 not into evidence, it certainly shows an
16 acknowledgement on the part of the insureds here that
17 if anybody ever finds out that they're giving false
18 information to the tax lawyers that were passing on
19 these, they face the threat of lawsuits.

20 So we submit under these circumstances
21 in this case, Your Honor, it's not close and we're not
22 asking Your Honor to look at a close question. This
23 is a pretty egregious violation of federal law that
24 was going on here at the time this application was
25 filled out, as of the date of the application.

1 A couple of other arguments I'll touch
2 on briefly. Quellos has challenge the insurer's
3 ability to rely on the applications. They've
4 suggested that we have to meet the Washington rescision
5 standard set out by statute, which has to show an
6 intent to deceive by clear and convincing conduct. We
7 are not relying on the fact that a misrepresentation
8 in the application. We're pointing to the fact that
9 knowledge existed.

10 So for that reason, we submit that the
11 Washington rescision regime doesn't even apply. We
12 cited a case to Your Honor that recognizes that
13 distinction. It's from the Eastern District of
14 Pennsylvania, but the Fojanini case notes expressly
15 that there's a difference between invoking a prior
16 knowledge exclusion and rescinding a policy. We would
17 stress that a distinction obtains here as well.

18 They've also suggested that we can't
19 rely on the application because it was not physically
20 attached to the policy, but in fact the operative
21 Washington State statute says that the application can
22 be attached or otherwise made part of the policy.

23 In Judge Pechman's 2004 decision in
24 Cutter and Buck, she expressly held that the language
25 otherwise made part of the policy includes

1 incorporation by reference. Here, the policy on its
2 very first page says 2004 application is part of the
3 policy. The 2004 application recites that it is a
4 supplement to the application that's part of the
5 expiring policy.

6 That's the one that contains the
7 question that we're talking about. And it further
8 states that the prior application, together with the
9 renewal application in 2004, constitute complete
10 application that shall be the basis of the contract
11 and form part of the policy.

12 So given that incorporation by
13 reference, we think we readily satisfy the requirement
14 under the Washington statute that the application
15 otherwise be made part of the policy.

16 So in short, Your Honor, we submit
17 that, based on the guilty plea, based on the
18 conviction of these two individuals who are now
19 serving several years in federal penitentiaries, we
20 can meet the standards for each of these four
21 exclusions, and no coverage exists for that reason.

22 THE COURT: Thank you very much.
23 Counsel, you want an adjointer?

24 MS. RICHEIMER: Yes. On behalf of
25 Indian Harbor, we join the arguments. We don't have

1 anything to add.

2 THE COURT: Thank you.

3 MS. MICHAELS: Thank you, Your Honor.

4 THE COURT: Good morning.

5 MS. MICHAELS: I have a couple of
6 boards that I think are going to be small, so if I may
7 approach the court and maybe hand you what I have.

8 THE COURT: Yeah, that's fine.

9 MS. MICHAELS: If your eyes are fine,
10 you may not need them.

11 THE COURT: Yeah, I probably can. I
12 can read close, but I can't read far, so...

13 MS. MICHAELS: (Unintelligible.)

14 UNIDENTIFIED SPEAKER: You want us to
15 move the boards up close to the court, or you don't
16 need them?

17 THE COURT: I guess we have the
18 handouts. We can just do the handouts. That's fine.

19 MS. MICHAELS: (Unintelligible.)

20 THE COURT: That's fine.

21 MS. MICHAELS: The critical issue --
22 there are three critical issues here at least that
23 condone denial of Federal summary judgement motions.
24 One of them is who are the insureds here, what are the
25 (unintelligible), and the court touched upon that in

1 asking were there losses incurred only on behalf of
2 Mr. Greenstein and Wilk, or were there costs incurred
3 on behalf of other officers and directors and the
4 Quellos entity itself.

5 THE COURT: And clearly there were,
6 right?

7 MS. MICHAELS: And clearly there were.
8 And indeed, the losses that we're including, we're
9 talking about, Your Honor, are 32 million dollars in
10 settlements and another 6 or so million dollars in
11 losses that covered liabilities of Quellos, the
12 Quellos entities themselves.

13 And as the essential inquiry then when
14 you are talking about the applicability of exclusions
15 is can or has Federal shown as a matter of law that
16 all of the losses incurred can be attributed to
17 conduct that's excluded by the policies. The answer
18 to that is no.

19 The severability provisions they've
20 acknowledged in the contract say that you cannot impute
21 any alleged wrongful acts of Mr. Greenstein and Wilk
22 to other insured individuals. Mrs. Bender's
23 declaration, which they do not and cannot dispute,
24 establishes that the settlements that were entered
25 into by Quellos or the Quellos entity on its own

1 behalf and all the insured officers and directors
2 release the claims as to all of the insured
3 individuals, in addition to Mr. Greenstein and Wilk
4 and the Quellos entities themselves.

5 No evidence on this record that those
6 payments can be attributed just to any wrongful acts
7 of Mr. Greenstein and Wilk.

8 THE COURT: So you dispute the
9 assertion that there are only 1.5 million dollars of
10 costs, whether they be defense costs or settlement,
11 that can be attributable solely to the -- even if we
12 have severability? You dispute their assertion.

13 MS. MICHAELS: Absolutely, Your Honor.
14 I mean, the number that counsel pointed to was simply
15 the number we identified in the interrogatory answers
16 as being defense costs paid on behalf of the
17 individual officers and directors with respect to some
18 of the underlying claims.

19 THE COURT: Right. So this is the
20 wrongful act exclusion, correct?

21 MS. MICHAELS: Correct.

22 THE COURT: And this is the one with
23 the severability clause, correct?

24 MS. MICHAELS: Yes.

25 THE COURT: All right. Okay. And the

1 other exclusions, though, do or do not have
2 severability?

3 MS. MICHAELS: There are two. Excuse
4 me for interrupting. I apologize, Your Honor.

5 There are two that have severability
6 provisions.

7 THE COURT: And the other one --

8 MS. MICHAELS: Those are the what
9 they've called the fraud exclusion, and the court may
10 be referring to as the wrongful acts exclusion --

11 THE COURT: Right.

12 MS. MICHAELS: -- but that's exclusion
13 section 411 in the policy and the other is the knowing
14 wrongful acts exclusion, whatever that means, and that
15 is section 413 in the policy. So those are the two as
16 to which you have a severability.

17 THE COURT: Right.

18 MS. MICHAELS: The fact that the
19 settlements were done to the benefit of all the
20 officers and directors compels denial of the summary
21 judgment motion as to these settlements for that
22 reason.

23 It's also critical, Your Honor, that
24 we move to --

25 THE COURT: Well, let me ask you this.

1 I mean, I guess that was part of the kind of a
2 mechanical issue of this particular motion. They
3 relate to exclusions, right, so and if there were a --
4 if I were to grant his motion completely I guess
5 that's one thing, but if I weren't to grant his
6 motion, there would be an issue, would there not?

7 Would you concede or not concede that
8 some of the costs that Quellos incurred were not
9 covered, particularly the specific defense costs,
10 after a certain -- after, you know, the specific
11 defense costs defending the people who actually went
12 to prison?

13 At some point, right, they -- would
14 you concede that some of those defense costs were not
15 covered?

16 MS. MICHAELS: Your Honor, we're not
17 seeking any defense costs associated with the defense
18 of Mr. Greenstein and Wilk after they pled guilty.

19 THE COURT: Right. I know there was a
20 dispute about before they pled guilty, right?

21 MS. MICHAELS: Sure.

22 THE COURT: But you concede that some
23 costs were not covered, and so if I were to grant
24 their motion in part, I mean, we'd still have to
25 figure out which costs were covered and which costs

1 were not covered, right?

2 I mean, for example, if I were to find
3 that this exclusion applies to some of your costs but
4 not all of them, mechanically the order would have to
5 set forth a procedure or be clear that the following
6 issues are still there for trial, but certain issues
7 are off the table.

8 For example, you've conceded that at
9 least some of these defense costs were not covered
10 because of this exclusion, right?

11 MS. MICHAELS: Which we have not even
12 identified in our interrogatory answers as being costs
13 proceedings. So in that sense, I don't think there's
14 a dispute, Your Honor.

15 On the key issue, which is the costs
16 incurred in connection with the settlements, the costs
17 incurred in connection with the defense of officers
18 and directors other than Mr. Greenstein and Wilk, and
19 the costs incurred for Mr. Greenstein and Wilk before
20 they pled guilty, there is a dispute.

21 It's their burden on this record, Your
22 Honor, to prove what, if any, of those costs are
23 attributable, any of those costs are excluded. And we
24 submit to you they haven't done it.

25 With respect to Quellos, the entities

1 themselves, we would ask the court also to look here
2 at the (unintelligible) case, which is cited in our
3 opposition brief, and the public utility case, because
4 the other component of who are the insureds and
5 timing. That's the other key thing that is fatal to
6 their motion.

7 The court properly grasps and I know
8 it's just argument, Your Honor, but you raise the
9 issue of hindsight, and that is a critical issue here.
10 We must look at in time at the point in time where
11 these liabilities were incurred to determine whether
12 in fact the exclusions could apply.

13 Federal has conceded or stated
14 accurately in its opening brief that the knowing the
15 -- let's call it the fraud exclusion, simply to
16 distinguish it from the others, requires a
17 determination that in fact there was wrongdoing. That
18 didn't happen. There was no determination of any
19 wrongdoing on behalf of Mr. Greenstein and Wilk until
20 they pled guilty in 2010.

21 And Your Honor, that's five years
22 after the bulk of these, after the claims began. It's
23 more than three years after the liabilities were
24 incurred in these settlements, and it's more than two
25 years at least after they denied coverage.

1 So the import of their argument is
2 that they can deny coverage and wait to see what
3 happens to the end and then say we're off the hook.
4 Feature Realty case, Your Honor, I think makes it
5 clear that it doesn't work that way. Feature Realty
6 involved, as here, a situation in which there were
7 allegation of fraudulent conduct and negligent
8 conduct.

9 In that context, it was securities
10 violations, but there were also claims of negligent
11 misrepresentations, failures to disclose things
12 essential to the transaction, and the court said in
13 that setting, where there was the possibility -- where
14 there were covered acts and a covered claim and
15 potentially a noncovered claim, the carrier wasn't
16 entitled at the end of the process to say no coverage
17 at all. There had to be an allocation.

18 And that's also what the -- we believe
19 the public utility case supports as well, Your Honor.
20 It says in the context of intentional misconduct and
21 negligent conduct, if the claims in fact rise out of
22 the same common core facts there may be no allocation
23 at all, but certainly the carrier cannot establish no
24 coverage whatsoever.

25 And there's no basis for reaching that

1 conclusion on this record, no coverage, as to Quellos
2 the entities, as to the individuals, directors and
3 officers, because it's also undisputed on the record
4 that there were negligent claims as well as claims for
5 intentional misconduct and that the settlements
6 resolved the claims for all. So there is no basis for
7 granting summary judgment for that reason.

8 (Unintelligible) or should I just
9 talk?

10 THE COURT: I think you should just
11 talk. I mean, that's fine. I think we all have a
12 copy of this, so I think we're okay.

13 MS. MICHAELS: All right. The
14 continuity date, the continuity -- the exclusions that
15 do not have severability provisions are the one
16 relating to wrongful acts occurring prior to the
17 continuity date. And that's point three on the slides
18 put together here.

19 The terms of the provision themselves
20 focus on and require consideration of the wrongful
21 acts of -- they apply to wrongful acts committed
22 before specified dates. Necessarily, you have to look
23 to who the alleged actors are.

24 There's no dispute on the record, Your
25 Honor, that the actors here were Custom, principal

1 actor was Custom Quellos, Custom Strategies, that and
2 the continuity date there, which is March 24, 1999.
3 It's long before the transactions were in fact
4 designed.

5 And Mr. Bontje's declaration
6 establishes that it was, and as counsel said, the
7 summer of '99. So there's no basis at all for
8 application of the continuity date exclusion, because
9 there's no evidence that anyone should have known, any
10 insured should have known of the possibility of
11 wrongful acts at a point in time where the
12 transactions had not even designed. So that, Your
13 Honor, is a nonissue.

14 You can look at the AISLIC policy,
15 Quellos Custom Strategies and the other entities. You
16 actually had dates earlier, which would make the
17 exclusion inapplicable again, are all insureds under
18 this policy. And the policies, the excess policies
19 explicitly recognize that the insured entity, which is
20 Quellos LLC, the entity to whom opposing counsel
21 referred, will act on behalf of the other insureds.

22 And if I can point the court to those
23 specific provisions. The continuity date, exclusion
24 date provide no basis for denying summary judgment
25 either.

1 The next issue that I think they raise
2 was this knowing wrongful acts exclusion. And again,
3 we have the problem of hindsight. To the extent that
4 the court determines that the exclusion makes any
5 sense at all and we would suggest there's an issue
6 about that addressed in the cases, identified in the
7 cases that we discussed in our opposition brief.

8 The exclusion can only properly be
9 construed to require -- to apply where there's
10 actually an intent to cause harm, because otherwise
11 you're basically saying that the exclusion would
12 extend to acts of misrepresentation, errors and
13 omissions that the definition of the policy explicitly
14 covers.

15 The policy explicitly states that it
16 -- a wrongful act, Your Honor, is any error, act,
17 misrepresentation, omission, breach of duty. Those
18 obviously extend to -- and that's the purpose of a
19 professional liability policy in the first place, is
20 to coverer errors in connection with providing your
21 services.

22 THE COURT: Right. Good point. But
23 the problem here being these guys got indicted and
24 they're serving in the pen, right? That's the
25 distinction, isn't it, I mean?

1 MS. MICHAELS: It's a question again
2 of timing, Your Honor. At the time that these
3 liabilities were incurred and at the time that we're
4 talking about here, Mr. Greenstein, and in the
5 testimony they rely upon, was vigorously defending the
6 validity of the POINT transactions, contesting every
7 point that Mr. Standish now argues he's admitted in
8 his pleas, which, by the way, we don't think are
9 admissible here. But in any event.

10 THE COURT: So is that material? For
11 example, had these two officers just stood on their
12 denial and said we didn't do it, we didn't do it, we
13 didn't do it. We're going to trial. They'd gone to
14 trial and been convicted and they appealed their
15 conviction, said we just didn't do it, we just didn't
16 do it, is that different than if they actually ended
17 up pleading guilty?

18 And I know you're -- let's assume that
19 these guilty pleas are admissible. In their
20 statements of plea of guilty they end up saying, yeah,
21 we did it. Is that different?

22 MS. MICHAELS: It's a question of
23 timing, absolutely essential here, because the
24 policies apply to exclude liabilities when they are
25 shown to arise out of certain kinds of conduct. When

1 the liability is incurred, before the adjudication has
2 happened, you cannot decide as a matter of law that
3 the conduct was done with the benefit of hindsight,
4 with the intent to injure, or with knowledge that it
5 was fraudulent. The evidence in front of the court
6 supports the opposite and --

7 THE COURT: Run that by me again. How
8 does it support the opposite if they said that at that
9 time I knowingly engaged in a crime?

10 MS. MICHAELS: Even the evidence they
11 rely on is equivocal on whether at the time these
12 people were acting with the fraudulent intent. The
13 evidence is they rely upon -- if you look at the
14 speech, which obviously is not, you know, a document
15 that we think is admissible at this point in time
16 either, Your Honor, there are many statements that
17 suggest I misled myself, I deceived myself, I
18 rationalized my conduct. Not necessarily
19 determinative that there was intent at the time to
20 commit the wrongful acts.

21 THE COURT: Wait a minute now. There
22 needs to be a factual basis for a criminal -- there
23 needs to be the mens rea requirement and a factual
24 basis for the guilty plea, and the criminal -- the
25 statute requires an intent to commit a crime, a

1 knowing, not an accidental, not a negligent kind of
2 act at the time.

3 Are you saying that there was no
4 factual basis for the criminal plea?

5 MS. MICHAELS: I'm saying the court
6 cannot make the decision that the liabilities that
7 were incurred here, the losses that were incurred
8 here, Your Honor, are all excluded based -- when they
9 were incurred in 2005, 2006, 2007, and there is a
10 guilty plea in 2010, because the policies cover a wide
11 variety of losses for wrongful acts, subject to
12 exclusions.

13 THE COURT: All right.

14 MS. MICHAELS: And again I would point
15 the court to Feature Realty and the public utility
16 case on that issue. The carriers, it's not
17 appropriate for them to deny coverage and then come
18 back, where there may be a basis for -- where the
19 liabilities incurred may be on a covered basis and a
20 noncovered basis and say got you. We waited long
21 enough that we can say it's now all excluded.

22 If they want to come forward now
23 having denied coverage, then they must show what
24 portion of these losses can be allocated to the
25 excluded conduct and that showing hasn't been made.

1 THE COURT: All right. That part I
2 understand. Okay. So all right.

3 MS. MICHAELS: I guess the last issue
4 raised by Mr. Standish was this issue of the policy
5 application. And a couple things, Your Honor. They
6 cite no case that suggests that the statute that we've
7 pointed the court to does not apply in this situation.
8 And we would -- and that statute requires a subjective
9 intent to deceive. If the court --

10 THE COURT: And this is the wrongful
11 act prior to the --

12 MS. MICHAELS: This is the does any
13 insured -- does the applicant or any insured have
14 knowledge of something that might lead to a claim.

15 THE COURT: Right.

16 MS. MICHAELS: Yeah, it's the policy
17 application.

18 THE COURT: So this is a prior
19 knowledge. We're calling it the prior knowledge
20 exclusion as opposed to the knowing wrongful act
21 exclusion?

22 MS. MICHAELS: That's what they call
23 it. We call it the policy application question. But
24 yes, that's what we're talking about.

25 The statute very plainly applies

1 beyond the context of a rescission claim by its own
2 terms. It refers and states that no written
3 misrepresentation or warranty made in the negotiation
4 of an insurance contract shall be deemed material or
5 to defeat or avoid the contract or prevent it from
6 attaching unless a representation or warranty is made
7 with the intent to deceive.

8 We cited the court to -- forgive me.
9 I'm trying to find the -- the Seafirst case, Your
10 Honor. That case arose in the context of the carrier
11 invoking an application question, which was very
12 similar to this one, to offset a claim, not a rescission
13 claim, and the court said that the requirements of the
14 statute had to be met.

15 No debate here that Ms. Bender
16 answered those questions too truthfully, with no
17 intent to deceive.

18 So in closing, Your Honor, because I
19 think I am about out of time subject to his rebuttal,
20 there are four issues of fact, at least. We put seven
21 on the slides, but there are four, at least, that
22 preclude -- and actually, there are four at least that
23 preclude summary judgement for Federal here. Those
24 are the truthful answers of Ms. Bender to the policy
25 application question that she was not aware of any

1 circumstances that might lead to the plaintiff's
2 claim.

3 The sworn -- the undisputed fact that
4 the entities that were acting here were Custom Fellow,
5 Custom Strategies and other affiliates, who were --
6 whose continuity dates predate even the design of the
7 POINT transactions.

8 The fact that, concededly, these
9 exclusions, two of the exclusions do not apply at all
10 to other insured officers and directors, and that the
11 settlements in dispute of this evidence resolve the
12 liability of those individuals as well as Mr.
13 Greenstein and Wilk.

14 The fact that the civil claimants
15 themselves asserted claims for negligence as well as
16 intentional misconduct, and that the settlements
17 resolve all of those claims and there is no evidence
18 at all on this record as to how you would allocate to
19 the noncovered portion of the settlement, if there is
20 one.

21 And finally, even as to Mr. Greenstein
22 and Wilk at the time the defense costs were incurred,
23 no evidence that they themselves at that time had in
24 fact been adjudicated to committing a wrongful act.

25 THE COURT: Thank you.

1 MS. MICHAELS: Thank you, Your Honor.

2 THE COURT: Thank you very much.

3 Counsel, the arising out of analysis applies to the
4 fraud exclusion, correct?

5 MR. STANDISH: That's correct.

6 THE COURT: And does it apply to any
7 other exclusion?

8 MR. STANDISH: Yes, it does. With
9 respect to the prior knowledge exclusion, it is agreed
10 that if such knowledge exists, any claim arising from
11 such fact or circumstances will not be covered by the
12 policy.

13 THE COURT: So both the fraud --

14 MR. STANDISH: But the fraud and the
15 prior knowledge exclusions use the arising out of
16 language.

17 THE COURT: But not the knowing
18 wrongful act exclusion?

19 MR. STANDISH: That's correct.

20 THE COURT: And not the wrongful act
21 prior to the commencement date or -- I'm sorry --

22 MR. STANDISH: Right. With respect to
23 the knowing wrongful act and the continuity date
24 exclusions, they don't use the term arising out of in
25 those two exclusions.

1 THE COURT: Right. All right. Go
2 ahead.

3 MR. STANDISH: Just very briefly, and
4 I'll take that point first, Your Honor. In Quellos's
5 opposition and in their presentation today here, I
6 have not heard them address yet the breadth of the
7 arising out of language and the import that it has
8 here in terms of knocking out coverage for both fraud
9 claims as well as negligence claims or any other
10 claims that arise out of the claims at issue, so I'd
11 like to emphasize that again.

12 They've also suggested that we haven't
13 carried our burden of showing who the claims were
14 against, but we actually put into the record, these
15 are the answers to interrogatories that Quellos served
16 in this case, as Exhibit G to the Seligman
17 declaration, Quellos's own description of each of the
18 claims at issue in this case.

19 This one's public record. It's the
20 Saban claim. They characterized it as being contacted
21 by the Saban parties and being advised that there
22 would be potential legal action against Quellos.
23 There's no mention of individuals.

24 The second civil claim is not public
25 knowledge, but the claimants there again, according to

1 their own characterization, advised Quellos that they
2 would consider legal action against Quellos. The IRS
3 investigation directed to Quellos Custom Strategies
4 LLC, the US Senate investigation, they list Quellos
5 Group LLC.

6 It's only with respect to the US
7 Attorney's Office investigation that they break out
8 separate costs for individuals other than Greenstein
9 and Wilk. And that's the source of the 1.2 plus
10 million dollars in fees and costs.

11 So we would submit that there is
12 evidence in the record that would support our position
13 that at most, to the extent severability applies to
14 one of the exclusions, or to the extent severability
15 applies to the fraud exclusion, they would only get
16 this 1.2 million dollars in fees and that doesn't even
17 tap the federal policy.

18 They also stress there was no
19 determination until 2010, but the words in fact only
20 appear in the fraud exclusion. They don't appear in
21 any other exclusion. And in any event, by the time
22 2010 rolled around, the policies, the excess policy
23 still had not been implicated. (Unintelligible) yet
24 to exhaust.

25 So there was a determination in fact

1 that allows us to rely on that as of the attachment
2 point of our policy, because our policy has not yet
3 been reached because the underlying policy has not yet
4 been satisfied.

5 The cases they cite are cases
6 involving primary insurers that have an ongoing duty
7 to advance defense expenses. I don't see how they can
8 argue that excess insurers whose policies have not yet
9 been triggered had some obligation to be advancing in
10 these circumstances.

11 With respect to the admissibility of
12 guilty plea, I refer Your Honor to Evidence Rule
13 803(A)22. I think that applies directly here and I
14 don't see any way they can get around that.

15 As to the prior knowledge exclusion,
16 it applies based on knowledge. It doesn't apply based
17 on the existence of a misrepresentation. And the
18 statute that Quellos is citing here for the
19 proposition that we have to show in knowing
20 intentional intent to deceive on the part of Ms.
21 Bender would only apply if we were relying on the fact
22 of misrepresentation. We are not.

23 We're relying on the fact that
24 knowledge existed on the part of Greenstein and Wilk
25 as of 2000 that there were facts and circumstances

1 that might give rise to a claim, and that's based on
2 their admitted guilty plea and the timeline in that
3 guilty plea that shows that the fraud started in 1999.

4 Unless Your Honor has further
5 questions, we would request that summary judgment be
6 granted in favor of Federal and Indian Harbor.

7 THE COURT: Thank you very much. All
8 right. Counsel, give me a moment. I'm just going to
9 sit right here, but give me a moment, okay?

10 Thank you. Let's take the defendants,
11 and I'll refer to both. When I say defendants, I mean
12 both Federal Insurance Company and Indian Harbor
13 Insurance Company.

14 Defendants, primarily Federal, I mean,
15 First Federal and then with adjinder from Indian
16 Harbor, have moved for summary judgment on the basis
17 of four exclusions. There's been an opposition and
18 reply as well as oral argument. The court appreciates
19 the briefing by fine counsel. I do -- I want to tell
20 you that I don't tell that to everybody who appears in
21 front of me, but I do appreciate your briefing.

22 I appreciate the thoroughness in which
23 you prepared. I appreciate you being willing to work
24 with me as I give you a hard time. I guarantee you
25 that when I give you a hard time it's not just because

1 I want to hear myself talk. It's just I want to see
2 what the outer bounds of your logic and your argument
3 are and I appreciate you being good sports when I
4 press you a little bit on that. It's very much
5 appreciated.

6 The question here, of course, is we're
7 dealing with exclusions, and of course exclusions to
8 coverage are in many ways to be construed narrowly.
9 They are not general grants of coverage and we
10 construe them narrowly. Although in the context of a
11 legal determination, we need to take a look at --
12 obviously rule on them as a matter of law.

13 There may be the question -- the real
14 question here, though, is whether there are genuine
15 issues of material fact which would preclude the grant
16 of summary judgment. Of course we are all aware of
17 the standards by which we evaluate summary judgements.

18 Factual disputes are resolved in favor
19 of the nonmoving party on summary judgements, and the
20 question here is -- there are several legal questions,
21 but it seems to me that the primary issue is whether
22 there are genuine issues of material fact which would
23 preclude summary judgment.

24 We have four different exclusions
25 here. We have a fraud exclusion which has a

1 severability clause and which includes the arising
2 from or essentially language similar to the arising
3 from language. We have a knowing wrongful act
4 exclusion, which also includes a severability clause,
5 but which does not contain any arising out of
6 language.

7 We have a prior knowledge exclusion,
8 which includes arising out of language, and then we
9 have a wrongful act prior to the continuity date
10 exclusion or argument which contains neither a
11 severability clause nor arising out of type language.

12 We have a evidentiary issue first.
13 The court will find that the defendants have
14 established admissibility for those exhibits to which
15 there was an objection. The bases for the
16 admissibility are set forth in Federal's rely brief
17 and the court adopts that rationale and the authority
18 by reference. Particularly, with particularity the
19 guilty pleas of the two officers who were indicted and
20 convicted and are now serving federal time in the
21 federal penitentiary.

22 Those are clearly admissible. Even if
23 the other exhibits are simply arguably admissible,
24 they are clearly statements of a party opponent. They
25 would be admitted in virtually any trial and the

1 foundation has been established for admissibility of
2 all of defendants' proposed exhibits, but with
3 particularity with those.

4 Let's take the fraud exception
5 exclusion first. The problem as I'm seeing it with
6 this now is there is a potential conflict, it seems to
7 me, between the severability clause and the arising
8 out of language here.

9 So you would have a situation in which
10 all of these costs technically would arise out of the
11 original conduct, but the question would be, well,
12 there are claims against other nonindicted claimants,
13 which arguably arise out of a fraud, but perhaps not,
14 which may more sound in negligence and maybe not.

15 I think there is a potential problem
16 or issue or conflict between the severability
17 language, the arising out of language, and the -- and
18 a showing of what actual costs were incurred.

19 I have no problem entering a partial
20 summary judgment order establishing the viability and
21 the applicability of the fraud exclusion insofar as it
22 clearly relates to certain costs incurred by those
23 individuals who were actually indicted.

24 The problem as I see it is I thought
25 that there are genuine issues of material fact as to

1 the other costs and the other nonindicted claimants
2 and potentially as to the company itself.

3 I think there is a genuine issue of
4 material fact as to what exactly arising out of means,
5 and so therefore I will grant in part and deny in part
6 summary judgment on the part of fraud exclusion.

7 Let's be clear. The fraud exclusion
8 is viability. The fraud exclusion clearly applies to
9 certain costs, but exactly what those costs are will
10 have to be either decided by the trier of fact or by
11 subsequent motion practice. I cannot grant complete
12 summary judgment on this exclusion on this record.

13 Second, the knowing wrongful exclusion
14 act, I will also -- my ruling is similar. This
15 exclusion is clearly viable. This exclusion clearly
16 excludes certain costs that were incurred by
17 plaintiff, but whether it excludes all costs, well,
18 there is a genuine issue of material fact as to which
19 costs are covered, which costs are not.

20 And so the court will grant partial
21 summary judgment, only to the extent that this
22 exclusion clearly applies to some damages, but as to
23 which damages it is, that will remain to be determined
24 by the trier of fact or by subsequent motion practice.

25 Similarly, I will deny the summary

1 judgment -- well, I grant partial summary judgment but
2 deny complete summary judgment on the other two
3 remaining exclusions for similar reasons. I will make
4 clear, though, I want to take off the table this
5 argument that under the fraud exclusion it only
6 applies to criminal defense costs that were incurred
7 after the guilty plea.

8 I don't think that's a good argument,
9 Counsel. I think that if they were excluded by the
10 fraud, then they were excluded all the way back. So I
11 didn't find that that temporal argument to be terribly
12 persuasive, although, obviously, I found other
13 arguments to be persuasive. That one I want to take
14 it off the table right now.

15 So Counsel, you will please -- what
16 I'm going to have you do is I'm going to have you go
17 back in the back room and we're going to draft some
18 language here before you leave so nobody -- I don't
19 want people leaving here and then, you know, fighting
20 later about what our language is going to be. All
21 right?

22 So we're going to be talking about
23 that we're going to draft some language and even
24 interlineate some language on your proposed orders and
25 then we're going to get them signed today. So we're

1 not going to have a big argument after you guys fly
2 back to your respective offices in other parts of the
3 country about what I actually said or didn't say. All
4 right?

5 So the defense motions for summary
6 judgment are granted in part and denied in part
7 pursuant to this particular -- on this particular
8 issue.

9 Now, let's get back to the -- let's
10 get back to the first set of motions. The court,
11 again, appreciates the briefing, appreciates argument
12 by counsel. The first issue is whether the federal
13 and Indian Harbor policies are ambiguous, and it seems
14 to me that this is the touchstone issue for this
15 particular motion or these essentially cross-motions,
16 because if the policy language is ambiguous, you can
17 cite to a whole line of cases which talk about public
18 policy and talk about the idea of promoting
19 settlements, the idea of talking about -- you get into
20 ambiguity, policy construction, and all kinds of
21 things, which actually make a lot of sense to me.

22 I don't have any criticism or anything
23 like that about those line of cases, but it seems to
24 me that if you have a different kind of policy
25 language which is not ambiguous, then there are a

1 whole other line of cases which construe those
2 unambiguous policies which say that if you have an
3 unambiguous policy, you're going to honor the right of
4 the parties to negotiate language.

5 And although we have never adopted a
6 sophisticated insured standard here in Washington,
7 when individuals do negotiate different forms of
8 policies -- and clearly these two policies differ.
9 They're not just, quote/unquote, boilerplate or
10 standard form policies -- when parties sit down and
11 have particular policy language, you need to give
12 effect to that policy, that policy language.

13 And in this particular case the court
14 finds that neither the Federal Insurance Company
15 policy nor the Indian Harbor Insurance Company policy
16 language are ambiguous, and if they're not ambiguous,
17 the court will give effect to the policy language that
18 the parties entered into and therefore the cases,
19 virtually all of the cases that the plaintiff cites to
20 the court on this particular issue, are not applicable
21 and are fully distinguishable.

22 Indeed, there are only two cases that
23 the plaintiff has cited to the court which use the
24 identical language that we have at bar here. One is a
25 federal court, which was construing New York law. And

1 there is a significant question of whether that
2 district court judge, with all due respect, got it
3 right. There's a significant question whether New
4 York law was contrary to the federal district court
5 judge's decision in that case.

6 The other is a case in which,
7 essentially, was a moot point by the time that the
8 court ended up ruling. Essentially, it appears that
9 the primary insurer had paid all of the underlying
10 limits. So it's unclear whether that was simply
11 dicta, whether the result would have been different
12 had the underlying limits actually been paid by the
13 insured or the policy holder.

14 All the other cases construing this,
15 the identical policy language as we have here, have
16 held that the language is unambiguous and specifically
17 requires the payment to come from the -- from the
18 primary insurer rather than allowing the difference to
19 be made up by the policy holder.

20 And so any other case holding to the
21 contrary, other than the two we mentioned, are really
22 talking about a different kind of scenario in which
23 certain policy terms were not defined or we have
24 ambiguous policy terms. That is not our case here.

25 In addition to the policy language

1 that was referenced earlier regarding the attachment
2 point, I did notice, probably about 1:00 a.m. last
3 night, in the footnote the language about insolvency
4 that we referenced a little bit earlier. It was
5 interesting in terms of the drop-down.

6 For example, we have in the Indian
7 Harbor policy, it says, this policy will not drop down
8 for any reason, including but not limited to
9 uncollectibility, paren, in whole or in part, closed
10 paren, whether because of financial impairment or
11 insolvency of the underlying insurance or for any
12 other reason, except for the actual payment of loss by
13 the applicable insurer thereunder.

14 This appears to be a reiteration of
15 the condition or the -- a reiteration of the
16 requirement that the limit be paid by the underlying
17 insurer, rather, the insured.

18 The Federal policy actually goes
19 further. Although it doesn't have a specific
20 drop-down clause, it has this following clause.
21 Quote, Federal shall continue in force as primary
22 insurance, but only in the event of exhaustion of the
23 underlying limit by reason of the insurers of the
24 underlying insurance or the insureds in the event of
25 financial impairment or insolvency of an insured of

1 the underlying insurance, paying in legal currency
2 loss which, except for the amount thereof, would have
3 been covered thereunder, closed quote.

4 In other words, the Federal policy
5 says that the loss will be -- has to be paid by the
6 primary carrier and the only specified way that the
7 insured can make up or pay the underlying limit is if
8 the primary insurer is financially impaired or
9 insolvent. This policy doesn't seem to allow for any
10 other situation where the insurer can pay or make up
11 the difference.

12 It seems to me that these two policies
13 are crystal clear that the underlying limit has to be
14 paid by the underlying insurer. So there is no
15 ambiguity in this particular case.

16 Second argument is that the -- that
17 doesn't matter, I guess. So the second argument is
18 that doesn't matter because the carriers have somehow
19 waived or are estopped from asserting that the
20 underlying limit needs to be exhausted or paid,
21 rather, needs to be paid, because they denied
22 coverage.

23 Well, the court respectfully declines
24 to accept this argument, primarily because it's a
25 fairly circular argument. The circular argument is

1 you can't deny coverage on the basis that the
2 underlying insurance limit wasn't exhausted now
3 because you took the same position before.
4 Essentially, that's what the argument boils down to.
5 And it really is an unpersuasive argument.

6 One of the reasons for the denial of
7 the coverage, as far as I can tell in the exhibits,
8 are that you didn't exhaust your underlying limits, it
9 hasn't been paid by the underlying insurer, is
10 completely consistent with the position that has been
11 taken now, particularly with respect to the
12 unambiguous policy language.

13 So I didn't find it terribly
14 persuasive the argument that they could not now assert
15 the same position that they've been asserting all
16 along.

17 The third argument, and the one that's
18 a little bit closer but equally unpersuasive, is that
19 that is a condition and that the insurers need to
20 establish a material breach and prejudice because it's
21 a condition.

22 However, if we take a close look at
23 the case law -- and I guess we can't cite to the
24 Kalama case, because it's an unpublished trial court
25 decision, but if we take a close look at the

1 Washington cases, the Washington cases do not actually
2 construe condition as -- the term condition as broadly
3 as the policy holder here would ask us to do and
4 simply there is a substantial difference between a
5 grant of coverage and conditions to that coverage
6 itself.

7 The prejudice analysis has only been
8 applied to the cooperation clause, the late notice
9 clause, and other types of collateral conditions that
10 we find here, but the Washington courts as well as
11 other courts have long held and have consistently held
12 that as to specific grant of coverage, defining
13 specific scope of coverage, that is not limited to the
14 -- that is not defined by the prejudice analysis.

15 And in this particular case, the
16 attachment point or underlying limit or however you
17 want to characterize it, that particular issue is the
18 essential characteristic of an excess insurance
19 policy. I mean, that is, essentially, what
20 distinguishes it from anything else. It follows from,
21 essentially, to the primary insurance and the only
22 difference is the attachment point. I mean, that is
23 the one distinguishing factor.

24 It is that factor which caused it to
25 be priced differently. It is that factor which

1 basically is the defining aspect of excess insurance
2 policy itself. So it is not a mere condition to
3 coverage that is susceptible to the prejudice
4 analysis, but rather, it is the defining
5 characteristic of an excess insurance policy.

6 Now, clearly it's material, so if we
7 were going down that analytical road, it is material,
8 but the court does not believe and will so find that
9 this is not -- this is subject to the condition,
10 slash, prejudice analysis.

11 But even if we were to go down that
12 analytical road, this court finds that there would be
13 -- it's obviously a material condition, even if it
14 were a condition, and the court finds prejudice in
15 this particular case.

16 I did press counsel a little bit on
17 this particular issue. And it might be a different
18 analysis if the policy holder had come here and
19 conceded that certain policy, certain damages were
20 clearly not recoverable and not covered and here's
21 what they were, but here are the other damages which
22 clearly are covered and here they are and so we're not
23 asking you to cover the uncovered portions, but we are
24 asking you to cover the covered portions.

25 If the policy holder had made a

1 different case, we might have a different situation,
2 but that's not the case that's been presented here.
3 What the policy holder here has done is consistently
4 represented that we have tens of millions of dollars
5 of losses, without segregating them.

6 And the court will find that in this
7 particular case the excess insurer has been prejudiced
8 by the failure of the primary carrier to pay 10
9 million dollars of covered losses.

10 The policy -- the policies do not
11 require that the policy holder have 10 million dollars
12 of losses of some sort. They need to be covered
13 losses. And there is a lot that goes into the primary
14 carrier defending or paying or making coverage
15 determinations as to these 10 million dollars of
16 covered losses that protects the excess insurer and
17 allows the excess insurer to price their policies
18 accordingly and act accordingly and they would be
19 acting in reliance upon that payment being made. It
20 is not an unreasonable reliance, given the unambiguous
21 language in the policy.

22 So to repeat. The court does not find
23 that the condition prejudice analysis applies to this
24 particular case, but the court makes an alternative
25 finding that even if it did apply, there -- the

1 condition is material and the policy holder did not
2 establish condition and that the insurance company,
3 excess insurers were prejudiced by the failure to
4 follow the condition.

5 The court respectfully denies
6 plaintiff's motion for summary judgment and grants
7 defendants' motion for summary judgment on this
8 particular issue.

9 Counsel, will you please retire to the
10 jury room, and will you please -- I'd like to have
11 orders signed before you leave today and we'll proceed
12 accordingly. I'll step off the bench. Thank you.

13 MS. RICHEIMER: Your Honor, you had a
14 list that you mentioned of the things that were
15 considered. If we have a copy of it, great;
16 otherwise, that might be helpful.

17 THE COURT: Yes. I will find it and
18 get it to you. All right? Thank you.

19 MS. RICHEIMER: I think we know it,
20 but that way we're all on the same page.

21 (END OF TRANSCRIPTION)
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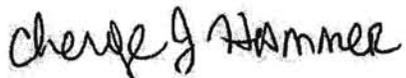
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TRANSCRIPTION CERTIFICATE

I, CHERYL J. HAMMER, the undersigned
Certified Court Reporter in and for Washington, do
hereby certify:

That the foregoing transcript was
transcribed under my direction; that the transcript is
true and accurate to the best of my knowledge and
ability to hear the audio; that I am not a relative or
employee of any attorney or counsel employed by the
parties hereto; nor am I financially interested in the
event of the cause.

WITNESS MY HAND this 2nd day of
January 2012.



CHERYL J. HAMMER
Certified Court Reporter
CCR No. 2512
chammer@yomreporting.com

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transcribed under my direction; that the transcript is
true and accurate to the best of my knowledge and
ability to hear the audio; that I am not a relative or
employee of any attorney or counsel employed by the
parties hereto; nor am I financially interested in the
event of the cause.

WITNESS MY HAND this 2nd day of
January 2012.

Cheryl J. Hammer
CHERYL J. HAMMER
Certified Court Reporter
CCR No. 2512
chammer@yomreporting.com

EXHIBIT B

FILED

11 OCT 28 PM 4:13

THE HONORABLE DEAN S. LUM
KING COUNTY
SUPERIOR COURT CLERK

E-FILED

CASE NUMBER: 10-2-41637-4 SEA

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IN THE SUPERIOR COURT OF THE STATE OF WASHINGTON
IN AND FOR KING COUNTY

QUELLOS GROUP LLC,

Plaintiff,

v.

FEDERAL INSURANCE COMPANY;
INDIAN HARBOR INSURANCE
COMPANY; STEADFAST INSURANCE
COMPANY; AND NUTMEG INSURANCE
COMPANY

Defendants.

No.: 10-2-41637-4 SEA

**DECLARATION OF NORM
BONTJE IN SUPPORT OF
QUELLOS GROUP LLC'S MOTION
FOR PARTIAL SUMMARY
JUDGMENT REGARDING
EXHAUSTION OF UNDERLYING
LIMITS OF INSURANCE**

I, Norm Bontje, declare:

1. I have personal knowledge of the matters contained in this declaration. If called as a witness, I could and would competently testify thereto.

2. In 1994, I began my employment at what is now known as Quellos Group LLC ("Quellos"). Since that time, I have served as the Chief Financial Officer ("CFO") for Quellos, including its successor and subsidiary entities.

3. I participated in the process of obtaining Quellos' insurance policies and have personal knowledge of Quellos' litigation against its investment management.

Bontje Declaration in Support of Quellos' Motion for Partial
Summary Judgment Regarding Exhaustion of Underlying
Limits of Insurance

1 insurance carriers, including Federal Insurance Company ("Federal") and Indian Harbor
2 Insurance Company ("Indian Harbor"). For a portion of my time as CFO, including the
3 present, I have had internal responsibility for overseeing insurance recovery efforts for
4 Quellos claims and acted as the primary point of contact within Quellos regarding the
5 instant lawsuit.
6

7 4. As part of the professional services provided to its clients, Quellos provided
8 certain clients with services and advice regarding portfolio optimized investment
9 transactions ("POINT").
10

11 5. Quellos purchased numerous layers of insurance coverage to protect against
12 losses incurred in connection with claims arising from the investment advisory services
13 provided to clients. For the policy period from September 21, 2004 to September 21,
14 2005, these policies included a primary policy sold by American International Surplus
15 Lines Insurance Company ("AISLIC"), and, among several others, excess policies sold by
16 Federal and Indian Harbor.
17

18 6. The 2004-2005 AISLIC Policy, Policy No. 885-37-42, provides primary
19 coverage of \$10 million.
20

21 7. Quellos paid a \$1,200,000 premium for the 2004-2005 AISLIC Policy.
22

23 8. The 2004-2005 Federal Policy, Policy No. 7023-2408, provides Quellos'
24 first layer of excess coverage, with limits of \$10 million in excess of the \$10 million limit
25 of the 2004-2005 AISLIC Policy.
26

9. Quellos paid a \$600,000 premium for the 2004-2005 Federal Policy.

2
Bontje Declaration in Support of Quellos' Motion for Partial
Summary Judgment Regarding Exhaustion of Underlying
Limits of Insurance

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CP 00210

1 10. The 2004-2005 Indian Harbor Policy, Policy No. ELU087006, provides
2 Quellos' second layer of excess coverage, with limits of \$20 million, in excess of the \$10
3 million 2004-2005 AISLIC Policy and the \$10 million Federal Policy.
4

5 11. Quellos paid a \$950,000 premium for the 2004-2005 Indian Harbor Policy.

6 12. In 2005, Quellos began giving notice to AISLIC, Federal, and Indian
7 Harbor of a number of government investigations, lawsuits and other claims arising out
8 the POINT transaction (the "POINT Claims").
9

10 13. Since it began giving such notice, Quellos has incurred defense costs and
11 other losses as a result of the POINT Claims.

12 14. Among counsel for Federal and Indian Harbor in the instant insurance
13 coverage suit are attorneys who have been representing these insurance companies in their
14 coverage dispute with Quellos regarding the POINT Claims since at least 2007.

15 15. The losses Quellos has incurred in connection with the POINT Claims now
16 exceed the policy limits of the 2004-2005 AISLIC Policy, the 2004-2005 Federal Policy
17 and the 2004-2005 Indian Harbor Policy.
18

19 16. On October 8, 2007, Federal denied coverage for certain losses Quellos has
20 incurred in connection with the POINT Claims. The losses for which Federal denied
21 coverage exceed the \$10 million limit of the AISLIC Policy.
22

23 17. On July 12, 2007, Indian Harbor denied coverage for certain losses Quellos
24 has incurred in connection with the POINT Claims. The losses for which Indian Harbor
25 denied coverage exceed the \$10 million limit of the 2004-2005 AISLIC primary policy,
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and the \$10 million limit of Federal's 2004-2005 first layer excess policy.

18. On August 26, 2009, AISLIC reimbursed Quellos \$4,982,973.58 for certain losses incurred in connection with the POINT Claims.

19. On June 27, 2011, Quellos and AISLIC entered into a \$15 million global settlement ("AISLIC Settlement Agreement"), resolving their coverage dispute with respect to various claims, including the POINT Claims, and releasing Quellos' claims for coverage under the 2004-2005 AISLIC Policy.

20. The terms of the AISLIC Settlement Agreement did not allocate any additional payment to the 2004-2005 AISLIC policy.

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To the best of my knowledge and belief, I declare under penalty of perjury that the foregoing is true and correct and that this declaration is executed on this 28th day of October, 2011, in Seattle, Washington.



Norm Bontje

5
Bontje Declaration in Support of Quellos' Motion for Partial Summary Judgment Regarding Exhaustion of Underlying Limits of Insurance

US2008 2693294.2

EXHIBIT C



AMERICAN INTERNATIONAL SPECIALTY LINES INSURANCE COMPANY

(a capital stock company)
175 Water Street
New York, N.Y. 10039

POLICY NUMBER:
885-37-42
REPLACEMENT OF
POLICY NUMBER:
473-56-73

**THIS IS A CLAIMS-MADE POLICY - PLEASE READ CAREFULLY
INVESTMENT MANAGEMENT INSURANCE POLICY**

NOTICE: THIS INSURER IS NOT LICENSED IN THE STATE OF NEW YORK AND IS NOT SUBJECT TO ITS SUPERVISION.

NOTICE: THE LIMIT OF LIABILITY AVAILABLE TO PAY JUDGMENTS OR SETTLEMENTS SHALL BE REDUCED BY AMOUNTS INCURRED FOR DEFENSE COSTS. AMOUNTS INCURRED FOR DEFENSE COSTS SHALL BE APPLIED AGAINST THE RETENTION AMOUNT. ALSO NOTE THAT THE COMPANY HAS THE RIGHT, BUT NOT THE DUTY TO DEFEND THE INSURED, BUT WILL PAY DEFENSE COSTS AS THEY ARE INCURRED.

DECLARATIONS

- ITEM 1. NAMED INSURED: **QUELLOS GROUP, . LLC**

MAILING ADDRESS: **601 UNION STREET, 56TH FLOOR
SEATTLE, WA 98101**
- ITEM 2. POLICY PERIOD: FROM: *September 21, 2004* TO: *September 21, 2005*
(12:01 A.M. standard time at the Address stated in Item 1.)
- ITEM 3. LIMIT OF LIABILITY: **\$10,000,000** Aggregate for all Coverages
Combined And Including Defense Costs
- ITEM 4. RETENTION (each Wrongful Act or related Wrongful Acts):
\$2,500,000 Entity Insureds retention
\$0 Individual Insureds retention
- ITEM 5. PREMIUM: **\$1,200,000**

Premium for Certified Acts of Terrorism Coverage under Terrorism Risk Insurance Act 2002: Not applicable, coverage rejected by insured. Any coverage provided for losses caused by an act of terrorism as defined by TRIA (TRIA Losses) may be partially reimbursed by the United States under a formula established by TRIA as follows: 90% of TRIA Losses in excess of the insurer deductible mandated by TRIA, the deductible to be based on a percentage of the insurer's direct earned premiums for the year preceding the act of terrorism. A copy of the TRIA disclosure sent with the original quote is attached hereto.

- ITEM 6. CONTINUITY DATE: **September 20, 2000**

7121215

ITEM 7. COVERAGES. Only those of the Coverages designated as "covered" by the corresponding letter for the coverage (for example the letter A for Coverage A) in the column under the heading "COVERED" next to where they are listed below are afforded by this policy. Absence of an entry means not covered:

	<u>COVERED</u>	<u>NOT COVERED</u>
COVERAGE A	X	
COVERAGE B	X	
COVERAGE C	X	
COVERAGE D	X	

FRANK CRYSTAL & CO, INC.
40 BROAD STREET
NEW YORK, NY 10004

Apr 21, 2005

AUTHORIZED REPRESENTATIVE
Or Countersignature (in states where applicable)

7121215

51500 (8/91)

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CP 00048

**POLICYHOLDER DISCLOSURE STATEMENT
UNDER
TERRORISM RISK INSURANCE ACT OF 2002**

You are hereby notified that under the federal Terrorism Risk Insurance Act of 2002 (the "Act") effective November 26, 2002, you now have a right to purchase insurance coverage for losses arising out of an Act of Terrorism, which is defined in the Act as an act certified by the Secretary of the Treasury (i) to be an act of terrorism, (ii) to be a violent act or an act that is dangerous to (A) human life; (B) property or (C) infrastructure, (iii) to have resulted in damage within the United States, or outside of the United States in case of an air carrier or vessel or the premises of a U.S. mission and (iv) to have been committed by an individual or individuals acting on behalf of any foreign person or foreign interest, as part of an effort to coerce the civilian population of the United States or to influence the policy or affect the conduct of the United States Government by coercion. You should read the Act for a complete description of its coverage. The Secretary's decision to certify or not to certify an event as an Act of Terrorism and thus covered by this law is final and not subject to review. There is a \$100 billion dollar annual cap on all losses resulting from Acts of Terrorism above which no coverage will be provided under this policy and under the Act unless Congress makes some other determination.

For your information, coverage provided by this policy for losses caused by an Act of Terrorism may be partially reimbursed by the United States under a formula established by the Act. Under this formula the United States pays 90% of terrorism losses covered by this law exceeding a statutorily established deductible that must be met by the insurer, and which deductible is based on a percentage of the insurer's direct earned premiums for the year preceding the Act of Terrorism.

COPY OF DISCLOSURE SENT WITH ORIGINAL QUOTE

Insured Name: *QUELLDS GROUP, LLC*

Policy Number: *886-37-42*

Policy Period Effective Date From: *September 21, 2004* To: *September 21, 2005*

AMERICAN INTERNATIONAL SPECIALTY LINES INSURANCE COMPANY

INVESTMENT MANAGEMENT INSURANCE POLICY

NOTICE: EXCEPT TO SUCH EXTENT AS MAY OTHERWISE BE PROVIDED HEREIN, THE COVERAGE OF THIS POLICY IS LIMITED GENERALLY TO LIABILITY FOR ONLY THOSE CLAIMS THAT ARE FIRST MADE AGAINST THE INSURED AND REPORTED TO THE COMPANY DURING THE POLICY PERIOD. PLEASE READ THE POLICY CAREFULLY AND DISCUSS THE COVERAGE THEREUNDER WITH YOUR INSURANCE AGENT OR BROKER.

In consideration of the payment of the premium, and in reliance upon the statements made to American International Specialty Lines Insurance Company (herein called the "Company") by application forming a part hereof and its attachments and the material incorporated therein, the Company agrees as follows:

1. INSURING AGREEMENTS

Only those of the insuring agreements designated as "covered" in the Declarations apply.

COVERAGE A: INVESTMENT ADVISER PROFESSIONAL LIABILITY - AND CORPORATE REIMBURSEMENT

This policy shall, subject to the limit of liability set forth in Item 3 of the Declarations, pay on behalf of the Insured all sums which the Insured shall become legally obligated to pay as damages resulting from any claim or claims first made against the Insured and reported in writing to the Company during the Policy Period or the Extended Reporting Period (if applicable) for any Wrongful Act of the Insured or of any other person for whose Wrongful Act the Insured is legally responsible, but only if such Wrongful Act occurs prior to the end of the Policy Period and solely in rendering or failing to render Investment Advisory Services for others for compensation in the course of the Entity Insured's business as an Investment Adviser; and with respect to the Entity Insured including amounts which the Entity Insured is permitted or required to pay as indemnification for such liability of the Individual Insured.

COVERAGE B: MUTUAL FUND PROFESSIONAL LIABILITY AND DIRECTORS AND OFFICERS LIABILITY AND CORPORATE REIMBURSEMENT

This policy shall, subject to the limit of liability set forth in Item 3 of the Declarations, pay on behalf of the Insured all sums which the Insured shall become legally obligated to pay as damages resulting from any claim or claims first made against the Insured and reported in writing to the Company during the Policy Period or the Extended Reporting Period (if applicable) for any Wrongful Act of the Insured or of any other person for whose Wrongful Act the Insured is legally responsible, but only if such Wrongful Act occurs prior to the end of the Policy Period and solely in the course of the management and/or operations of the Fund(s); and with respect to the Entity Insured including amounts which the Entity Insured is permitted or required to pay as indemnification for such liability of the Individual Insured.

COVERAGE C: DIRECTORS AND OFFICERS LIABILITY AND CORPORATE REIMBURSEMENT

This policy shall, subject to the limit of liability set forth in Item 3 of the Declarations, pay on behalf of the Executive Insured all sums which the Executive Insured shall become legally obligated to pay as damages resulting from any claim or claims first made against the Executive Insured and reported in writing to the Company during the Policy Period or the Extended Reporting Period (if applicable) for any Wrongful Act of the Executive Insured or of any other person for whose Wrongful Act the Executive Insured is legally responsible, but not Wrongful Acts to which Coverage A or Coverage D applies or would apply if it had been effected under this policy, and only if such Wrongful Act occurs prior to the end of the Policy Period; and with respect to the Entity Insured including amounts which the Entity Insured is permitted or required to pay as indemnification for such liability of the Executive Insured. This Coverage C shall not apply to Executive Insureds of the Funds for any Wrongful Act in their capacity as such.

COVERAGE D: DISTRIBUTOR PROFESSIONAL LIABILITY - AND CORPORATE REIMBURSEMENT

This policy shall, subject to the limit of liability set forth in Item 3 of the Declarations, pay on behalf of the Insured all sums which the Insured shall become legally obligated to pay as damages resulting from any claim or claims first made against the Insured and reported in writing to the Company during the Policy Period or the Extended Reporting Period (if applicable) for any Wrongful Act of the Insured or of any other person for whose Wrongful Act the Insured is legally responsible, but only if such Wrongful Act occurs prior to the end of the Policy Period and solely in rendering or failing to render Distributor Services for others for compensation in the course of the Entity Insured's business as a Distributor; and with respect to the Entity Insured including amounts which the Entity Insured is permitted or required to pay as indemnification for such liability of the Individual Insured.

II

DEFENSE COSTS (INCLUDED IN THE LIMIT OF LIABILITY)

With respect to any such Wrongful Act for which insurance is afforded by this policy under Insuring Agreement I Coverages A, B, C or D above, the Company shall, as part of and subject to the limit of liability set forth in Item 3 of the Declarations, pay the Insured's Defense Costs as they are incurred, and with respect to the Entity Insured including amounts which the Entity Insured is permitted or required to pay as indemnification for such Defense Costs of the Individual Insured. The Company shall at all times have the right, but not the duty, to assume the defense of any claim against the Insured. The Insured shall give the Company such information and cooperation as it may reasonably require. In the event the Company does not assume the defense of the Insured, the Company shall, nevertheless, have the right to effectively associate with the Insured in the defense and settlement of any claim that appears reasonably likely to involve the Company, including, but not limited to, the right to effectively associate in the negotiation of a settlement.

The Insured shall not admit liability for or settle any claim or incur any Defense Costs without the Company's prior written consent, which consent shall not be unreasonably withheld; however, if the Insured is able to dispose of all claims which are subject to one retention amount for an amount not exceeding the retention amount (inclusive of Defense Costs), then the Company's consent shall not be required for such claims.

If the Insured refuses to consent to any settlement recommended by the Company and acceptable to the claimant, the Company may then withdraw from the defense of the Insured (if it has assumed the Insured's defense) by tendering control of the defense to the Insured, and the Insured shall thereafter at his own expense negotiate or defend such claim independently of the Company, and the Company's liability shall not exceed the amount for which the claim could have been settled if such recommendation was consented to, plus Defense Costs incurred by the Company, and Defense Costs incurred by the Insured with the Company's written consent, prior to the date of such refusal.

The Company shall not be obligated to pay any claim or judgment or Defense Costs, or to defend or continue to defend any claim if the Company has assumed the defense of the Insured, after the limit liability set forth in Item 3 of the Declarations has been exhausted by payment by the Company of judgments and/or settlements and/or Defense Costs for any claim or claims in an amount equal to the limit of liability set forth in Item 3 of the Declarations.

With respect to the Defense Costs and any settlement of any claim made against the Insured, such Defense Costs and settlement having been consented to by the Company, the Insured and the Company agree to use their best efforts to determine a fair and proper allocation of the amounts as between the Insured and the Company.

2. DEFINITIONS

- (a) "Defense Costs" means reasonable and necessary fees, costs and expenses (including premiums for any appeal bond, attachment bond or similar bond, but without any obligation to apply for or furnish any such bond), incurred by the Company or by the Insured with the written consent of the Company, and resulting solely from the investigation, adjustment, defense and appeal of any claim against the Insured, but excluding salaries of any Insured and excluding loss of earnings by any Insured.
- (b) "Distributor" means the principal underwriter (as that term is defined in the Investment Company Act of 1940, as amended) of the Fund(s).
- (c) "Distributor Services" means the professional services as a Distributor.
- (d) "Fund(s)" means the investment company(ies) specifically listed in this policy as a Named Insured and the automatically covered funds below.

If Coverage B is in effect, then the insurance afforded hereunder shall automatically extend, for a period of sixty (60) days from the date the securities are first sold to the public, to any newly established investment company sponsored by a Named Insured and/or portfolio of an investment company sponsored by a Named Insured which has been declared effective by the SEC.

This extension shall expire sixty (60) days from the date the securities are first sold to the public unless the Company in its absolute discretion agrees to endorse the newly established investment company and/or portfolio as an additional Named Insured under this policy. Nothing contained herein shall operate to extend the length of the Policy Period. With regard to these automatically covered Funds, the Insured shall provide the Company with whatever underwriting information is requested, and pay whatever additional premium is required by the Company. It is agreed that the decision to extend the insurance beyond sixty (60) days is solely within the Company's absolute discretion.

- (e) "Insured" means the Named Insured, the automatically covered Funds, and any past, present or future partner, officer, director, trustee or employee of the Named Insured or the automatically covered Funds against whom claim is made in their capacity as such partner, officer, director, trustee or employee.

"Named Insured" means the individual, partnership, trust, corporation, Fund(s) or firm named in Item 1 of the Declarations.

"Entity Insured" means an Insured which is not a natural person.

"Individual Insured" means an Insured who is a natural person."

"Executive Insured" means an Individual Insured who is a past, present or future partner, officer, director or trustee of the Named Insured or the automatically covered Funds against whom claim is made in his capacity as such partner, officer, director or trustee.

- (f) Investment Adviser means an Insured who, for compensation, engages in the business of rendering Investment Advisory Services.
- (g) Investment Advisory Services means giving financial, economic or investment advice regarding investments in securities and/or rendering investment management services pursuant to a written contract defining the scope of such advice and/or services and the compensation to be paid therefor.
- (h) "Policy Period" means the period of time from the inception date shown in Item 2 of the Declarations to the earlier of the expiration date shown in Item 2 Declarations or the effective date of cancellation of this policy; however, to the extent this policy replaces coverage in other policies terminating at noon standard time on the inception date of such coverage hereunder, then such coverage as is provided by this policy shall not become effective until such other coverage has terminated.
- (i) "Wrongful Act" means any breach of duty, neglect, error, misstatement, misleading statement, omission or other act wrongfully done or attempted by the Insured.

8. TERRITORY

This policy applies to Wrongful Acts which occur anywhere in the world, but only if the

claim therefor is brought against the Insured in the United States of America, its territories or possessions, or Canada.

4. EXCLUSIONS

I. This policy does not apply:

- 1) to any actual or alleged fraud, dishonesty, criminal or malicious acts or omissions; however, if such allegations are subsequently disproven by a final adjudication favorable to the Insured, then the Company shall reimburse the Insured for all reasonable Defense Costs which would have been collectible under this policy;
- 2) to any actual or alleged gaining of any profit or advantage to which any Insured is not legally entitled; however, if such allegations are subsequently disproven by a final adjudication favorable to the Insured, then the Company shall reimburse the Insured for all reasonable Defense Costs which would have been collectible under this policy;
- 3) to any actual or alleged Wrongful Act committed with knowledge that it was a Wrongful Act;
- 4) to the payment to the Executive Insured of any remuneration without the previous approval of the shareholders of the Entity Insured, which payment without such previous approval shall be held to have been illegal;
- 5) to any claim arising out of profits in fact made from the purchase or sale by the Individual Insured of securities of the Entity Insured within the meaning of Section 16(b) of the Securities Exchange Act of 1934 and amendments thereto or similar provisions of any state statutory law;

NOTE: The Wrongful Act of any partner, officer, director, trustee or employee who is an Insured under this policy shall not be imputed to any other partner, officer, director, trustee or employee who is an Insured under this policy for the purpose of exclusions I. 1) through 5).

II. This policy does not apply:

- 1) to any actual or alleged libel, slander or defamation;
- 2) to any actual or alleged bodily injury to or sickness, disease or death of any person, or damage to or destruction of any tangible property, including the loss of use thereof;
- 3) to any claim arising out of the actual or alleged inability to make any payment by any bank or banking firm or broker or dealer in securities or commodities, or selection of such;
- 4) to any actual or alleged Wrongful Act occurring prior to the Continuity

Date specified in Item 8 of the Declarations, if on or before such Continuity Date any Insured knew of such Wrongful Act or could have reasonably foreseen that such Wrongful Act could lead to a claim;

- 5) to any claim arising out of any pension or employee benefit plan or trust sponsored or established by any Insured for the benefit of the employees of any Insured;
- 6) to any claim arising out of disputes involving fees or charges for any Insured's services, including but not limited to any fees or charges pursuant to a 12b-1 plan of distribution adopted by a Fund pursuant to Rule 12b-1; however, if the dispute is resolved by settlement consented to by the Company, or if such allegations are subsequently disproven by a final adjudication favorable to the Insured, then the Company shall reimburse the Insured for all reasonable Defense Costs which would have been collectible under this policy;
- 7) to any claim against any Insured which is brought by, or on behalf of, or in the right of, any other Insured or any affiliate thereof, including but not limited to shareholders' derivative suits and/or representative class action suits; unless, however, only with respect to suits brought by or on behalf of the shareholders of an Entity Insured, such suit(s) is instigated and continued totally independent of, and totally without the solicitation of, or assistance of, or participation of, or intervention of, any other Insured or any affiliate thereof. However, this exclusion shall not apply to any claim by a Fund where in the opinion of independent legal counsel selected by and at the expense of an Entity Insured, (selection of such counsel being subject to approval by the Company, which approval shall not be unreasonably withheld), the failure to make such claim would result in liability upon the directors, officers, partners or trustees of such Fund(s), for failure to assert such claim.

With respect to claims made against an Executive Insured, this exclusion shall not apply to claims brought by an individual Insured who is not a present or former director or partner of the Named Insured for wrongful termination of employment or other unfair employment practices with respect to such individual Insured bringing the claim.

- 8) to any claim arising out of the actual or alleged rendering or failing to render advice or other services to clients of any Insured in connection with any merger, acquisition, restructuring or divestiture. With respect to Coverage A, this exclusion shall not apply to coverage for the Named Insured's activities of managing securities portfolios, giving of financial advice or investment management services relating to or in connection with investing in securities of entities which are involved in mergers, acquisitions, restructurings or divestitures, as long as the Named Insured is not a participant in such transactions;

- 9) to any claim arising out of the facts alleged, or arising out of the same or related Wrongful Acts alleged or contained, in any claim which has been reported, or in any circumstances of which notice has been given, under any policy of which this policy is a renewal or replacement or which it may succeed in time;
- 10) to any claim arising out of any actual or alleged act or omission by, or arising out of the status of, an Individual Insured in his capacity as a partner, officer, director, trustee or employee of any other person or entity other than the Named Insured;
- 11) to fines, penalties, punitive or exemplary damages, the multiplied portion of multiplied damages, taxes, nonpecuniary relief, any amount for which the Insured is not financially liable or which is without legal recourse to the Insured, or matters which may be deemed uninsurable under the law pursuant to which this policy shall be construed;
- 12) to any claim alleging, arising out of, based upon, attributable to or in any way involving, directly or indirectly:
- (1) the actual, alleged or threatened discharge, dispersal, release or escape of pollutants, or
 - (2) any direction or request to test for, monitor, clean up, remove, contain, treat, detoxify or neutralize pollutants,

Including but not limited to claims alleging damage to an Entity Insured or its securityholders.

Pollutants includes (but is not limited to) any solid, liquid, gaseous or thermal irritant or contaminant, infectious or otherwise, including (but not limited to) smoke, vapor, soot, fumes, acids, alkalis, chemicals and waste. Waste includes (but is not limited to) materials to be recycled, reconditioned or reclaimed;

- 13) with respect to any particular Fund or portfolio of a Fund, to any actual or alleged Wrongful Act occurring prior to the date the registration statement pertaining thereto was declared effective by the SEC;
- 14) to any claim arising out of any attempt, whether successful or unsuccessful, by any person or entity to acquire securities of an Entity Insured against the opposition of the Executive Insureds, or any action, whether successful or unsuccessful, by the Entity Insured or the Executive Insureds to resist such attempts; however, this exclusion shall not apply if, before taking any such resistive action, the Entity Insured or the Executive Insureds has obtained a written opinion (1) from independent legal counsel that such resistive action is a lawful exercise of the Executive Insureds' business judgment and (2) from an independent investment banking firm that the price of such acquisition of securities is inadequate, and that any financial transaction approved by the Executive Insureds which is resistive of such acquisition is fair to the Entity Insured and its shareholders;

15) to any:

- a) actual or alleged use by any insured of, or
- b) actual or alleged aiding or abetting by any insured in the use of, or
- c) actual or alleged participating after the fact by any insured in the use of,

non-public information in a manner prohibited by the laws of the United States, including, but not limited to, the Insider Trading and Securities Fraud Enforcement Act of 1988 (as amended), Section 10(b) of the Securities Exchange Act of 1934 (as amended) and Rule 10b-5 thereunder, any state, commonwealth, territory or subdivision thereof, or the laws of any other jurisdiction, or any rules or regulations promulgated under any of the foregoing;

16) to any claim arising out of any insured's activities as an Underwriter or Broker or Dealer. As used in this exclusion:

- 1) "Underwriter" means an underwriter as defined in section 2.(11) of the Securities Act of 1933 as amended;
- 2) "Broker" and "Dealer" shall mean broker and dealer as those terms in section 3.(a) (4) and section 3.(a) (5) of the Securities Exchange Act of 1934 as amended;

17) to any actual or alleged failure of any insured to effect or maintain insurance;

18) to any claim arising out of any pending or prior litigation as of the inception date of this policy, or arising out of the same or essentially the same Wrongful Acts alleged in such pending or prior litigation.

5. LIMIT OF LIABILITY (INCLUDING DEFENSE COSTS)

The limit of liability stated in the Declarations is the limit of the Company's liability for all amounts payable hereunder for all Coverages combined in settlement or satisfaction of claims, judgments or awards, and including Defense Costs, arising out of claims first made and reported to the Company during the Policy Period or during the Extended Reporting Period, regardless of the number of insureds, claims or claimants. The aggregate limit of liability for the Extended Reporting Period shall be part of, and not in addition to, the aggregate limit of liability for the Policy Period. The Company shall be absolutely entitled to pay settlements, judgments, awards and Defense Costs as they become due and payable by the insured without consideration of other future payment obligations.

Defense Costs are subject to, part of, and not payable by the Company in addition to, the limit of liability.

6. RETENTION

The Company shall only be liable for those amounts payable hereunder in settlement or satisfaction of claims, judgments or awards and Defense Costs arising from any claim which is in excess of the retention amount stated in Item 4 of the Declarations, and such retention amount shall be borne by the Insured and remain uninsured. A single retention amount shall apply to all amounts payable hereunder arising from all claims alleging the same Wrongful Act or related Wrongful Acts.

The retention stated in the Declarations as the "Entity Insureds retention" shall apply to all Insureds under this policy when claim is made:

- 1) against both one or more Individual Insureds and one or more Entity Insureds except in the case where the Entity Insureds have not indemnified and are neither permitted nor required to indemnify the Individual Insureds for the amounts they have become liable to pay in which case the Entity Insureds retention shall apply to the Entity Insureds and the Individual Insureds retention shall apply to the Individual Insureds; or
- 2) against Entity Insureds and not against any Individual Insureds.

The Individual Insureds retention shall apply to the Individual Insureds when claim is made against only one or more Individual Insureds and not against any of the Entity Insureds and the Entity Insureds have not indemnified and are neither permitted nor required to indemnify the Individual Insureds for the amounts they have become liable to pay; however, if the Entity Insureds are permitted or required to indemnify the Individual Insureds, then the Entity Insureds retention shall apply.

In cases where the Individual Insureds retention applies, it shall apply severally to each Individual Insured against whom claim is made, notwithstanding language above stating "A single retention amount shall apply to all amounts payable hereunder arising from all claims alleging the same Wrongful Act or related Wrongful Acts".

In no event shall the total amount of retentions applied to amounts payable hereunder arising from the same or related Wrongful Act(s) exceed the Entity Insureds retention amount.

7. NOTICE/CLAIM REPORTING PROVISIONS

Notice hereunder shall be given in writing to A.I. Management and Professional Liability Claims Adjusters, P.O. Box 1000, New York, NY 10268. If mailed, the date of mailing of such notice shall constitute the date that such notice was given and proof of mailing shall be sufficient proof of notice. Notice given by or on behalf of the Insured to any authorized representative of the Company shall be deemed notice to the Company.

- (a) The Insured shall, as a condition precedent to the obligations of the Company under this policy, give written notice to the Company as soon as practicable during the Policy Period, or during the Extended Reporting Period (if applicable), of any claim made against the Insured.

- (b) If during the Policy Period or during the Extended Reporting Period (if applicable), written notice of a claim has been given to the Company pursuant to Clause 7(a) above, then any claim which is subsequently made against the Insured and reported to the Company alleging, arising out of, based upon or attributable to the facts alleged in the claim of which such notice has been given, or alleging any Wrongful Act which is the same as or related to any Wrongful Act alleged in the claim of which such notice has been given, shall be considered made at the time such notice was given.
- (c) If during the Policy Period or during the Extended Reporting Period (if applicable), the Insured shall become aware of any circumstances which may reasonably be expected to give rise to a claim being made against the Insured and shall give written notice to the Company of the circumstances and the reasons for anticipating such a claim, with full particulars as to dates and persons involved, then any claim which is subsequently made against the Insured and reported to the Company alleging, arising out of, based upon or attributable to such noticed circumstances or alleging any Wrongful Act which is the same as or related to any Wrongful Act alleged or contained in such noticed circumstances, shall be considered made at the time such notice of such circumstances was given.

8. COOPERATION

The Insured shall cooperate with the Company and, upon the Company's request, assist in making settlements, in the conduct of suits or proceedings, and in enforcing any right of contribution or indemnity against any person or organization who may be liable to the Insured. The Insured shall attend hearings, trials and depositions and shall assist in securing and giving evidence and obtaining the attendance of witnesses.

9. EXTENDED REPORTING CLAUSE

If the Company shall cancel or decline to renew this policy, the Insured shall have the right, upon payment of an additional premium of 50% of the full annual premium, to a period of one year following the effective date of such cancellation or non-renewal (herein referred to as the Extended Reporting Period) in which to give written notice to the Company of claims first made against the Insured during such Extended Reporting Period for any Wrongful Act occurring prior to the end of the Policy Period and otherwise covered by this policy. As used herein, "full annual premium" means the premium level in effect immediately prior to the end of the Policy Period.

The rights contained in this clause shall terminate, however, unless written notice of such election together with the additional premium due is received by the Company within ten (10) days of the effective date of cancellation or non-renewal. The additional premium for the Extended Reporting Period shall be fully earned at the inception of the Extended Reporting Period. The Extended Reporting Period is not cancellable. This clause and the rights contained herein shall not apply to any cancellation resulting from non-payment of premium.

The offer by the Company of renewal terms, conditions, limit of liability and/or premiums different from those of the expiring policy shall not constitute a declination to renew by the Company.

10. CANCELLATION CLAUSE

This policy may be cancelled by the insured at any time only by mailing written prior notice to the Company or by surrender of this policy to the Company or its authorized agent. This policy may also be cancelled by the Company by delivering to the insured or by mailing to the insured by registered, certified, or other first class mail, at the insured's address as shown in Item 1 of the Declarations, written notice stating when, not less than sixty (60) days thereafter, or not less than ten (10) days thereafter if cancellation is because of nonpayment of premium when due, the cancellation shall be effective. The mailing of such notice as aforesaid shall be sufficient proof of notice. The Policy Period terminates at the date and hour specified in such notice, or at the date and time of surrender.

If this policy shall be cancelled by the insured, the Company shall retain the customary short rate proportion of the premium hereon.

If this policy shall be cancelled by the Company, the Company shall retain the pro rata proportion of the premium hereon.

Payment or tender of any unearned premium by the Company shall not be a condition precedent to the effectiveness of cancellation but such payment shall be made as soon as practicable.

If the period of limitation relating to the giving of notice is prohibited or made void by any law controlling the construction thereof, such period shall be deemed to be amended so as to be equal to the minimum period of limitation permitted by such law.

11. SUBROGATION

In the event of any payment under this policy, the Company shall be subrogated to the extent of such payment to all the insured's rights of recovery therefor, and the insured shall execute all papers required and shall do everything that may be necessary to secure such rights including the execution of such documents necessary to enable the Company effectively to bring suit in the name of the insured.

12. OTHER INSURANCE

Such insurance as is provided by this policy shall apply only as excess over any other valid and collectible insurance.

13. NOTICE AND AUTHORITY

It is agreed that the insured first named in Item 1 of the Declarations shall act on behalf of all insureds with respect to the giving and receiving of notice of claim and cancellation, the payment of premiums and the receiving of any return premiums that may become due under this policy, the receipt and acceptance of any endorsements issued to form a part of this policy and the exercising or declining to exercise any right to an Extended Reporting Period.

14. ASSIGNMENT

This policy and any and all rights hereunder are not assignable without the written consent of the Company.

15. ACTION AGAINST COMPANY

No action shall lie against the Company unless, as a condition precedent thereto, there shall have been full compliance with all of the terms of this policy, nor until the amount of the Insured's obligation to pay shall have been finally determined either by judgment against the Insured after actual trial or by written agreement of the Insured, the claimant and the Company.

Any person or organization or the legal representative thereof who has secured such judgment or written agreement shall thereafter be entitled to recover under this policy to the extent of the insurance afforded by this policy. No person or organization shall have any right under this policy to join the Company as a party to any action against the Insured to determine the Insured's liability, nor shall the Company be impleaded by the Insured or his legal representative. Bankruptcy or insolvency of the Insured or of his estate shall not relieve the Company of any of its obligations hereunder.

16. TERMINATION OF COVERAGE FOR SUBSEQUENT WRONGFUL ACTS AFTER CERTAIN TRANSACTIONS

PART A

If, during the Policy Period, there shall occur a change of control of any Investment Adviser which is an Insured under this policy, then coverage (including but not limited to Clause 9, EXTENDED REPORTING CLAUSE), for any and all Insureds hereunder, with respect to such Investment Adviser and all of its activities, shall not apply to Wrongful Acts occurring subsequent to such change of control.

PART B

If, during the Policy Period, there shall be a change in the majority of the partners, directors, trustees and/or officers of any Fund, or if any Fund shall be merged, consolidated or otherwise combined with any other entity or liquidated, or if the Investment Adviser and/or principal underwriter/general distributor of any Fund(s) ceases to act as such and/or any Fund(s) ceases to exist, terminates operations and/or liquidates, then coverage (including but not limited to Clause 9, EXTENDED REPORTING CLAUSE), for any and all Insureds hereunder, with respect to the Fund which underwent such event, shall not apply to Wrongful Acts occurring subsequent to such event unless the Company in its absolute discretion gives its consent in writing by endorsement to this policy. Written notice of such event must be given to the Company as soon as practicable, but not later than 15 days after the occurrence thereof.

PART C

If during the Policy Period:

1. the Entity Insured first named in Item 1 of the Declarations (herein called the "First

Named Insured") shall consolidate with or merge into, or sell all or substantially all of its assets to, any other person or entity or group of persons and/or entities acting in concert; or

2. any person or entity or group of persons and/or entities acting in concert shall acquire an amount of the outstanding securities representing more than 50% of the voting power for the election of Directors of the First Named Insured, or acquires the voting rights of such an amount of such securities;

(either of the above events herein referred to as the Transaction")

then, there shall be no coverage afforded by any provision of this policy (including but not limited to Clause 9, EXTENDED REPORTING CLAUSE) for any alleged Wrongful Act occurring after the effective date of the Transaction.

The First Named Insured shall give the insurer written notice of the Transaction as soon as practicable, but not later than 15 days after the effective date of the Transaction.

17. SERVICE OF SUIT

It is agreed that in the event of failure of the Company to pay any amount claimed to be due hereunder, the Company, at the request of the Insured, will submit to the jurisdiction of a court of competent jurisdiction within the United States. Nothing in this condition constitutes or should be understood to constitute a waiver of the Company's rights to commence an action in any court of competent jurisdiction in the United States to remove an action to a United States District Court or to seek a transfer of a case to another court as permitted by the laws of the United States or of any state in the United States. It is further agreed that service of process in such suit may be made upon General Counsel, Legal Department, American International Specialty Lines Insurance Company, 70 Pine Street, New York, N.Y. 10270, or his or her representative, and that in any suit instituted against the Company upon this contract, the Company will abide by the final decision of such court or of any appellate court in the event of any appeal.

Further, pursuant to any statute of any state, territory, or district of the United States which makes provision therefor, the Company hereby designates the Superintendent Commissioner, or Director of Insurance, other officer specified for that purpose in the statute, or his or her successor or successors in office as its true and lawful attorney upon whom may be served any lawful process in any action, suit, or proceeding instituted by or on behalf of the insured or any beneficiary hereunder arising out of this contract of insurance, and hereby designates the above named Counsel as the person to whom the said officer is authorized to mail such process or a true copy thereof.

IN WITNESS WHEREOF, the Company has caused this policy to be signed by its President and a Secretary and signed on the Declarations page by a duly authorized representative of the Company.

Elizabeth M. Tuck

SECRETARY



PRESIDENT

ENDORSEMENT# 1

This endorsement, effective 12:01 am September 21, 2004 forms a part of policy number 885-37-42 issued to QUELLOS GROUP, LLC

by American International Specialty Lines Insurance Company

IMPROPER MUTUAL FUND PRACTICES EXCLUSION

In consideration of the premium charged, it is hereby understood and agreed that the Insurer shall not make any payment for loss in connection with any claim made against any Insured alleging, arising out of, based upon or attributable to any allegation(s) that any Insured intentionally or negligently permitted, or aided or abetted others in using, was aware of others using, or was a participant or connected in any way in the use of: 1) Late Trading; 2) Market Timing; 3) Soft-dollar Activity; or, 4) Front Running related to a mutual fund.

It is the intent of the parties that this policy shall exclude such loss regardless of the form, style, or denomination of any such claim, regardless of whether the claim is criminal, administrative or civil, and shall specifically apply but not be limited to claims alleging breach of contract, failure to supervise, negligent supervision or negligence of any kind, controlling person liability, breach of fiduciary duty, personal profiting, criminal activity, market manipulation, violation of any law related to mutual funds, misrepresentation, estoppel or repudiation of any commitment and any other theory of liability.

Solely for the purpose of this endorsement, "Late Trading" means: 1) any transaction involving mutual fund shares made after the determination of the mutual fund's Current Net Asset Value (as defined in Rule 2a-4 of the Investment Company Act of 1940), including but not limited to, the placement or confirmation of orders for, or the purchase or redemption of mutual fund shares, but made at a price based on the fund's previously determined Current Net Asset Value calculated that same day, in contravention of Rule 22c-1 of the Investment Company Act of 1940; or, 2) any transaction defined as late trading by any state or federal statute or regulation, or any prospectus, policy, limitation, agreement or procedure of the mutual fund.

Solely for the purpose of this endorsement, "Market Timing" means the making of short-term purchases or sales of mutual fund shares, contrary to or in violation of any mutual fund prospectus, policy, limitation, agreement or procedure, or contrary to or in violation of any state or federal statute or regulation, and the conduct associated therewith, including, but not be limited to:

- (1) the waiver of redemption fees associated with Short-Term Trading contrary to the mutual fund's prospectus, policies, limitations, agreements or procedures;
- (2) the failure to abide by written representations regarding the permissibility of Short-Term Trading, or written representations regarding the mutual fund's efforts to monitor or prevent Short-Term Trading;

END 1

CP 00063

ENDORSEMENT# 1 (Continued)

This endorsement, effective 12:01 am September 21, 2004 forms a part of
policy number 885-37-42
issued to QUELLOS GROUP, LLC

by *American International Specialty Lines Insurance Company*

- (3) the receipt of fees or other compensation from certain investors in exchange for providing such investors with Short-Term Trading privileges not available to other investors;
- (4) the failure to monitor, detect, identify or remediate Short-Term Trading.

Solely for the purpose of this endorsement, "Short-Term Trading" means the redemption of shares of a mutual fund in a time period less than that provided in a mutual fund prospectus, or the policies, limitations, agreements or procedures of a mutual fund, or at law, including without limitation any so-called "in and out" trading of mutual fund shares or any other trade of mutual fund shares designed to take advantage of inefficiencies in the method the mutual fund uses to price its shares.

Solely for the purpose of this endorsement, "Soft Dollar Activities" means paying or providing, or receiving or accepting, fees, commissions, bonuses, gratuities, services or any other form of compensation in exchange for the preferential treatment of a particular mutual fund or particular class of mutual fund share.

Solely for the purpose of this endorsement, "Front Running" means the trading by brokers of mutual fund shares based on information received internally, before clients of the broker have been given the information.

ALL OTHER TERMS, CONDITIONS, AND LIMITATIONS REMAIN UNCHANGED.

END 1



AUTHORIZED REPRESENTATIVE
Or Countersignature (In states where applicable)

CP 00064

ENDORSEMENT# 2

This endorsement, effective 12:01 am September 21, 2004 forms a part of policy number 885-37-42 issued to QUELLOS GROUP, LLC

by American International Specialty Lines Insurance Company

THIS ENDORSEMENT CHANGES THE POLICY. PLEASE READ IT CAREFULLY.

TERRORISM EXCLUSION ENDORSEMENT

In consideration of the premium charged, it is hereby understood and agreed that this insurance does not apply to any loss, injury, damage, claim or suit, arising directly or indirectly as a result of a certified "act of terrorism" defined by Section 102. Definitions, of the Terrorism Risk Insurance Act of 2002 and any revisions or amendments.

Wherever used in this endorsement: 1) "insurer" means the insurance company which issued this policy; and 2) "insured" means the Named Employer, Named Corporation, Named Sponsor, Named Organization, Named Entity, Named Insured or Insured stated in item 1. of the Declarations.

For purposes of this endorsement and in compliance with the Terrorism Risk Insurance Act of 2002, an "act of terrorism" shall mean:

(1) Act of Terrorism -

- (A) Certification. - The term "act of terrorism" means any act that is certified by the Secretary of the Treasury of the United States of America, in concurrence with the Secretary of State, and the Attorney General of the United States of America --
- (i) to be an act of terrorism;
 - (ii) to be a violent act or an act that is dangerous to --
 - (I) human life;
 - (II) property; or
 - (III) infrastructure;
 - (iii) to have resulted in damage within the United States of America, or outside of the United States of America in the case of --
 - (I) an air carrier or vessel described in paragraph (5)(B); [for the convenience of this endorsement, paragraph (5)(B) reads: occurs to an air carrier (as defined in Section 40102 of title 49, United States Code) to a United States flag vessel (or a vessel based principally in the United States of America, on which United States income tax is paid and whose insurance coverage is subject to regulation in the United States of America), regardless of where the loss occurs, or at the premises of any United States of America mission]; or
 - (II) the premises of a United States of America mission; and
 - (iv) to have been committed by an individual or individuals acting on behalf of any foreign person or foreign interest, as part of an effort to coerce the civilian population of the United States of America or to influence the policy or affect the conduct of the United States Government by coercion.

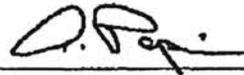
END 002

ENDORSEMENT# 2 (continued)

- (B) **Limitation.** — No act shall be certified by the Secretary as an act of terrorism if —
- (i) the act is committed as part of the course of a war declared by the Congress, except that this clause shall not apply with respect to any coverage for workers' compensation; or
 - (ii) property and casualty insurance losses resulting from the act, in the aggregate, do not exceed \$5,000,000.
- (C) **Determinations Final.** — Any certification of, or determination not to certify, an act as an act of terrorism under this paragraph shall be final, and shall not be subject to judicial review.
- (D) **Nondelegation.** — The Secretary may not delegate or designate to any other officer, employee, or person, any determination under this paragraph of whether, during the effective period of the Program, an act of terrorism has occurred.

For the purposes of this endorsement, the Insured: 1) acknowledges that it has received a Policyholder Disclosure Statement Under Terrorism Risk Insurance Act of 2002; 2) has elected not to purchase insurance coverage for losses arising out of an Act of Terrorism; 3) has not paid any premium for such coverage; and 4) has affirmatively authorized the Insurer to attach this exclusion.

ALL OTHER TERMS, CONDITIONS AND EXCLUSIONS REMAIN UNCHANGED.



AUTHORIZED REPRESENTATIVE
Or Countersignature (In states where applicable)

END 002

Page 2 of 2

81316 (2/03)

NU of 81127

CP 00066

ENDORSEMENT# 3

This endorsement, effective 12:01 am September 21, 2004 forms a part of
policy number 885-37-42
issued to QUELLOS GROUP, LLC

by *American International Specialty Lines Insurance Company*

PATENT INFRINGEMENT EXCLUSION

In consideration of the premium charged it is hereby understood and agreed that
SECTION 4. EXCLUSIONS, CLAUSE II is amended to include the following:

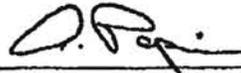
The policy does not apply:

- 18) to any claim alleging, based upon or arising out of infringement of patent, trademark
or misappropriation of trade secrets.

Moreover, SECTION 2, DEFINITIONS is amended to include the following:

- (j) "Trade Secret" means information, including a formula, compilation, pattern, program,
device, method, process or technique that derives independent economic value,
actual or potential, from not being generally known and not readily ascertainable
through proper means by other person who can obtain economic advantage from its
disclosure or use.

ALL OTHER TERMS, CONDITIONS, AND EXCLUSIONS REMAIN UNCHANGED.



AUTHORIZED REPRESENTATIVE
Or Countersignature (In states where applicable)

END 003

CP 00067

ENDORSEMENT# 4

This endorsement, effective 12:01 am September 21, 2004 forms a part of
policy number 885-37-42
issued to QUELLOS GROUP, LLC

by American International Specialty Lines Insurance Company

COST OF CORRECTIONS ENDORSEMENT

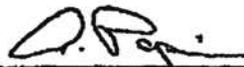
In consideration of the premium charged, it is hereby understood and agreed that the Company shall pay on behalf of the Insured all loss, costs and expenses incurred by the Insured with the Company's written consent to correct any situation arising out of any actual or alleged Wrongful Act when such Wrongful Act, if not corrected, would automatically have resulted in a loss or damage to any shareholder of the Fund(s) and/or any client of the named Insured or any entity covered under this policy, and which loss would, in the absence of any correction, have constituted a valid claim under this policy.

Furthermore, it is understood and agreed that coverage as is provided by the preceding paragraph shall not extended to any:

- (i) diminution in value or damages resulting from the diminution in value of money, securities, property or any other item of value, unless caused by a Wrongful Act of any person or entity insured under this policy in the execution or implementation of investment advice or any investment decision or any other activity covered under this policy; or
- (ii) loss of actual money, securities or other property in the custody or control of the Insured.

Further, it is agreed and understood that if the Insurer determines that it lacks sufficient information to make a decision as to coverage, then the Insured shall have no recourse under this policy against the Insurer until the Insurer determines that sufficient information has been provided or until an actual claim has been filed under the policy.

END 4



AUTHORIZED REPRESENTATIVE
Or Countersignature (In states where applicable)

CP 00068

ENDORSEMENT# 5

This endorsement, effective 12:01 am September 21, 2004 forms a part of policy number 885-37-42 issued to QUELLOS GROUP, LLC

by American International Specialty Lines Insurance Company

INVESTMENT MANAGEMENT INSURANCE ENDORSEMENT (REVISED)

In consideration of the premium charged, it is hereby understood and agreed that the policy is amended as follows:

1. Exclusion I. 1) and I. 2) are deleted and replaced with the following:

This policy does not apply:

- 1) to any claim arising out of, based upon or attributable to the committing in fact of any criminal or deliberate fraudulent act by any Insured, or any knowing or willful violation of any statute by any Insured;
- 2) to any claim arising out of, based upon or attributable to the gaining in fact of any profit or advantage to which any Insured was not legally entitled;

2. Exclusions II.12), II.13) and II. 14) are deleted.

3. Exclusion II. 1) is deleted and replaced by the following:

II. 1) to any actual or alleged libel or slander;

4. Exclusion II. 3) is deleted and replaced by the following:

II. 3) to any claim arising out of the actual inability to make payment by any bank or banking firm or other broker or dealer in securities or commodities.

RIGHT TO SELECT COUNSEL

5. The Insured shall have the right to select his/her own legal defense counsel, subject to the approval of the Company which shall not be unreasonably withheld.

ESTATES/MARITAL EXTENSION

6. a) Subject otherwise to the terms hereof, this policy shall cover loss arising from a Claim made against the estates, heirs, or legal representatives of deceased Executive Insureds, and the legal representatives of Executive Insureds in the event of incompetency, insolvency or bankruptcy, who were Executive Insureds at the time the Wrongful Acts upon which such Claims are based were committed
- b) Subject otherwise to the terms hereof, this policy shall cover loss arising from a Claim made against the lawful spouse (whether such status is derived by reason of statutory law, common law or otherwise of any applicable jurisdiction in the

END 5

CP 00069

ENDORSEMENT# 5 (Continued)

This endorsement, effective 12:01 am September 21, 2004 forms a part of policy number 885-37-42 issued to QUELLOS GROUP, LLC

by *American International Specialty Lines Insurance Company*

world) of an individual Executive Insureds for a Claim arising solely out of his or her status as the spouse of an individual Executive Insureds, including a Claim that seeks damages recoverable from marital community property, property jointly held by the individual Executive Insureds and the spouse, or property transferred from the individual Executive Insureds to the spouse; provided, however, that this extension shall not afford coverage for any Claim for any actual or alleged Wrongful Act of the spouse, but shall apply only to Claims arising out of any actual or alleged Wrongful Acts of an individual Executive Insureds, subject to the policy's terms, conditions and exclusions.

7. Section 3, TERRITORY is deleted and replaced with the following:

3. TERRITORY

This policy applies to Wrongful Acts which occur anywhere in the world.

8. Clause 9, EXTENDED REPORTING CLAUSE, is deleted and replaced by the following:

EXTENDED REPORTING CLAUSE

If the Company or the Insured shall cancel or decline to renew this policy, the Insured shall have the right, upon payment of an additional premium to be determined but which shall not exceed 250% of the full annual premium, to a period of 365 days following the effective date of such cancellation or non-renewal (herein referred to as the Extended Reporting Period) in which to give written notice to the Company of claims first made against the Insured during such Extended Reporting Period for any Wrongful Act occurring prior to the end of the Policy Period and otherwise covered by this policy.

The rights contained in this clause shall terminate, however, unless written notice of such election together with the additional premium due is received by the Company within ten (10) days of the effective date of cancellation or non-renewal. The additional premium for the Extended Reporting Period shall be fully earned at the inception of the Extended Reporting Period. The Extended Reporting Period is not cancelable. This clause and the rights contained herein shall not apply to any cancellation resulting from non-payment of premium.

9. Clause 10., CANCELLATION CLAUSE, is deleted and replaced by the following:

10.CANCELLATION CLAUSE

END 5

ENDORSEMENT# 6 (Continued)

This endorsement, effective 12:01 am September 21, 2004 forms a part of policy number 885-37-42 issued to QUELLOS GROUP, LLC

by *American International Specialty Lines Insurance Company*

The Company may not cancel this policy except for non-payment of premium when due. In such event the Company may cancel this policy by providing the Named Insured first listed in Item 1 of the Declarations written notice stating when, not less than thirty (30) days thereafter, such cancellation shall be effective.

This policy may be cancelled by the Insured at any time only by mailing written prior notice to the Company or by surrender of this policy to the Company or its authorized agent. If this policy shall be cancelled by the Insured, the Company shall retain the customary short rate proportion of the premium hereon.

If this policy shall be cancelled by the Company, the Company shall retain the pro rata proportion of the premium hereon.

If the period of limitation relating to the giving of notice is prohibited or made void by any law controlling the construction thereof, such period shall be deemed to be amended so as to be equal to the minimum period of limitation permitted by such law.

10. Clause 7. NOTICE/CLAIM REPORTING PROVISIONS is deleted and replaced by the following:

NOTICE/CLAIM REPORTING PROVISIONS

Notice hereunder shall be given in writing to Raymond DeCarlo, 175 Water Street, New York, NY 10038. If mailed, the date of mailing of such notice shall constitute the date that such notice was given and proof of mailing shall be sufficient proof of notice. Notice given by or on behalf of the Insured to any authorized representative of the Company shall be deemed notice to the Company.

- (a) The Insureds shall, as a condition precedent to the obligations of the Insurer under this policy, give written notice to the Insurer of a Claim made against an Insured as soon as practicable and either:
- (1) anytime during the Policy Period or during the Extended Reporting Period (if applicable); or
 - (2) within 30 days after the end of the Policy Period or the Extended Reporting Period (if applicable), as long as such Claim(s) is reported no later than 30 days after the date such Claim was first made against an Insured.

END 5

CP 00071

ENDORSEMENT# 5 (Continued)

This endorsement, effective 12:01 am September 21, 2004 forms a part of
policy number 885-37-42
issued to QUELLOS GROUP, LLC

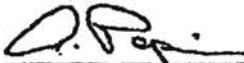
by *American International Specialty Lines Insurance Company*

- (b) If written notice of a Claim has been given to the Insurer pursuant to Clause 7(a) above, then a Claim which is subsequently made against the Insureds and reported to the Insurer alleging, arising out of, based upon or attributable to the facts alleged in the Claim for which such notice has been given, or alleging any Wrongful Act which is the same as or related to any Wrongful Act alleged in the Claim of which such notice has been given, shall be considered made at the time such notice was given.

- (c) If during the Policy Period or during the Extended Reporting Period (if applicable) the Company or the Insureds shall become aware of any circumstances which may reasonably be expected to give rise to a Claim being made against the Insureds and shall give written notice to the Insurer of the circumstances and the reasons for anticipating such a Claim, with full particulars as to dates, persons and entities involved, then a Claim which is subsequently made against the Insureds and reported to the Insurer alleging, arising out of, based upon or attributable to such circumstances or alleging any Wrongful Act which is the same as or related to any Wrongful Act alleged or contained in such circumstances, shall be considered made at the time such notice of such circumstances was given.

ALL OTHER TERMS, CONDITIONS AND EXCLUSION SHALL REMAIN UNCHANGED.

END 5



AUTHORIZED REPRESENTATIVE
Or Countersignature (In states where applicable)

CP 00072

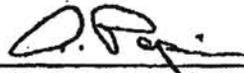
ENDORSEMENT# 6

This endorsement, effective 12:01 am September 21, 2004 forms a part of
policy number 885-37-42
issued to QUELLOS GROUP, LLC

by *American International Specialty Lines Insurance Company*

DELETE EXCLUSION II.16 FOR COVERAGE D

In consideration of the premium charged, it is hereby understood and agreed that
Exclusion II.16) does not apply with respect to coverage afforded by Coverage D.



AUTHORIZED REPRESENTATIVE
Or Countersignature (In states where applicable)

END 6

CP 00073

ENDORSEMENT# 7

This endorsement, effective **12:01 am** **September 21, 2004** forms a part of
policy number **885-37-42**
issued to **QUELLOS GROUP, LLC**

by **American International Specialty Lines Insurance Company**

ADDITIONAL INSURED ENDORSEMENT - LIST FUNDS

In consideration of the premium charged, it is hereby understood and agreed that
Clause 2. Definitions, paragraph (d) is amended to include the following entities:

<u>NAMED INSURED FUNDS</u>	<u>RETROACTIVE DATE</u>
QUELLOS APPRECIATION FUND, INC.	AUGUST 1, 1995
QUELLOS APPRECIATION FUND, LP	AUGUST 1, 1995
QUELLOS APPRECIATION FUND II, LLC	AUGUST 1, 2000
QUELLOS APPRECIATION FUND III, LLC	JULY 1, 2001
ILF, LTD	JULY 1, 2001
Q APPRECIATION FUND A, LLC	AUGUST 1, 2001
Q APPRECIATION FUND A-1, LTD	JULY 1, 2001
Q APPRECIATION FUND A, LTD	JULY 1, 2001
Q APPRECIATION FUND B, LTD	JULY 1, 2001
TORTUGA, LTD	MAY 28, 2001
QAF III HOLDINGS, LTD	JULY 1, 2001
QUELLOS STRATEGIC PARTNERS, INC.	AUGUST 1, 1995
QUELLOS STRATEGIC PARTNERS II, LTD	NOVEMBER 1, 2001
QUELLOS STRUCTURED EQUITIES, LP	JUNE 1, 1997
QUELLOS PROVENANCE FUND, LLC	NOVEMBER 1, 2003
QUELLOS ALPHA ENGINE, LTD	APRIL 1, 1998
QUELLOS ALPHA ENGINE, LP	APRIL 1, 1998
QUELLOS ALPHA TRANSPORT FUND, LLC	MAY 1, 2002
QUELLOS ALPHA TRANSPORT TRUST	NOVEMBER 1, 2003
QUELLOS EQUITY EDGE PORTFOLIO, LP	JANUARY 1, 2000
QUELLOS EQUITY EDGE PORTFOLIO, LTD	JULY 1, 1999
QUELLOS GLOBAL RESTRUCTURING FUND, LTD	AUGUST 1, 2001
QUELLOS (CRT) FUND, LLC	JANUARY 2, 2002
QUELLOS (CRT) FUND, LTD	JANUARY 1, 2002
QUADRA PRESERVATION FUND, LP	JANUARY 1, 1997
AECF FUND, LTD	JANUARY 1, 2003
LETO FUND TRUST	DECEMBER 1, 2003
Q DOM FUND, LTD	APRIL 1, 2004
QW FUND, LTD	OCTOBER 1, 2003
Q KORAKI TRUST	OCTOBER 1, 2003
LATONA FUND, LTD	SEPTEMBER 1, 2003
OPA FUND, LTD	JUNE 1, 2004
QIF TRUST	MARCH 1, 2003
QIF A, LTD	MARCH 1, 2003

END 7

CP 00074

ENDORSEMENT# 7 (Continued)

This endorsement, effective 12:01 am September 21, 2004 forms a part of
policy number 885-37-42
issued to QUELLOS GROUP, LLC

by *American International Specialty Lines Insurance Company*

QIF B, LTD	MARCH 1, 2003
QIF C, LTD	MARCH 1, 2003
QIF D, LTD	MARCH 1, 2003
QIF E, LTD	MARCH 1, 2003
QIF F, LTD	MARCH 1, 2003
QUELLOS COLUMBIA RIVER FUND, LP	DECEMBER 30, 2002
CARS, LP	SEPTEMBER 1, 2002
DELOS FUND, LTD	MARCH 1, 2000
DELOS II FUND, LTD	APRIL 1, 2002
LORICA FUND, LTD	NOVEMBER 1, 2001
ZAO FUND, LTD	FEBRUARY 1, 2002
QUELLOS SPECIALIZED APPRECIATION FUND, LTD	MAY 1, 2001
QUELLOS ALTERNATIVE SPECIALIZED FUND, LTD	JULY 1, 2001
QUELLOS TUNE FUND, LTD	AUGUST 1, 2001
QUELLOS LF, LTD	JULY 1, 1998
QM AIS PORTFOLIO, LTD	JULY 1, 1999
QT ALTERNATIVES, LLC	SEPTEMBER 1, 1997
QUELLOS HPC FUND, LLC	NOVEMBER 1, 2000
QVDM FUND, INC	MARCH 1, 2001
CRIAR STRATEGIC FUND	NOVEMBER 1, 2000
QUETNA FUND, LLC	JANUARY 1, 2001
SQ INVESTORS, LP	NOVEMBER 1, 1997
QV INVESTMENTS, LLC	JANUARY 1, 2004
QS ALTERNATIVE INVESTMENTS, LP	JUNE 1, 1997
QR ALTERNATIVE INVESTMENTS, LP	JULY 1, 1996
REFLEB INVESTORS II, LLC	JUNE 24, 2003
REFLEB INVESTORS II, LTD	NOVEMBER 20, 2003
REFLEB INVESTORS IIA, LTD	NOVEMBER 11, 2003
CASTLETOP TRADING PARTNERS II, LP	OCTOBER 13, 1998
CROWN TRADING PARTNERS, LP	OCTOBER 21, 1998
DELTA TRADING PARTNERS I, LP	OCTOBER 13, 1998
DELTA TRADING PARTNERS II, LP	OCTOBER 13, 1998
DELTA TRADING PARTNERS IV, LP	OCTOBER 13, 1998
QUADRA TRADING PARTNERS, LP	SEPTEMBER 14, 1998
BRS INVESTMENTS, LP	JANUARY 1, 1997
SALTZ FAMILY INVESTMENTS, LP	NOVEMBER 1, 2001
JACK SALTZ DISCRETIONARY PORTFOLIO	SEPTEMBER 1, 2003
SALTZ 2001 FAMILY LLC	JANUARY 1, 2004
SALTZ FAMILY, LP	FEBRUARY 1, 2002
FRONTIER FUND, LTD	NOVEMBER 1, 1998

END 7

CP 00075

ENDORSEMENT# 7 (Continued)

This endorsement, effective 12:01 am September 21, 2004 forms a part of
policy number 885-37-42
issued to QUELLOS GROUP, LLC

by American International Specialty Lines Insurance Company

QUELLOS FINANCIAL VENTURES, LP	OCTOBER 1, 2001
QUELLOS FINANCIAL VENTURES (OFFSHORE), LP	OCTOBER 1, 2001
QUELLOS FINANCIAL VENTURES II, LP	MAY 28, 2004
QUELLOS FINANCIAL VENTURES II (OFFSHORE), LP	MAY 28, 2004
QUELLOS FINANCIAL VENTURES II (CRT), LP	MAY 28, 2004
QUELLOS DIVERSIFIED PORTFOLIO	APRIL 8, 2002
QUELLOS US VENTURE CAPITAL	APRIL 8, 2002
QUELLOS US MATURE COMPANY	APRIL 8, 2002
QUELLOS OVERSEAS PORTFOLIO	APRIL 8, 2002
QUELLOS PRIVATE CAPITAL 2002 (OFFSHORE), LP	APRIL 8, 2002
QUELLOS REAL ASSETS, LP	SEPTEMBER 24, 2003
QUELLOS TIMBER PORTFOLIO	SEPTEMBER 24, 2003
QUELLOS ENERGY PORTFOLIO	SEPTEMBER 24, 2003
QUELLOS REAL ESTATE PORTFOLIO	SEPTEMBER 24, 2003
QUELLOS REAL ASSETS (OFFSHORE), LP	SEPTEMBER 24, 2003
WORLDWIDE REDART TRADING PARTNERS, LP	MAY 27, 1999
OZ TRADING PARTNERS, LP	JUNE 30, 1998
OZ TRADING PARTNERS II, LP	JANUARY 6, 1999
KEL FUND	AUGUST 1, 2003
ACOMTE I, LP	NOVEMBER 5, 1999
ACOMTE II, LP	NOVEMBER 5, 1999
CTP ONE, LP	MAY 25, 1999
CTP ONE TRADING, LLC	OCTOBER 23, 2001
CTP TWO, LP	MAY 25, 1999
CTP TWO TRADING, LLC	OCTOBER 23, 2001
STP TRADING PARTNERS, LP	SEPTEMBER 2, 1999
SCEPTRE TRADING PARTNERS, LP	NOVEMBER 20, 1998
CATAMARAN TRADING PARTNERS, LP	FEBRUARY 24, 1999
PORTSIDE TRADING PARTNERS, LP	FEBRUARY 12, 1999
RAINIER TRADING PARTNERS, LP	FEBRUARY 24, 1999
STARBOARD TRADING PARTNERS, LP	FEBRUARY 23, 1999
COMPASS TRADING PARTNERS, LP	SEPTEMBER 9, 1999
SAGUARO TRADING PARTNERS, LP	SEPTEMBER 2, 1999
SPINNAKER TRADING PARTNERS, LP	FEBRUARY 12, 1999
QUELLOS CASH RESERVE FUND	APRIL 3, 2000
QUELLOS LIQUID RESERVE FUND	MARCH 16, 2001
QUELLOS MODERATE DURATION FIXED INCOME FUND	MARCH 16, 2001
QUELLOS CORE FIXED INCOME FUND	MARCH 16, 2001
QUELLOS TAX-EFFICIENT CASH RESERVE FUND	JANUARY 1, 2001
QUELLOS TAX-EFFICIENT LIQUID RESERVE FUND	JANUARY 1, 2001

END 7

CP 00076

ENDORSEMENT# 7 (Continued)

This endorsement, effective 12:01 am September 21, 2004 forms a part of
policy number 885-37-42
issued to QUELLOS GROUP, LLC

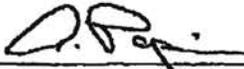
by *American International Specialty Lines Insurance Company*

QUELLOS TAX-EFFICIENT MODERATE DURATION FIXED INCOME FUND	JANUARY 1, 2001
QUELLOS TAX-EFFICIENT CORE FIXED INCOME FUND	JANUARY 1, 2001

Further it is hereby understood and agreed that notwithstanding anything contained in this policy to the contrary, with respect to each Named Insured Fund stated above, this policy does not apply to any wrongful acts occurring prior to the Retroactive Date stated above in this endorsement next to the particular Named Insured Fund. Insureds other than Named Insured Funds shall be subject to the Retroactive Date applicable to the Named Insured Fund of which they are or were a partner, officer, director, trustee or employee for claims made against them in such capacity.

ALL OTHER TERMS, CONDITIONS AND EXCLUSIONS REMAIN UNCHANGED.

END 7



AUTHORIZED REPRESENTATIVE
Or Countersignature (in states where applicable)

CP 00077

ENDORSEMENT# 8

This endorsement, effective 12:01 am September 21, 2004 forms a part of
policy number 885-37-42
issued to QUELLOS GROUP, LLC

by American International Specialty Lines Insurance Company

ADDITIONAL INSURED ENDORSEMENT

In consideration of the premium charged, it is hereby understood and agreed that the
Definition of "Insured" shall also include the following listed insured(s), subject to the
corresponding Continuity Date:

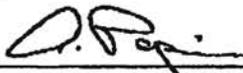
INSURED(S)

CONTINUITY DATE

QUELLOS GROUP, LLC	AUGUST 25, 2000
QUADRA FINANCIAL GROUP, LP	NOVEMBER 7, 1994
QUELLOS HOLDINGS, LLC	AUGUST 25, 2000
QUELLOS HOLDINGS, INC.	NOVEMBER 7, 1994
QUELLOS CAPITAL INTERNATIONAL, LLC	OCTOBER 9, 1998
QUELLOS CUSTOM STRATEGIES, LLC	MARCH 24, 1999
QUELLOS FINANCIAL ADVISORS, LLC	JULY 1, 1997
QUELLOS FIXED INCOME ADVISORS, LLC	NOVEMBER 5, 1999
QUELLOS BROKERAGE SERVICES, LLC	JULY 29, 1998
QUELLOS CAPITAL MANAGEMENT, LP	DECEMBER 3, 1997
QUELLOS CORPORATE ADVISORS, LLC	MARCH 30, 1998
QUELLOS ADVISORS, LLC	FEBRUARY 18, 1997
QA INVESTMENTS, LLC	JULY 1, 1997
UNION PERSONAL GUARANTY, LLC	AUGUST 31, 2000
Q PEPPERCORN, LLC	JULY 2, 2001
QFV GP, LLC	JULY 18, 2001
QPCM GP, LLC	APRIL 8, 2002
QUELLOS PRIVATE CAPITAL MARKETS, LP	APRIL 8, 2002
Q CO, LLC	JANUARY 2, 2002
QUELLOS (BERMUDA) LIMITED	DECEMBER 21, 2001
QUELLOS EUROPE, LTD	JUNE 1, 2002
QPCM REAL ASSETS GP, LLC	JULY 8, 2003
Q90, LP	JULY 1, 1999
QFV II GP, LLC	FEBRUARY 26, 2004

ALL OTHER TERMS, CONDITIONS AND EXCLUSIONS REMAIN UNCHANGED.

END 8



AUTHORIZED REPRESENTATIVE
Or Countersignature (In states where applicable)

CP 00078

ENDORSEMENT# 9

This endorsement, effective 12:01 am September 21, 2004 forms a part of
policy number 885-37-42
issued to QUELLOS GROUP, LLC

by *American International Specialty Lines Insurance Company*

AMENDED FEE EXCLUSION ENDORSEMENT

In consideration of the premium charged, it is hereby understood and agreed that Exclusion
II.6) is deleted in its entirety and replaced with the following:

6) any disbursement or reimbursement of fees;

ALL OTHER TERMS, CONDITIONS AND EXCLUSIONS REMAIN UNCHANGED.

END 9



AUTHORIZED REPRESENTATIVE
Or Countersignature (In states where applicable)

CP 00079

ENDORSEMENT# 10

This endorsement, effective 12:01 am September 21, 2004 forms a part of
policy number 885-37-42
issued to QUELLOS GROUP, LLC

by *American International Specialty Lines Insurance Company*

AMEND DEFINITION G ENDORSEMENT - INVESTMENT ADVISORY SERVICES

In consideration of the premium charged, it is hereby understood and agreed that Clause 2. DEFINITIONS, paragraph (g) "INVESTMENT ADVISORY SERVICES" is deleted in its entirety and replaced by the following:

- (g) Investment Advisory Services means giving financial, economic or investment advice regarding investments in securities or other financial instruments and/or rendering investment management services pursuant to a written contract defining the scope of such advice and/or services and the compensation to be paid therefor.

ALL OTHER TERMS, CONDITIONS, AND EXCLUSIONS SHALL REMAIN UNCHANGED.

END 10



AUTHORIZED REPRESENTATIVE
Or Countersignature (In states where applicable)

CP 00080

ENDORSEMENT# 11

This endorsement, effective 12:01 am September 21, 2004 forms a part of policy number 885-37-42 issued to QUELLOS GROUP, LLC

by American International Specialty Lines Insurance Company

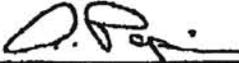
AMENDED EXCLUSION II.7

In consideration of the premium charged, it is hereby understood and agreed as follows:

- A. Exclusion II.7) is deleted in its entirety and replaced with the following:
- 7) to any claim against any Insured which is brought by, or on behalf of, or in the right of, any other insured or any affiliate thereof, including but not limited to shareholders' derivative suits and/or representative class action suits; unless, however, only with respect to suits brought by or on behalf of the shareholders of an Entity Insured, such suit(s) is instigated and continued totally independent of, and totally without the solicitation of, or assistance of, or participation of, or intervention of, any other insured or any affiliate thereof. However, this exclusion shall not apply to any claim by a Fund where in the opinion of independent legal counsel selected by and at the expense of an Entity Insured, (selection of such counsel being subject to approval by the Company, which approval shall not be unreasonably withheld), the failure to make such claim would result in liability upon the directors, officers, partners or trustees of such Fund(s), for failure to assert such claim; furthermore, this exclusion shall not apply to any *bona fide* claim:
- (A) by an Investment Adviser against: (i) any past, present or future partner, officer, director, trustee or employee of a fund who is not employed by, or a director of, the Investment Adviser; or (ii) any Fund; or
- (B) by any Insured(s) against any Independent Director, or against any Fund so long as it remains a codefendant in a claim against one or more Independent Directors;
- B. With respect to claims made against an Executive Insured, this foregoing exclusion shall not apply to claims brought by an Individual Insured who is not a present or former director or partner of the Named Insured for wrongful termination of employment or other unfair employment practices with respect to such Individual Insured bringing the claim.
- C. For purposes of this Endorsement, "Independent Director" means any Insured while acting in his or her capacity as a director or trustee of any Fund, if such Insured is not an "interested person" of such Fund within the meaning of Section 2(a)(19) of the Investment Company Act of 1940.

ALL OTHER TERMS AND CONDITIONS OF THE POLICY REMAIN UNCHANGED.

END 11



AUTHORIZED REPRESENTATIVE
Or Countersignature (in states where applicable)

CP 00081

ENDORSEMENT# 12

This endorsement, effective 12:01 am September 21, 2004 forms a part of
policy number 885-37-42
issued to QUELLOS GROUP, LLC

by American International Specialty Lines Insurance Company

SECURITY BROKER/DEALER EXTENSION ENDORSEMENT (REVISED)

In consideration of the premium charged, it is hereby understood and agreed that the following additional coverage is added to Part I of 1. "Insuring Agreement":

This policy shall, subject to the limit of liability set forth in Item 3 of the Declarations, pay of behalf of the Insured all sums which the Insured shall become legally obligated to pay as damages resulting from any claim or claims first made against the Insured and reported in writing to the Company during the Policy Period or the Extended Reporting Period (if applicable) for any Wrongful Act of the Insured or of any other person for whose actions the Insured is legally responsible, but only if such Wrongful Act occurs prior to the end of the Policy Period and solely in rendering or failing to render Securities Broker/Dealer Services for others for compensation in the course of the Entity Insured's business as a securities broker/dealer; and with respect to the Entity Insured including amounts which the Entity Insured is permitted or required to pay as indemnification for such liability of the Individual Insured(s).

PART II. "DEFENSE COSTS (INCLUDED IN THE LIMIT OF LIABILITY)" shall also apply with respect to any such Wrongful Act for which insurance is afforded under the Coverage afforded by this endorsement.

In this endorsement, "Securities Broker/Dealer Services" means trading in securities, derivatives and other financial instruments, investment management services, placement agent services, the giving of financial investment advice, the purchase and/or sale of securities, and the administration of individual retirement agreements (IRAs) and Keogh retirement plans.

Exclusion II.16 does not apply with respect to coverage afforded by this endorsement.

In addition to the exclusions contained elsewhere in this policy form, the coverage afforded by this endorsement does not apply:

1. to any claim arising out of any function of any Insured as a specialist or market maker for any securities or arising out of failing to make a market for any securities;
2. to any claim arising out of any actual or alleged mechanical or electronic failure, breakdown or malfunction of machines or system;
3. to any actual or alleged rendering of or failure to render Securities Broker/Dealer Services to any Broker or Dealer other than a dealer who buys, sells or trades in securities exclusively as a principal for its own account;

END 12

ENDORSEMENT# 12 (Continued)

This endorsement, effective 12:01 am September 21, 2004 forms a part of
policy number 885-37-42
Issued to QUELDS GROUP, LLC

by *American International Specialty Lines Insurance Company*

4. to any claim brought by or on behalf of the Securities Investor Protection Corporation;
5. to any claim arising out of any underwriting, syndicating, or investment banking work, or associated counseling or investment activities, including but not limited to, any aspect of any actual, attempted or threatened mergers, acquisitions, divestitures, tender offers, proxy contests, leverage buy-outs, going private transactions, reorganizations, capital restructuring, recapitalizations, spin-off, primary or secondary offerings of securities (regardless of whether the offering is a public offering or a private placement), other efforts to raise or furnish capital or finance for any enterprise or entity or any disclosure requirements in connection with any of the foregoing; provided however, that this exclusion shall not apply to claims arising from an Insured acting as Placement Agent for interests of any Fund(s) or the structuring of various derivative transactions, including swaps, structured notes and similar instruments.

ALL OTHER TERMS, CONDITIONS, AND EXCLUSIONS SHALL REMAIN UNCHANGED.



AUTHORIZED REPRESENTATIVE
Or Countersignature (In states where applicable)

END 12

CP 00083

ENDORSEMENT# 13

This endorsement, effective 12:01 am September 21, 2004 forms a part of policy number 885-37-42 issued to QUELLOS GROUP, LLC

by American International Specialty Lines Insurance Company

INVESTIGATION ENDORSEMENT (REVISED)

In consideration of the premium charged, it is hereby understood and agreed that the policy is amended as follows:

1. Solely with respect to "covered" insuring clauses as set forth in Item 7. of the Declarations, the Company shall, subject to the terms, conditions and exclusions of this policy, including the limit of liability set forth in Item 3 of the Declarations, pay on behalf of the Insured all sums which the Insured shall become legally obligated to pay as Formal Investigation Costs in response to a Formal Investigation, provided the Formal Investigation is reported in writing to the Company during the Policy Period or the Extended Reporting Period (if applicable), is attributable to a Wrongful Act of the Insured and is otherwise covered by the applicable insuring clause.
2. The applicable RETENTION amount shall be equal to 100% of the amount set forth in Item 4. of the Declarations. Such Retention amount shall apply to each Wrongful Act or related Wrongful Act.
3. With respect to sums the Insured shall become legally obligated to pay as Formal Investigation Costs and otherwise covered under this endorsement, the Company shall be liable to pay 100% of such Formal Investigation Costs, excess of the applicable Retention amount described in paragraph 2 above, up to the Limit of Liability described in the Declarations, it being a condition of this insurance that the remaining 0% of the remaining Formal Investigation Costs shall be carried by the Insured at its own risk and be uninsured.
4. Any coverage provided by this endorsement shall only be provided for Formal Investigation Costs the Insured shall become legally obligated to pay after the service of a subpoena or other writing by a government body or Self-Regulatory Organization identifying the Insured as a person or entity against whom a civil or criminal enforcement action has been commenced.
5. No coverage shall be provided by this endorsement for any investigation costs prior to the service of a subpoena or other writing by a government body or Self-Regulatory Organization identifying the Insured as a person or entity against whom a civil or criminal enforcement action has been commenced.
6. The policy's Section 2, DEFINITIONS, is amended by adding the following:
 - (j) "Formal Investigation" means any investigation, by a governmental body or Self-Regulatory Organization, into possible violations of law or

END 13

CP 00084

ENDORSEMENT# 13 (Continued)

This endorsement, effective *12:01 am September 21, 2004* forms a part of
policy number *885-37-42*
issued to *QUELLOS GROUP, LLC*

by *American International Specialty Lines Insurance Company*

regulation(s) by the Insured, after the service of a subpoena or other writing identifying the Insured as a person or entity against whom a civil or criminal enforcement action has been commenced.

(k) "Formal Investigation Costs" means reasonable and necessary Defense Costs incurred by an Insured in response to a Formal Investigation.

(l) "Self-Regulatory Organization" means any association of investment advisers or securities dealers registered under the federal securities laws or any national securities exchange with the Securities and Exchange Commission under the Securities and Exchange Act of 1933 (as amended) or any similar Securities Act under the laws of Canada;

ALL OTHER TERMS, CONDITIONS AND EXCLUSIONS REMAIN UNCHANGED.

END 13



AUTHORIZED REPRESENTATIVE
Or Countersignature (In states where applicable)

CP 00085

ENDORSEMENT# 14

This endorsement, effective 12:01 am September 21, 2004 forms a part of
policy number 885-37-42
issued to QUELLOS GROUP, LLC

by American International Specialty Lines Insurance Company

AMEND DEFINITION OF "FUND" ENDORSEMENT

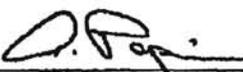
In consideration of the premium charged, it is hereby understood and agreed that Section 2(d) of the policy's DEFINITIONS, "Fund", is deleted in its entirety and replaced by the following:

- (d) "Fund(s)" means the investment company(ies) specifically listed in this policy as a Named Insured and the automatically covered funds below.

If Coverage B is in effect, then the insurance afforded hereunder shall automatically extend, for a period of sixty (60) days from the date the securities are first sold to the public, to any newly established investment company sponsored by a Named Insured and/or portfolio of an investment company sponsored by a Named Insured. This extension shall expire sixty (60) days from the date the securities are first sold to the public unless the Company in its absolute discretion agrees to endorse the newly established investment company and/or portfolio as an additional Named Insured under this policy. Nothing contained herein shall operate to extend the length of the Policy Period. With regard to these automatically covered Funds, the Insured shall provide the Company with whatever underwriting information is requested, and pay whatever additional premium is required by the Company. It is agreed that the decision to extend the insurance beyond sixty (60) days is solely within the Company's absolute discretion.

ALL OTHER TERMS, CONDITIONS AND EXCLUSIONS REMAIN UNCHANGED.

END 14



AUTHORIZED REPRESENTATIVE
Or Countersignature (In states where applicable)

CP 00086

ENDORSEMENT# 15

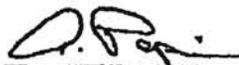
This endorsement, effective *12:01 am* *September 21, 2004* forms a part of
policy number *886-37-42*
issued to *QUELLOS GROUP, LLC*

by *American International Specialty Lines Insurance Company*

DELETE EXCLUSION II.16 FOR COVERAGE D

;In consideration of the premium charged, it is hereby understood and agreed that Exclusion
II.16) does not apply with respect to coverage afforded by Coverage D.

ALL OTHER TERMS, CONDITIONS, AND EXCLUSIONS SHALL REMAIN UNCHANGED.



**AUTHORIZED REPRESENTATIVE
Or Countersignature (In states where applicable)**

END 15

CP 000087

ENDORSEMENT# 16

This endorsement, effective 12:01 am September 21, 2004 forms a part of
policy number 885-37-42
issued to QUELLOS GROUP, LLC

by American International Specialty Lines Insurance Company

GENERAL PARTNERSHIP LIABILITY ENDORSEMENT (REVISED)

In consideration of the premium charged, it is hereby understood and agreed that Item 1. Named Insured, is amended to include the Limited Partnerships listed below as well as the General Partners:

Quadra Financial Group, L.P.
Quellos Capital Management, L.P.
Quellos Private Capital Markets, L.P.
Q9D, L.P.
Quellos Appreciation Fund, L.P.
Quellos Structured Equities, L.P.
Quellos Alpha Engine, L.P.
Quellos Equity Edge Portfolio, L.P.
Quadra Preservation Fund, L.P.
Quellos Columbia River Fund, L.P.
CARS, L.P.
SQ Investors, L.P.
QS Alternative Investments, L.P.
QR Alternative Investments, L.P.
QR Alternative Investments, L.P.- OCR Portfolio
QR Alternative Investments, L.P.- Opportunity Portfolio
Castletop Trading Partners II, L.P.
Crown Trading Partners, L.P.
Delta Trading Partners I, L.P.
Delta Trading Partners II, L.P.
Delta Trading Partners IV, L.P.
Quadra Trading Partners, L.P.
BRS Investments, L.P.-Discretionary
Saltz Family Investments, L.P.
Saltz Family, L.P.
BRS Investments, L.P.
QI Trading Partners, LP
Castletop 1999 Limited Partnership
Quellos Financial Ventures, L.P.
Quellos Financial Ventures (Offshore), L.P.
Quellos Financial Ventures II, L.P.
Quellos Financial Ventures II (Offshore), L.P.
Quellos Financial Ventures II (CRT), L.P.
Quellos Private Capital 2002, L.P.
Quellos Private Capital 2002 (Offshore), L.P.
Quellos Real Assets, L.P.

END 16

CP 00088

ENDORSEMENT# 16 (Continued)

This endorsement, effective *12:01 am September 21, 2004* forms a part of
policy number *885-37-42*
Issued to *QUELLOS GROUP, LLC*

by *American International Specialty Lines Insurance Company*

Quellos Real Assets (Offshore), L.P.
Worldwide Redart Trading Partners, L.P.
OZ Trading Partners, L.P.
OZ Trading Partners II, L.P.
Acomte I, L.P.
Acomte II, L.P.
CTP One, L.P.

In addition to the exclusions contained elsewhere in this policy form, the coverage afforded by this endorsement does not apply:

1. to any claim or claims based on, arising out of or attributable to an offering of additional partnership units subsequent to the final closing of the partnership. With respect to any partnership for which the partnership agreement does not provide for a final closing, the partnership shall be considered to have a continuous offering for which there is no final closing date.

It is further understood and agreed, the Insurer will consider providing coverage for an additional partnership units subsequent to the final closing of the partnership, but only after the Insured has provided whatever underwriting information is requested and paid whatever additional premium is required;

2. to any claim or claims based on, arising out of or attributable to the commingling of funds;
3. to any claim made against the general partners of any remuneration paid to them without previous approval of the limited partners of the limited partnership(s) named in Item 1 which payment shall be held by the courts to have been illegal;

It is further understood and agreed that Section 2, DEFINITIONS, is amended to include the following:

1. "General Partner" means the General Partners of the named limited partnership(s) identified in this endorsement and shall also include any past, present or future partner, officer, director, member, trustee or employee of any corporate general partner (including any direct or indirect general partner or managing member of such corporate general partner) which is a Named

END 16

CP 00089

ENDORSEMENT# 16 (Continued)

This endorsement, effective *12:01 am September 21, 2004* forms a part of
policy number *885-37-42*
Issued to *QUELLOS GROUP, LLC*

by *American International Specialty Lines Insurance Company*

Insured while acting on behalf of the Named Insured, but only as respect to
the Named Insured acting in its fiduciary capacity as a General Partner of its
respective limited partnership(s).

ALL OTHER TERMS, CONDITIONS, AND LIMITATIONS REMAIN UNCHANGED.



AUTHORIZED REPRESENTATIVE
Or Countersignature (In states where applicable)

END 16

CP 00090

ENDORSEMENT# 17

This endorsement, effective 12:01 am September 21, 2004 forms a part of policy number 885-37-42 issued to QUELLOS GROUP, LLC

by American International Specialty Lines Insurance Company

AMEND DEFINITION OF "INSURED" ENDORSEMENT

In consideration of the premium charged, it is hereby understood and agreed that Section 2(e) of the policy's DEFINITIONS, "Insured", is deleted in its entirety and replaced by the following:

(e) "Insured" means the Named Insured, the automatically covered Funds, and any past, present or future partner, officer, director, trustee, managing member or employee of the Named Insured or the automatically covered Funds against whom claim is made in their capacity as such partner, officer, director, trustee, managing member or employee.

"Named Insured" means the individual, partnership, trust, corporation, Fund(s) or firm named in Item 1 of the Declarations.

"Entity Insured" means an Insured which is not a natural person.

"Individual Insured" means an Insured who is a natural person.

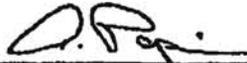
"Executive Insured" means an Individual Insured who is a past, present or future partner, officer, director, managing member or trustee of the Named Insured or the automatically covered Funds against whom claim is made in his capacity as such partner, officer, director, managing member or trustee.

It is further understood and agreed that the last paragraph of Section 4, Exclusions 1, is deleted in its entirety and replaced by the following:

NOTE: The Wrongful Act of any partner, officer, director, trustee, managing member or employee who is an Insured under this policy shall not be imputed to any other partner, officer, director, trustee, managing member or employee who is an Insured under this policy for the purpose of exclusions 1.1) through 5).

ALL OTHER TERMS, CONDITIONS, AND EXCLUSIONS SHALL REMAIN UNCHANGED.

END 17



AUTHORIZED REPRESENTATIVE
Or Countersignature (In states where applicable)

CP 00091

ENDORSEMENT# 18

This endorsement, effective *12:01 am* *September 21, 2004* forms a part of
policy number *885-37-42*
issued to *QUELLOS GROUP, LLC*

by *American International Specialty Lines Insurance Company*

DELETE ENDORSEMENT NO. 3 AND 15 ENDORSEMENT

In consideration of the premium charged, it is hereby understood and agreed that
Endorsement No. 3, PATENT INFRINGEMENT EXCLUSION and Endorsement No. 15,
DELETE EXCLUSION II.16 FOR COVERAGE D are deleted in the entirety.

ALL OTHER TERMS, CONDITIONS AND EXCLUSIONS SHALL REMAIN UNCHANGED.



AUTHORIZED REPRESENTATIVE
Or Countersignature (In states where applicable)

END 18

CP 00092

ENDORSEMENT# 19

This endorsement, effective 12:01 am September 21, 2004 forms a part of
policy number 885-37-42
issued to QUELLOS GROUP, LLC

by *American International Specialty Lines Insurance Company*

AMEND SECTION 16 PART B ENDORSEMENT

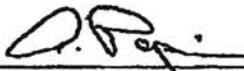
In consideration of the premium charged, it is hereby understood and agreed that Section 16, TERMINATION OF COVERAGE FOR SUBSEQUENT WRONGFUL ACTS AFTER CERTAIN TRANSACTIONS, Part B is deleted in its entirety and replaced by the following:

PART B

If, during the Policy Period, there shall be a change in the majority of the general partners of any Fund, or if any Fund shall be merged, consolidated or otherwise combined with any other entity (other than another Fund covered by this policy) or liquidated, or if the Investment Adviser or affiliate of the Investment Adviser of any Fund(s) ceases to act as such and/or any Fund(s) ceases to exist, terminates operations and/or liquidates, then coverage (including but not limited to Clause 9, EXTENDED REPORTING CLAUSE), for any and all Insureds hereunder, with respect to the Fund which underwent such event, shall not apply to Wrongful Acts occurring subsequent to such event unless the Company in its absolute discretion gives its consent in writing by endorsement to this policy. Written notice of such event must be given to the Company as soon as practicable, but not later than 15 days after the occurrence thereof.

ALL OTHER TERMS, CONDITIONS AND EXCLUSIONS REMAIN UNCHANGED.

END 19



AUTHORIZED REPRESENTATIVE
Or Countersignature (In states where applicable)

CP 00093

ENDORSEMENT# 20

This endorsement, effective 12:01 am September 21, 2004 forms a part of
policy number 885-37-42
issued to QUELLDS GROUP, LLC

by *American International Specialty Lines Insurance Company*

EXTENDED PROFESSIONAL SERVICES ENDORSEMENT

In consideration of the premium charged, it is hereby understood and agreed that the following additional coverage is added to Part 1, Insuring Agreements:

This policy shall, subject to the limit of liability set forth in Item 3. of the Declarations, pay on behalf of the Insured all sums which the Insured shall become legally obligated to pay as damages resulting from any claim or claims first made against the Insured and reported in writing to the Company during the Policy Period or the Extended Reporting Period (if applicable) for any Wrongful Act of the Insured or of any other person for whose Wrongful Act the Insured is legally responsible, but only if such Wrongful Act occurs prior to the end of the Policy Period and solely in rendering or failing to render Extended Professional Services for other for compensation in the course of the Entity Insured's business; and with respect to the Entity Insured including amounts which the Entity Insured is permitted or required to pay as indemnification for such liability of the Individual Insured(s).

Part II. "DEFENSE COSTS (INCLUDED IN THE LIMIT OF LIABILITY)" shall also apply with respect to any such Wrongful Act for which insurance is afforded under the Coverage afforded by this endorsement.

For the purposes of this endorsement, "Extended Professional Services" means providing, executing or implementing tax planning, tax strategy, advice and consulting, tax preparation, estate planning, investment planning, asset allocation, legal services accounting services, and similar services for others.

ALL OTHER TERMS, CONDITIONS AND EXCLUSIONS REMAIN UNCHANGED.



AUTHORIZED REPRESENTATIVE
Or Countersignature (in states where applicable)

END 20

CP 00094

ENDORSEMENT# 21

This endorsement, effective 12:01 am September 21, 2004 forms a part of
policy number 885-37-42
issued to QUELLOS GROUP, LLC

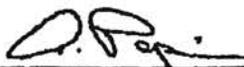
by *American International Specialty Lines Insurance Company*

DELETE ENDORSEMENT NO. 11 ENDORSEMENT - AMENDED EXCLUSION II.7

In consideration of the premium charged, it is hereby understood and agreed that
Endorsement No. 11, AMENDED EXCLUSION II.7, is deleted in its entirety.

ALL OTHER TERMS, CONDITIONS AND EXCLUSIONS REMAIN UNCHANGED.

END 21



AUTHORIZED REPRESENTATIVE
Or Countersignature (In states where applicable)

CP 00095

EXHIBIT D



EXCESS POLICY

DECLARATIONS

Policy Number 7023-2408

Federal Insurance Company,
a stock insurance company,
incorporated under the laws of
Indiana, herein called the
Company.

- Item 1. Parent Organization: **Quellos Group, LLC**
- Item 2. Principal Address: **601 Union Street
56th Floor
Seattle, WA 98101**

Item 3. Limit of Liability:

Each Policy Period \$10,000,000

Item 4. Underlying Insurance:

(A) Primary Policy

<u>Insurer</u>	<u>Policy Number</u>	<u>Limits</u>	<u>Policy Period</u>
American International Specialty Lines Insurance Company	885-37-42	\$10,000,000.00	September 21, 2004 To September 21, 2005

(B) Other Policies

<u>Insurer</u>	<u>Policy Number</u>	<u>Limits</u>	<u>Policy Period</u> To

Item 5. Policy Period: From: 12:01 a.m. on September 21, 2004
To: 12:01 a.m. on September 21, 2005

Item 6. Endorsements Effective at Inception: **See Schedule of Forms Attached**

Item 7. Termination of Prior Policies: **None**

Item 8. Pending or Prior Date: **September 21, 2000**

The Company issuing this policy has caused this policy to be signed by its authorized officers, but it shall not be valid unless also signed by a duly authorized representative of the Company.

FEDERAL INSURANCE COMPANY

W. Andrew Mason

Secretary

Thomas F. Moloney

President

09/14/2005

Date

Robert Hamburger

Authorized Representative



Excess Policy

In consideration of the payment of the premium and subject to the Declarations, limitations, conditions, provisions and other terms of this policy, the Company agrees as follows:

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- | | |
|------------------------|------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| Insuring Clause | 1. The Company shall provide the Insureds with insurance during the Policy Period excess of the Underlying Limit. Coverage hereunder shall attach only after the insurers of the Underlying Insurance shall have paid in legal currency the full amount of the Underlying Limit for such Policy Period. Coverage hereunder shall then apply in conformance with the terms and conditions of the Primary Policy as amended by any more restrictive terms and conditions of any other policy designated in Item 4(B) of the Declarations, except as otherwise provided herein. |
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|--------------------------------------------|----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| Maintenance of Underlying Insurance | 2. All Underlying Insurance shall be maintained in full effect during the Policy Period and shall afford the same coverage provided by all Underlying Insurance in effect upon inception of this Policy Period, except for any depletion or exhaustion of the Underlying Limit solely by reason of payment of losses thereunder. |
|--------------------------------------------|----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
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|--------------------------------------|-----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| Depletion of Underlying Limit | 3. Only in the event of exhaustion of the Underlying Limit by reason of the insurers of the Underlying Insurance, or the Insureds in the event of financial impairment or insolvency of an insurer of the Underlying Insurance, paying in legal currency loss which, except for the amount thereof, would have been covered hereunder, this policy shall continue in force as primary insurance, subject to its terms and conditions and any retention applicable to the Primary Policy, which retention shall be applied to any subsequent loss in the same manner as specified in the Primary Policy.

The risk of uncollectability of any Underlying Insurance, whether because of financial impairment or insolvency of an underlying insurer or any other reason, is expressly retained by the Insureds and is not in any way insured or assumed by the Company. |
|--------------------------------------|-----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
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|-----------------------------|----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| Underlying Sublimits | 4. If any Underlying Limit is subject to a Sublimit:

a. coverage hereunder shall not apply to any claim which is subject to such Sublimit, however,

b. the Underlying Limit shall be recognized hereunder as depleted to the extent of any payment of such claim subject to such Sublimit. |
|-----------------------------|----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
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|---------------------------|----------------------------------------------------------------------------------------------------------|
| Limit of Liability | 5. The Company's maximum liability for loss shall be the amount set forth in Item 3 of the Declarations. |
|---------------------------|----------------------------------------------------------------------------------------------------------|
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|----------------------------|-----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| Claim Participation | 6. The Company may, at its sole discretion, elect to participate in the investigation, settlement or defense of any claim covered by this policy even if the Underlying Insurance has not been exhausted. |
|----------------------------|-----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
-

Pending or Prior Matters

7. The Company shall not be liable under this policy for any loss which is based upon, arises from or is in consequence of any demand, suit or other proceeding pending, or order, decree or judgment entered against any Insured on or prior to the Pending or Prior Date set forth in Item 8 of the Declarations, or the same or any substantially similar fact, circumstance or situation underlying or alleged therein.

Subrogation - Recoveries

8. In the event of any payment under this policy, the Company shall be subrogated to the extent of such payment to all the Insureds' rights of recovery and the Insureds shall execute all papers required and shall do everything necessary to secure and preserve such rights, including the execution of such documents necessary to enable the Company effectively to bring suit in the name of the Insured.

Any amounts recovered after payment of loss hereunder shall be apportioned in the inverse order of payment to the extent of actual payment. The expenses of all recovery proceedings shall be apportioned among the recipients of the recovery in the ratio of their respective recoveries.

Notice

9. The Insureds shall, as a condition precedent to exercising their rights under this policy, give to the Company written notice as soon as practicable of the cancellation of any Underlying Insurance, any notice given under any Underlying Insurance and additional or return premiums charged or paid in connection with any Underlying Insurance.

Notice to the Company under this policy shall be given in writing addressed to:

Notice of claim: Home Office Claims Department
Chubb Group of Insurance Companies
15 Mountain View Road
Warren, New Jersey 07059

All other notices: Executive Protection Practice
Chubb Group of Insurance Companies
15 Mountain View Road
Warren, New Jersey 07059

Such notice shall be effective on the date of receipt by the Company at such address.

Company Authorization Clause

10. By acceptance of this policy, the Parent Organization named in Item 1 of the Declarations agrees to act on behalf of all the Insureds with respect to the giving and receiving of notice of claim or termination, the payment of premiums and the receiving of any return premiums that may become due under this policy, the negotiation, agreement to and acceptance of endorsements, and the giving or receiving of any notice provided for under this policy (except the giving of notice to apply for any extended reporting period), and the Insureds agree that the Parent Organization shall act on their behalf.

Alteration

11. No change in, modification of, or assignment of interest under this policy shall be effective except when made by written endorsement to this policy which is signed by an authorized representative of the Company.



Excess Policy

Policy Termination

12. This policy shall terminate at the earliest of the following times:
- (a) sixty days after the receipt by the Parent Organization of a written notice of termination from the Company;
 - (b) upon the receipt by the Company of written notice of termination from the Parent Organization;
 - (c) upon expiration of the Policy Period;
 - (d) thirty days after the effective date of any alteration or termination of any Underlying Insurance, whether by the Insureds or any insurer of the Underlying Insurer, unless the Company (i) receives written notice of such alteration or termination from the Parent Organization, (ii) receives such information as the Company reasonably requests, and (iii) agrees, pursuant to an endorsement, not to terminate this policy; or
 - (e) at such other time as may be agreed upon by the Company and the Parent Organization.

Notice of cancellation or non-renewal of the Primary Policy duly given by the primary insurer shall serve as notice of the cancellation or non-renewal of this policy by the Company.

The Company shall refund the unearned premium computed at customary short rates if the policy is terminated by the Parent Organization. Under any other circumstances the refund shall be computed pro rata.

Termination of Prior Policies

13. Any policies specified in Item 7 of the Declarations shall terminate, if not already terminated, as of the inception date of this policy.

Policy Definitions

14. When used in this policy:

Insureds means those persons or organizations insured under the Primary Policy.

Parent Organization means the organization designated in Item 1 of the Declarations.

Primary Policy means the policy scheduled in Item 4(A) of the Declarations or any policy of the same insurer replacing or renewing such policy.

Policy Period means the period of time specified in Item 5 of the Declarations, subject to prior termination in accordance with Section 12 above. If any extended reporting period is exercised, such extension shall be treated as set forth in the Primary Policy.

Sublimit means any Underlying Insurance limit of liability which:

- a. applies only to a particular grant of coverage under such Underlying Insurance, and
- b. reduces and is part of the otherwise applicable limits of liability of such Underlying Insurance set forth in Item 4 of the Declarations.

Policy Definitions
(continued)

Underlying Insurance means all policies scheduled in Item 4 of the Declarations and any policies of the same Insurers replacing or renewing them.

Underlying Limit means the amount equal to the aggregate of all limits of liability as set forth in Item 4 of the Declarations for all Underlying Insurance, subject to any Sublimits, plus the applicable uninsured retention, if any, under the Primary Policy.



ENDORSEMENT

Effective date of
this endorsement: September 21, 2004

Company: Federal Insurance Company

Endorsement No. 1

To be attached to and
form a part of Policy No. 7023-2408

Issued to: Quellos Group, LLC

WASHINGTON AMENDATORY ENDORSEMENT

In consideration of the premium charged, it is agreed that:

- (1) Section 2. Maintenance of Underlying Insurance is amended to include the following:

Maintenance of all Underlying Insurance is a condition precedent to coverage under this policy. No insurance will be available under this policy in the event that any Underlying Insurance is not maintained in full force and effect as required under the terms of this policy.

- (2) The Company may cancel the policy 45 days after the receipt by the Parent Organization of written notice of cancellation because of any alteration, termination or non-renewal of any Underlying Insurance, whether by the Insureds or any insurer of the Underlying Insurer, unless the Company (i) receives written notice of such alteration, termination or non-renewal from the Parent Organization, (ii) receives such information as the Company reasonably requests, and (iii) agrees, pursuant to an endorsement, not to terminate this policy; provided that in no event will the Company be liable under the policy to any earlier or greater extent than it would have been in the absence of such alteration, termination or non-renewal of such Underlying Insurance. Section 12(d) of the policy is amended to the extent necessary to effectuate the purposes of this paragraph and this paragraph (2) does not amend any other provision of the policy.
- (3) Any notice of cancellation by the Company shall be mailed or delivered to the Parent Organization and shall set forth the reason(s) for cancellation. Sections 12(a) and (d) of the policy are amended to the extent necessary to effectuate the purposes of this paragraph.
- (4) Section 12 of the policy, Policy Termination, is amended by deleting the following sentence therefrom:
- "Notice of cancellation or non-renewal of the Primary Policy duty given by the primary insurer shall serve as notice of the cancellation or non-renewal of this policy by the Company."
- (5) The Company has no obligation to renew the policy. In the event that the Company does not renew the policy it will mail or deliver to the Parent Organization written notice of non-renewal at least 45 days before the expiration date of the policy. This section shall not apply if the Company has given at

least twenty days' written notice of its willingness to renew, including the premium for any renewal policy, or if the Insured has procured equivalent coverage prior to the policy expiration date. Section 12(c) is amended to the extent necessary to effectuate the purposes of this paragraph.

The regulatory requirements set forth in this Amendatory Endorsement shall supersede and take precedence over any provisions of the policy or any endorsement to the policy, whenever added, that are inconsistent with or contrary to the provisions of this Amendatory Endorsement, unless such policy or endorsement provisions comply with the applicable insurance laws of the state of Washington.

All other terms, conditions and limitations of this policy shall remain unchanged.



Authorized Representative



Effective date of
this endorsement: September 21, 2004

Federal Insurance Company

Endorsement No.: 2

To be attached to and form a part of Policy
Number: 7023-2408

Issued to: Quellos Group, LLC

COMPLIANCE WITH APPLICABLE TRADE SANCTION LAWS

It is agreed that this insurance does not apply to the extent that trade or economic sanctions or other laws or regulations prohibit the coverage provided by this insurance.

ALL OTHER TERMS AND CONDITIONS OF THIS POLICY REMAIN UNCHANGED.

Date: September 14, 2005

By

A handwritten signature in cursive script that reads 'Robert Hamburger'.

Authorized Representative



Effective date of
this Endorsement: September 21, 2004

Federal Insurance Company

Endorsement No.: 3

To be attached to and form a part of Policy
Number: 7023-2408

Issued to: Quellos Group, LLC

AMENDED NOTICE ENDORSEMENT

It is agreed that Section 9, Notice, of this Policy, is amended by deleting the second paragraph in its entirety and replacing it with the following:

Notices required to be given to the Company under this policy shall be given in writing addressed to:

Notice of Claims:

Home Office Claims Department
Chubb Group of Insurance Companies
15 Mountain View Road
Warren, New Jersey 07059

All Other Notices:

Department of Financial Institutions
Chubb Group of Insurance Companies
15 Mountain View Road
Warren, New Jersey 07059

ALL OTHER TERMS AND CONDITIONS OF THIS POLICY REMAIN UNCHANGED.

Date: September 21, 2004.

By

Authorized Representative



Schedule of Forms

To be attached to and form part of
Policy No. 7023-2408

Company: Federal Insurance Company

Issued to: Quellos Group, LLC

14-02-6010 (8/00 ed.)

14-02-9228 (4/04 ed.)

17-02-2373 (5/01 ed.)



Chubb & Son, div. of Federal Insurance Company
as manager of the member Insurers of the
Chubb Group of Insurance Companies

**POLICYHOLDER
DISCLOSURE NOTICE OF
TERRORISM INSURANCE COVERAGE**
(for policies with no terrorism exclusion or sublimit)

You are hereby notified that, under the Terrorism Risk Insurance Act of 2002 (the "Act") effective November 26, 2002, this policy makes available to you insurance for losses arising out of certain acts of international terrorism. Terrorism is defined as any act certified by the Secretary of the Treasury, in concurrence with the Secretary of State and the Attorney General of the United States, to be an act of terrorism; to be a violent act or an act that is dangerous to human life, property or infrastructure; to have resulted in damage within the United States, or outside the United States in the case of an air carrier or vessel or the premises of a United States Mission; and to have been committed by an individual or individuals acting on behalf of any foreign person or foreign interest, as part of an effort to coerce the civilian population of the United States or to influence the policy or affect the conduct of the United States Government by coercion.

You should know that the insurance provided by your policy for losses caused by acts of terrorism is partially reimbursed by the United States under the formula set forth in the Act. Under this formula, the United States pays 90% of covered terrorism losses that exceed the statutorily established deductible to be paid by the insurance company providing the coverage. The portion of your policy's annual premium that is attributable to insurance for such acts of terrorism is: \$ -0-.

If you have any questions about this notice, please contact your agent or broker.

EXHIBIT E

EXCESS POLICY COVERAGE FORM

THIS IS A CLAIMS MADE POLICY. EXCEPT AS OTHERWISE PROVIDED HEREIN, THIS POLICY ONLY APPLIES TO CLAIMS FIRST MADE DURING THE POLICY PERIOD. THE LIMIT OF LIABILITY AVAILABLE TO PAY DAMAGES OR SETTLEMENTS SHALL BE REDUCED AND MAY BE EXHAUSTED BY THE PAYMENT OF DEFENSE EXPENSES. THIS POLICY DOES NOT PROVIDE FOR ANY DUTY BY THE INSURER TO DEFEND ANY INSURED. PLEASE READ AND REVIEW THE POLICY CAREFULLY.

In consideration of the payment of the premium, and in reliance on all statements made and information furnished to Executive Liability Underwriters, the Underwriting Manager for the Insurer identified in the Declarations (hereinafter the Insurer) and to the Issuer(s) of the Underlying Insurance, and subject to all of the terms, conditions and endorsements of this Policy, the Insurer and the Insured Entity, on its own behalf and on behalf of all persons and entity(s) entitled to coverage hereunder, agree as follows:

I. INSURING AGREEMENT

The Insurer will provide the Insured with insurance coverage for claims first made against the Insured during the Policy Period excess of the Underlying Insurance stated in ITEM 4 of the Declarations. Coverage hereunder will apply in conformance with the terms, conditions, endorsements and warranties of the Primary Policy together with the terms, conditions, endorsements and warranties of any other Underlying Insurance. The coverage hereunder will attach only after all of the Underlying Insurance has been exhausted by the actual payment of loss by the applicable Insurers thereunder and in no event will the coverage under this Policy be broader than the coverage under any Underlying Insurance.

II. DEFINITIONS

- (A) "Insured" means, either in the singular or plural, those persons or organizations designated as Insureds in the Underlying Insurance.
- (B) "Policy Period" means the period designated in ITEM 2 of the Declarations, or to any earlier cancellation date.
- (C) "Primary Policy" means the policy designated in ITEM 4 (A) of the Declarations.
- (D) "Underlying Insurance" means all policy(s) designated in ITEM 4 of the Declarations.

III. DEPLETION OF UNDERLYING LIMITS OF LIABILITY

- (A) This Policy, subject to the terms, conditions, limitations and endorsements of this Policy and the Underlying Insurance, will continue to apply to loss as excess insurance remaining under such Underlying Insurance, in the event of the reduction or exhaustion of the limits of liability of the Underlying Insurance solely as the result of the actual payment of loss by the applicable insurer thereunder.
- (B) This Policy, subject to the terms, conditions, limitations and endorsements of this Policy and the Underlying Insurance, will continue for subsequent claims or loss as primary insurance in the event of the exhaustion of all of the limits of liability of such Underlying Insurance solely as the result of the actual payment of loss by the applicable insurer thereunder.
- (C) Any risk of uncollectibility with respect to the Underlying Insurance will be expressly retained by the Insured and will not be assumed by the Insurer.

This Policy, subject to all its terms, conditions and endorsements, will not drop down for any reason including, but not limited to uncollectibility (in whole or in part) whether because of financial impairment or insolvency of the Underlying Insurance or for any other reason except for the actual payment of loss by the applicable Insurer thereunder.

IV. MAINTENANCE OF UNDERLYING INSURANCE

- (A) The limit(s) of liability of the Underlying Insurance designated in ITEM 4 of the Declarations shall be maintained during the Policy Period in full effect except for any reduction or exhaustion of the aggregate limits of liability available under the Underlying Insurance solely by reason of actual payment of loss thereunder. Failure to comply with the foregoing will not invalidate this Policy but the Insurer will not be liable to a greater extent than if this condition had been complied with. If for any reason the Underlying Insurance is not maintained, then the Insured will be deemed to be self-insured for that amount of the limit(s) of liability of such Underlying Insurance.
- (B) In the event of a change of any kind to any Underlying Insurance by endorsement, rewrite or otherwise, the coverage under this Policy will become subject to such change only if and to the extent that the Insurer consents to such change by written endorsement to this Policy.
- (C) The Insurer will not be liable under this Policy earlier or to any greater extent than it would have been as a result of the actual or alleged failure by the Insureds to give notice or to exercise any extensions under any Underlying Insurance, or misrepresentation or breach of warranty with respect to any Underlying Insurance.

V. CLAIM PARTICIPATION

The Insurer may, at its sole discretion, elect to participate in the investigation, settlement and/or defense of any claim against the Insured even if the Underlying Insurance has not been exhausted and the Insured will provide such information and cooperation as is reasonably requested.

VI. LIMIT OF LIABILITY

The amount stated in ITEM 3 of the Declarations is the limit of liability of the Insurer and shall be the maximum amount payable, including Defense Expenses, by the Insurer under this Policy. Defense Expenses are part of and not in addition to the limit of liability and the payment of such will reduce the limit of liability.

VII. NOTICE

The Insured will, as a condition precedent to the coverage available under this Policy, give written notice as soon as practicable to the Insurer of:

- (A) any claim under any Underlying Insurance, or any situation that is required to be reported under any Underlying Insurance that could give rise to a claim under any Underlying Insurance;
- (B) the cancellation of any Underlying Insurance;
- (C) any change to the Underlying Insurance by rewrite, endorsement or otherwise; or
- (D) any additional or return premiums charged or allowed in connection with any Underlying Insurance.

The Insured Entity will be the sole agent for and will act on behalf, of the Insured with respect to all matters under this Policy, including but not limited to giving and receiving notices and other communications, effecting or accepting any endorsements to or notice of cancellation of this Policy, paying premium and receipt of any return premiums.

Notice given to any underlying insurer of any claim or any situation that could give rise to a claim under any Underlying Insurance scheduled in ITEM 4 of the Declarations will not be deemed notice to the Insurer. Notice of any claim or situation that could give rise to a claim must be sent by certified mail or the equivalent to the address set forth in ITEM 5 of the Declarations; Attention: Claim Department.

VIII. POLICY TERMINATION

- (A) The Insured Entity may cancel this Policy by mailing to the Insurer written notice when such cancellation shall be effective, provided the date of cancellation is not later than the Expiration Date set forth in ITEM 2 of the Declarations.
- (B) The Insurer will refund the unearned premium computed at the customary short rate if the Policy is canceled by the Insured Entity. Under all other circumstances, any unearned premium will be computed pro rata.
- (C) This Policy will terminate immediately upon the termination of any of the policies scheduled in ITEM 4 of the Declarations, whether canceled by the Insured Entity or the applicable insurer. Notice of cancellation or non-renewal of any such policies duly given by any of the applicable insurers shall serve as notice of the cancellation or non-renewal of this Policy by the Insurer.

IX. ALTERATION

No change in or modification of this Policy shall be effective unless made by endorsement signed by an authorized employee of the Insurer.

EXHIBIT F

1 THE HONORABLE DEAN S. LUM

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7 IN THE SUPERIOR COURT OF THE STATE OF WASHINGTON
8 IN AND FOR KING COUNTY

9 QUELLOS GROUP LLC,

10 Plaintiff,

11 v.

12 FEDERAL INSURANCE COMPANY;
13 INDIAN HARBOR INSURANCE
14 COMPANY; AND NUTMEG INSURANCE
15 COMPANY

Defendants.

No.: 10-2-41637-4 SEA

DECLARATION OF MARIE M.
BENDER IN FURTHER SUPPORT
OF QUELLOS GROUP LLC' S
MOTION FOR PARTIAL
SUMMARY JUDGMENT
REGARDING EXHAUSTION OF
UNDERLYING LIMITS OF
INSURANCE

16
17 I, Marie M. Bender, declare:

18 1. The information contained herein is based upon my personal knowledge or a
19 reasonable inquiry gained from my review of relevant documents and information. If called
20 as a witness, I could and would competently testify thereto.

21
22 2. I was the General Counsel for Quellos Group LLC and its predecessors
23 (collectively "Quellos") during the relevant period and was involved in the negotiations for
24 and purchase of the 2004-2005 Indian Harbor Excess Policy.

25 3. Quellos was never offered the "Amend Section III Endorsement" attached as

26
1
Bender Declaration in Further Support of Quellos'
Motion for Partial Summary Judgment Regarding
Exhaustion of Underlying Limits of Insurance

1 Exhibit 1 to the Declaration of Marc DeSteno, Esq. in Support of Defendant Indian Harbor
2 Insurance Company's Opposition to Quellos' Motion for Summary Judgment, and was
3 otherwise unaware of the existence of this endorsement at the time Quellos negotiated and
4 purchased the 2004-2005 Indian Harbor Excess Policy.
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26 **Bender Declaration in Further Support of Quellos'²
Motion for Partial Summary Judgment Regarding
Exhaustion of Underlying Limits of Insurance**

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To the best of my knowledge and belief, I declare under penalty of perjury that the foregoing is true and correct and that this declaration is executed on this 6th day of December, 2011, in Seattle, Washington.



Marie M. Bender

³
Bender Declaration in Further Support of Quellos' Motion for Partial Summary Judgment Regarding Exhaustion of Underlying Limits of Insurance

NO. 68478-7

IN THE COURT OF APPEALS OF THE STATE OF WASHINGTON
DIVISION I

QUELLOS GROUP LLC, *Appellant/Cross-Respondent*,

v.

FEDERAL INSURANCE COMPANY and INDIAN HARBOR
INSURANCE COMPANY, *Respondents/Cross-Appellants*

**UNPUBLISHED CASES CITED IN
BRIEF OF APPELLANT/CROSS-RESPONDENT**

2012 JUN 20 PM 3: 23
COURT OF APPEALS DIV I
STATE OF WASHINGTON

Attorneys for Appellant/Cross-Respondent:

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607 14th Street NW, Suite 900
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Fax: (202) 508-5858

Not Reported in F.Supp.2d, 2011 WL 5024823 (N.D. Ohio)
(Cite as: 2011 WL 5024823 (N.D. Ohio))

H

Only the Westlaw citation is currently available.

United States District Court,
N.D. Ohio,
Eastern Division.
The GOODYEAR TIRE & RUBBER COMPANY,
Plaintiff,
v.
NATIONAL UNION INSURANCE COMPANY
OF PITTSBURGH, et al., Defendants.

No. 5:08CV1789.
Sept. 19, 2011.

Steven E. Sigalow, Mark J. Andreini, Sarah F. Suma, Jones Day, Cleveland, OH, for Plaintiff.

Cara Tseng Duffield, Daniel J. Standish, Wiley Rein, Washington, DC, Michele L. Jakubs, Patrick M. Watts, Zashin & Rich, Cleveland, OH, for Defendants.

OPINION AND ORDER

CHRISTOPHER A. BOYKO, District Judge.

*1 This matter comes before the Court upon the Motion (ECF DKT # 103) of Defendant Federal Insurance Company ("Federal") for Summary Judgment. For the following reasons, the Motion is granted.

I. FACTUAL BACKGROUND

The Goodyear Tire & Rubber Company ("Goodyear") instituted this lawsuit in July of 2008, and filed its Amended Complaint on March 23, 2009. Count I alleges breach of directors and officers ("D & O") liability policies issued by National Union Insurance Company of Pittsburgh ("National Union") and Federal; and seeks reimbursement of Goodyear's legal and accounting costs, amounting to approximately \$30 million, incurred in defending numerous securities class action and derivative lawsuits and an SEC investigation. Count II, which sought a declaratory judgment,

pursuant to the Declaratory Judgment Act, 28 U.S.C. § 2201, against Federal only, was dismissed by the Court's Opinion and Order issued on October 23, 2009. (ECF DKT # 37).

Subject to its terms, conditions and limitations, the National Union Policy has an aggregate limit of liability of \$15 million, and a \$5 million retention for Securities Claims. The Federal Policy has an aggregate limit of liability of \$10 million, that is excess of the National Union Policy limit of liability and applicable retention.

The insuring agreement of the Federal Policy recites:

The Company shall provide the Insureds with insurance during the Policy Period excess of the Underlying Limit. Coverage hereunder *shall attach only after the insurers of the Underlying Insurance shall have paid in legal currency the full amount of the Underlying Limit* for such Policy Period. (Emphasis added).

At Section 3, the Federal Policy further provides:

Only in the event of exhaustion of the Underlying Limit by reason of the insurers of the Underlying Insurance, or the Insureds in the event of financial impairment or insolvency of an insurer of the Underlying Insurance, paying in legal currency loss which, except for the amount thereof, would have been covered hereunder, this policy shall continue in force as primary insurance, subject to its terms and conditions and any retention applicable to the Primary Policy, which retention shall be applied to any subsequent loss in the same manner as specified in the Primary Policy.

In the course of this litigation, on July 16, 2010, Goodyear informed Federal and the Court that it had entered into a settlement with National Union, for \$10 million and some nonmonetary considerations.

Not Reported in F.Supp.2d, 2011 WL 5024823 (N.D. Ohio)
 (Cite as: 2011 WL 5024823 (N.D. Ohio))

Following that, the Court overruled as moot all of the parties' pending motions, and granted leave until September 7, 2010 to file renewed dispositive motions, including arguments and applicable law on settlement and exhaustion. (ECF DKT # 102). Those motions have been filed and fully briefed. Federal argues: (1) The Federal Policy does not attach because the National Union Policy was not fully exhausted; (2) The disputed fees did not "result solely" from a "claim" against an insured; (3) The "related claims" provision does not create coverage for Goodyear's internal investigation or the SEC investigation; (4) Goodyear did not seek or obtain Federal's consent to incur the disputed fees; and (5) The disputed fees incurred for Goodyear's overseas internal investigation were not reasonable and necessary to the defense of the litigation or SEC investigation. Goodyear counters: (1) Under Ohio law, a policy condition requiring exhaustion of the limits of another policy before the insurer pays cannot result in a forfeiture of coverage, at least where the insurer has not been prejudiced by the other policy's failure to pay limits; (2) It is uncontroverted that the disputed defense costs resulted solely from the investigation and defense of a claim; (3) By treating all related claims as having been made at the same time, National Union's clause 7(B) is designed to avoid any issue of "pre-claim" expenses or allocation of defense costs incurred in the defense of the same wrongful act; (4) Federal has no basis to assert consent as a defense; and (5) Examination of overseas accounting irregularities was necessary to the SEC investigation, and Federal's unsupported assertion to the contrary raises at most a question of fact for the jury.

II. LAW AND ANALYSIS

Civil Rule 56 Standard

*2 A summary judgment shall be granted only if "the movant shows that there is no genuine dispute as to any material fact and the movant is entitled to judgment as a matter of law." Fed.R.Civ.P. 56(a). The burden is on the moving party to conclusively show no genuine issue of material fact exists, *Celotex Corp. v. Catrett*, 477 U.S. 317, 323,

106 S.Ct. 2548, 91 L.Ed.2d 265 (1986); *Lansing Dairy, Inc. v. Espy*, 39 F.3d 1339, 1347 (6th Cir.1994). The moving party must do so by either pointing to "particular parts of materials in the record, including depositions, documents, electronically stored information, affidavits or declarations, stipulations, admissions, interrogatory answers, or other materials" or by "showing that the materials cited (by the adverse party) do not establish the absence or presence of a genuine dispute, or that an adverse party cannot produce admissible evidence to support the fact." Fed.R.Civ.P. 56(c)(1)(A), (B). A court considering a motion for summary judgment must view the facts and all inferences in the light most favorable to the nonmoving party. *Matsushita Elec. Indus. Co. v. Zenith Radio Corp.*, 475 U.S. 574, 587, 106 S.Ct. 1348, 89 L.Ed.2d 538 (1986). Once the movant presents evidence to meet its burden, the nonmoving party may not rest on its pleadings, but must come forward with some significant probative evidence to support its claim. *Celotex*, 477 U.S. at 324; *Lansing Dairy*, 39 F.3d at 1347. Whether summary judgment is appropriate depends upon "whether the evidence presents a sufficient disagreement to require submission to a jury or whether it is so one-sided that one party must prevail as a matter of law." *Amway Distributors Benefits Ass'n v. Northfield Ins. Co.*, 323 F.3d 386, 390 (6th Cir.2003) (quoting *Anderson*, 477 U.S. at 251-52).

Applicable law

A federal court sitting in diversity must apply the substantive law of the forum state. *Erie R.R. Co. v. Tompkins*, 304 U.S. 64, 58 S.Ct. 817, 82 L.Ed. 1188 (1938); *Talley v. State Farm Fire & Cas. Co.*, 223 F.3d 323, 326 (6th Cir.2000). In this case, Ohio law governs.

Contract Interpretation

The Supreme Court of Ohio has instructed that "insurance contracts must be construed in accordance with the same rules as other written contracts." *Hybud Equip. Corp. v. Sphere Drake Ins. Co.*, 64 Ohio St.3d 657, 597 N.E.2d 1096, 1102

Not Reported in F.Supp.2d, 2011 WL 5024823 (N.D. Ohio)
 (Cite as: 2011 WL 5024823 (N.D. Ohio))

(1992), *cert. denied*, 507 U.S. 987, 113 S.Ct. 1585, 123 L.Ed.2d 152 (1993). Furthermore, “words and phrases used in an insurance policy must be given their natural and commonly accepted meaning * * * to the end that a reasonable interpretation of the insurance contract consistent with the apparent object and plain intent of the parties may be determined.” *Gomolka v. State Auto. Mut. Ins. Co.*, 70 Ohio St.2d 166, 436 N.E.2d 1347, 1348 (1982).

The Court must interpret the contract as a whole. *Westfield Ins. Co. v. Galatis*, 100 Ohio St.3d 216, 219, 797 N.E.2d 1256 (2003). “If the language used by the parties [in a contract] is plain, complete, and unambiguous, the intention of the parties must be gathered from that language, and from that language alone.” Williston on Contracts § 31:4. “When the terms of the contract are clear and unambiguous, courts will not in effect create a new contract by finding an intent not expressed in the clear language employed by the parties.” *Shifrin v. Forest City Enterprises, Inc.*, 64 Ohio St.3d 635, 638, 597 N.E.2d 499 (1992). In a fully integrated agreement, intentions not expressed in the writing are deemed to have no existence. *Construction Interior Systems, Inc. v. Marriott Family Restaurants, Inc.*, 984 F.2d 749, 754 (6th Cir.1993) (quoting *Aultman Hosp. Ass'n v. Community Mut. Ins. Co.*, 46 Ohio St.3d 51, 544 N.E.2d 920 (1989)) (interior citations omitted).

*3 To reiterate, the Federal Policy coverage attaches “only after the insurers of the underlying insurance shall have paid in legal currency the full amount of the underlying limit for such policy period.” The parties do not dispute that the underlying insurer, National Union, paid Goodyear \$10 million in settlement; while its policy limit for the relevant coverage period was \$15 million, with a \$5 million self-insured retention.

Goodyear insists that Federal's exhaustion provision is unenforceable, because the interest in enforcing it is outweighed by the strong Ohio public policy favoring settlements. An Ohio appellate panel addressed this principle of public policy, and

cited the Ohio Supreme Court's decision in *Bogan v. Progressive Casualty Insurance Co.*, 36 Ohio St.3d 22, 521 N.E.2d 447 (1988), saying:

It is uncontroverted that public policy favors settlement. When parties agree to settle cases, litigation is avoided, costs of litigation are contained, and the legal system is relieved of the burden of resolving the dispute with the resulting effect of alleviating an already overcrowded docket. When the amount of settlement is less than the policy limits, the unpaid amount may represent a significant savings cost since litigation was avoided or curtailed ... Thus, separate from the contract of insurance, considerations of public policy generally favor settlements. *Triplett v. Rosen*, Nos. 92AP-816 & 92AP-817, 1992 WL 394867, at *18-19 (10th Dist. Dec. 29, 1992).

The Court recognizes this compelling public policy and the line of Ohio cases espousing it; yet, will not go so far as to find Federal's contract provision unenforceable. The Court agrees, first, with Federal's position that this Ohio precedent almost exclusively arose in the context of uninsured/underinsured motorist litigation. The language of those types of policies is clearly distinguishable from the language of the D & O policy before us. Moreover, Ohio state law mandates uninsured/underinsured coverage; thus motivating courts to find coverage wherever possible. There is no similar statutory mandate with regard to business and commercial excess liability coverage. Thus, although there is a substantial public interest in encouraging settlements, the Court finds an equally potent interest in fostering freedom of contract and holding parties to the agreements they make.

Goodyear further argues that settlement for an amount less than the full limits of the underlying limits is a failure of a condition precedent, which can result in the forfeiture of coverage *only* where the excess insurer is prejudiced. Goodyear contends that Federal is not prejudiced. Goodyear intends to prove it suffered losses exceeding the limits of the underlying National Union Policy; and thus, Feder-

Not Reported in F.Supp.2d, 2011 WL 5024823 (N.D.Ohio)
 (Cite as: 2011 WL 5024823 (N.D.Ohio))

al would only ever have to pay the amount it agreed to pay. The Court does not agree. Federal is indeed prejudiced. It has been required to litigate since the inception of this suit in state court in 2008. Approximately two years ago, Federal briefed, and successfully obtained, dismissal of Count II of the Complaint for Declaratory Judgment on the exhaustion provision. Federal, National Union and Goodyear attempted mediation, pursued vigorous discovery, and briefed summary judgment. Then, following the settlement with National Union, the summary judgment briefing was repeated, leading the Court to this stage. Would these significant litigation efforts have been necessary *but for* Goodyear's insistence that the underlying policy limits were exhausted by a less-than-the-limits settlement?

*4 Placing itself in the shoes of an insurer for a moment, the Court recognizes the realities of defining the scope of coverages and setting premiums accordingly. Certainly, the potential exposure of an excess insurance provider and the triggering point of that exposure inform the calculus used in setting the premiums the insured will be charged. Will coverage be triggered by losses amounting to \$20 million ... \$15 million ... or \$10 million? An excess insurer, in the Court's opinion, is entitled to at least that degree of certainty. Here, Federal's expectation was a triggering point of \$15 million plus the \$5 million self-insured retention. Federal based the premium it charged Goodyear on that expectation, not some lesser amount. Therefore, Federal has suffered real prejudice.

Goodyear and Federal are commercial enterprises of such size and quality as to presumably possess a high degree of sophistication in matters of contract. Each has the ability to retain highly competent counsel, skilled in negotiating and/or drafting insurance contract terms and advising on the impact of inserting or deleting coverage provisions. Additionally, in this free market society, Goodyear could have "shopped around" to other excess insurance providers for a different, broader exhaustion

clause.

Finally, in the Court's view, the plain language of the Federal Policy's insuring clause—"the full amount of the underlying limit"—does not mean "some lesser amount" or "partial amount," nor does it contemplate the insured "filling the gap" or "crediting the difference."

III. CONCLUSION

Therefore, the Court finds, as a matter of law, that coverage under the Federal Policy does not attach because the underlying insurer, National Union, did not pay, in legal currency, the full amount of its Policy limit. Since the clear and plain language of the Federal Policy's insuring clause drives this Court's conclusion, the Court need not address any other issues, including claims or related claims, consent, and reasonable and necessary expenses and costs. The Motion (ECF DKT # 103) of Defendant Federal Insurance Company for Summary Judgment is granted. The Amended Complaint of Plaintiff Goodyear Tire & Rubber Company is dismissed. The Motion (ECF DKT # 108) of Plaintiff Goodyear Tire & Rubber Company for Partial Summary Judgment is denied. The Motion (ECF DKT # 123) of Defendant Federal Insurance Company to Strike the Expert Report and Exclude the Testimony of Tom Baker is denied as moot.

IT IS SO ORDERED.

N.D.Ohio,2011.
 Goodyear Tire & Rubber Co. v. National Union
 Ins. Co. of Pittsburgh
 Not Reported in F.Supp.2d, 2011 WL 5024823
 (N.D.Ohio)

END OF DOCUMENT

Not Reported in A.2d, 2008 WL 3413327 (Del.Super.)
(Cite as: 2008 WL 3413327 (Del.Super.))

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Only the Westlaw citation is currently available.

UNPUBLISHED OPINION. CHECK COURT
RULES BEFORE CITING.

Superior Court of Delaware,
New Castle County.
HLTH CORPORATION and Emdeon Practice Ser-
vices, Inc., Plaintiffs,
v.

AGRICULTURAL EXCESS AND SURPLUS IN-
SURANCE COMPANY; Certain Underwriters at
Lloyd's, London; Clarendon National Insurance
Company; Federal Insurance Company; Great
American Insurance Company; Gulf Insurance
Company n/k/a The Travelers Indemnity Company;
New Hampshire Insurance Company; Old Republic
Insurance Company; Safeco Insurance Company of
America; Zurich American Insurance Company,
Defendants.

C.A. No. 07C-09-102 RRC.
Submitted: May 5, 2008.
Decided: July 31, 2008.

On Defendant Federal Insurance Company's
"Motion for Partial Summary Judgment on Allocation."
DENIED.

On Plaintiffs' "Motion for Partial Summary Judgment to Enforce [Certain Defendant Insurance Companies'] Duty to Advance and Reimburse Defense Costs."
GRANTED.

David J. Baldwin, Esquire and Jennifer C. Wasson, Esquire, Potter Anderson Corroon LLP, Wilmington, Delaware; William G. Passannante, Esquire, Anderson, Kill and Olick, P.C., New York, New York; James J. Fournier, Esquire, Anderson, Kill and Olick, P.C., Washington, D.C., Attorneys for Plaintiffs HLTH Corporation and Emdeon Practice Services, Inc.

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Kevin F. Brady, Esquire, Connolly Bove Lodge & Hutz LLP, Wilmington, Delaware; Gary V. Dixon, Esquire, John W. Duchelle, Esquire and Meredith E. Werner, Esquire, Ross, Dixon & Bell LLP, Washington, D.C., Attorneys for Defendant Clarendon National Insurance Company.

David P. Primack, Esquire and Janet R. McFadden, Esquire, Drinker Biddle & Reath LLP, Wilmington, Delaware, Attorneys for Defendant Gulf Insurance Company n/k/a The Travelers Indemnity Company.

John D. Balaguer, Esquire, White and Williams LLP, Wilmington, Delaware; Michael S. Loeffler, Esquire, Loeffler Thomas Touzalin LLP, Northbrook, Illinois, Attorneys for Defendant New Hampshire Insurance Company.

Neal J. Levitsky, Esquire and Seth A. Niederman, Esquire, Fox Rothschild LLP, Wilmington, Delaware; Michael Goodstein, Esquire and Matthew J. Burkhart, Esquire, Bailey Cavaliere LLC, Columbus, Ohio, Attorneys for Defendant Old Republic Insurance Company.

J. Scott Shannon, Esquire, Marshall, Dennehey, Warner, Coleman & Goggin, Wilmington, Delaware; Robert W. Jozwik, Esquire, Marshall, Dennehey, Warner, Coleman & Goggin, Philadelphia, Pennsylvania, Attorneys for Defendant Safeco Insurance Company of America.

Not Reported in A.2d, 2008 WL 3413327 (Del.Super.)
(Cite as: 2008 WL 3413327 (Del.Super.))

MEMORANDUM OPINION

COOCH, J.

I. INTRODUCTION

*1 This Court is called upon to address Plaintiffs' and Defendants' cross motions for partial summary judgment in this insurance coverage case. The parties agree that there are no genuine issues of material fact in dispute. The issue in this case is whether the Court must allocate the defense costs of Plaintiffs' former directors and officers, while a criminal case against them is ongoing, across the multiple towers of directors' and officers' liability insurance purchased by Plaintiffs and in the absence of contract language that would require it. The issue at hand is not where the defense costs will ultimately lie but rather is which company or companies contracted to be exposed to the present risk of funding the Plaintiffs' directors' and officers' defenses during litigation that implicates coverage.

Given the complexity of the underlying facts of this case and the resulting latticework of issues of law which they create, neither the Court nor the parties have identified any precedent from any jurisdiction that squarely answers the questions raised. Defendants argue that New Jersey law, by purportedly requiring allocation at this juncture, resolves this issue in their favor, but the Court concludes that there is no true conflict between the law of Delaware and that of New Jersey with respect to this issue.

Therefore, and for reasons discussed below, having duly considered the applicable contract language, case law, public policy and the parties' respective arguments, the Court **DENIES** Defendant Federal Insurance Company's "Motion for Partial Summary Judgment on Allocation" and **GRANTS** Plaintiffs' "Motion for Partial Summary Judgment to Enforce [Certain Defendant Insurance Companies'] Duty to Advance and Reimburse Defense Costs."

II. BACKGROUND

A. FACTS^{FN1}

FN1. The factual background of the case (including footnotes) has been taken in its entirety and nearly verbatim from the "Joint Statement of Undisputed Facts" submitted at the request of the Court by Plaintiffs and Defendants on May 30, 2008. Docket 70.

Also on that day, Plaintiffs filed an additional document: "Plaintiffs' Statement of Uncontroverted Facts Not Stipulated to by Defendants." This pleading, unsolicited by the Court, has not been considered in the Court's decision and is not a part of the factual background provided here. Docket 71.

The following defendant insurance companies joined in Federal's Motion for Partial Summary Judgment on Allocation ("Federal's Motion"): Travelers, Clarendon, Lloyd's, Old Republic and Safeco.

HLTH's Motion for Partial Summary Judgment on the Defendant Insurance Companies Duty to Advance Defense Costs is directed to Defendants Federal, Travelers, Clarendon, Lloyd's and New Hampshire. A slightly different set of defendant insurance companies joined in Federal's Opposition to Plaintiffs' Motion for Partial Summary Judgment on the Defendant Insurance Companies' Duty to Advance Defense Costs ("Opposition"): New Hampshire, Travelers, Clarendon and Lloyd's. Old Republic and Safeco did not join in Federal's Opposition. New Hampshire did not join in Federal's Motion.

The defendant insurance companies are collectively referred to as "Federal" or the "defendant insurance companies." The insurance policy that Federal sold to Plaintiffs for which Plaintiffs seek insur-

Not Reported in A.2d, 2008 WL 3413327 (Del.Super.)
 (Cite as: 2008 WL 3413327 (Del.Super.))

ance coverage is referred to as the
 "Federal Policy."

1. Medical Manager Corporation ("MMC") was formed in July 1996 and, prior to July 23, 1999, was an independent, publicly-traded company. MMC's primary business was the development and sales of computer software to assist healthcare providers in managing their healthcare practices.

2. On July 23, 1999, MMC was acquired by Syntec, Inc. ("Syntec"), which assumed the name Medical Manager Corporation ("New MMC") and changed the name of its wholly-owned subsidiary MMC to Medical Manager Health Systems, Inc. The following year, on September 12, 2000, Syntec/New MMC was acquired by Healtheon WebMD Corporation, which was subsequently renamed Emdeon Corporation ("Emdeon") and most recently changed its name to HLTH Corporation.

3. Each of the companies, MMC, Syntec and Emdeon, had its own program of D & O insurance, referred to here as a "tower." The tower of insurance maintained by MMC, as a stand-alone company, is referred to herein as the "MMC Tower." The tower of insurance maintained by Syntec is referred to herein as the "Syntec Tower." The tower of insurance maintained by Emdeon is referred to herein as the "Emdeon Tower."

*2 4. The MMC Tower provides a total of \$20 million in coverage.

5. The MMC policies state:

If during the Policy Period (i) the Parent Company [MMC] is acquired by merger into or consolidation with another entity, or (ii) another entity, or person or group of entities and/or persons acting in concert acquires securities or voting rights which result in ownership or voting control by the other entity(ies) or person(s) of more than 50% of the outstanding securities representing the present right to vote for the election of direct-

ors of the Parent Company, then coverage under this Policy shall continue until termination of the Policy Period, but only with respect to Claims for Wrongful Acts taking place prior to such merger, consolidation or acquisition.

Syntec's acquisition of MMC occurred on July 23, 1999.

6. Federal did not participate in the MMC Tower.

7. The Syntec Tower provides a total of \$100 million in coverage.

8. The Syntec policies state:

In all events, coverage as is afforded under this policy with respect to any Claim made against a Subsidiary or any Director or Officer thereof shall only apply for Wrongful Acts committed or allegedly committed after the effective time that such Subsidiary became a Subsidiary and prior to the time that such Subsidiary ceased to be a Subsidiary.

MMC became a Subsidiary, as that term is defined in the Syntec policies on July 23, 1999.

9. The Syntec policies also state:

[If Syntec] (a) ... shall consolidate with or merge into, or sell all or substantially all of its assets to any other person or entity, or group of persons and/or entities acting in concert ... herein referred to as the Transaction ... then this policy shall continue in full force and effect as to Wrongful Acts occurring prior to the effective time of the Transaction, but there shall be no coverage afforded by any provision of this policy for any actual or alleged Wrongful Act occurring after the effective time of the Transaction.

Syntec was acquired by Emdeon on September 12, 2000.

10. The period during which claims may be re-

Not Reported in A.2d, 2008 WL 3413327 (Del.Super.)
 (Cite as: 2008 WL 3413327 (Del.Super.))

ported under the Synetic Tower commenced on December 14, 1997 and initially ended on December 14, 2000, but HLTH purchased an endorsement to the Synetic policies when it acquired Synetic (and MMC) that extends the period during which claims may be reported for a period of six years following the merger until September 12, 2006. The endorsement states in part:

RUN-OFF ENDORSEMENT (SELLER/BUYER MERGER)

In consideration of the additional premium of \$241,552 it is hereby understood and agreed that as of the time and date designated as the effective time of the merger or acquisition (hereinafter the "Effective Time") in the merger agreement or plan of merger or similarly titled contract executed by and between MEDICAL MANAGER CORPORATION f/k/a SYNETIC, INC. and HEALTHEON WebMD CORPORATION, dated as of September 12, 2000 including any amendments or revisions thereto, (hereinafter the "Merger Agreement") the following provisions shall apply and be added to the policy:

* * * * *

***3 RUN-OFF COVERAGE CLAUSE**

The Named Corporation shall have the right to a period of time Six (6) years commencing on the Effective Time (herein referred to as the Discovery Period or Run-off Coverage) in which to give written notice to the Insurer of any Claim(s) first made against any Insured(s) during said Run-off Coverage for any Wrongful Act(s) occurring on or prior to the Effective Time and otherwise covered by this policy.

11. The Synetic policies define "Wrongful Act" as the following:

[A]ny breach of duty, neglect, error, misstatement, misleading statement, omission or act by the Directors or Officers of the Company in their respective capacities as such, or any matter

claimed against them solely by reason of their status as Directors or Officers of the Company.

12. The Synetic policies also state:

[E]xcept as hereinafter stated, the Insurer shall advance, at the written request of the Insured, Defense Costs prior to the final disposition of a Claim. Such advanced payments by the Insurer shall be repaid to the Insurer by the Insureds or the Company severally according to their respective interests, in the event and to the extent that the Insured or the Company shall not be entitled under the terms and conditions of this policy to payment of such Loss.

13. The Emdeon Tower provides a total of \$70 million in coverage.

14. The Emdeon policies state:

In all events, coverage is afforded under this policy with respect to a Claim made against any Organization and/or any Insured Person thereof shall only apply for Wrongful Acts committed or allegedly committed after the effective time such Organization became an Organization and such Insured Person became an Insured Person, and prior to the effective time that such Organization ceases to be an Organization or such Insured Person ceases to be an Insured Person.

Emdeon acquired Synetic on September 12, 2000.

15. On December 15, 2005, a federal grand jury returned a first superseding indictment against ten former MMC directors and officers for allegedly participating in a conspiracy to inflate fraudulently MMC's earnings between 1997 and 2001 and for money laundering.

16. On February 27, 2007, the grand jury returned a Second Superseding Indictment, which omitted one defendant, Maxie L. Juzang (the "Indictment"). The Indictment includes many of the same substantive facts and charges as the first su-

Not Reported in A.2d, 2008 WL 3413327 (Del.Super.)
(Cite as: 2008 WL 3413327 (Del.Super.))

perseding indictment, including allegations of a conspiracy to commit securities, mail, and wire fraud between February 1997 and at least 2003 (Count 1) and a money laundering conspiracy between 1997 and at least 2004 (Count 2).

17. The Indictment names nine defendants all of whom were directors or officers of MMC (Maxie Juzang was dismissed from the case) and contains seven counts. Count One alleges that the defendants conspired to commit wire fraud, mail fraud and securities fraud, in violation of 18 U.S.C. § 371, by fraudulently inflating the earnings of MMC and WebMD and concealing their fraudulent conduct by making false statements in public filings and to auditors. Count Two alleges a money laundering conspiracy, 18 U.S.C. § 1956(h), in that the defendants agreed to engage in monetary transactions with proceeds from sales of MMC stock made at fraudulently inflated prices. Counts Three through Seven allege substantive money laundering crimes, in violation of 18 U.S.C. § 1957. All nine defendants are charged in the first two counts, and only defendant John Sessions is charged in the five substantive money laundering counts. There is also a forfeiture allegation against all nine defendants, which seeks disgorgement of \$34,346,974 “representing the total proceeds from the conspiracy ... alleged in Count 1.”

*4 18. The Indictment remains pending and counsel for the indicted former officers and directors of MMC recently has informed the parties that a trial date of February 2, 2009 has been set. Each of the MMC officers has expressly denied any wrongdoing and has entered a plea of “Not Guilty” with respect to each and every count of the Superseding Indictment and the Second Superseding Indictment. There has been no adjudication of any wrongdoing alleged in the Indictment.

19. HLTH is indemnifying each of the MMC officers for their costs in defending the Indictment. The Wrongful Acts alleged in the Indictment implicate the MMC Tower, the Synthetic Tower and the Emdeon Tower, and HLTH has provided notice to

the insurers under each of these three towers. In this litigation, HLTH asserts claims for coverage only under the MMC Tower and the Synthetic Tower and has not asserted claims in this action for reimbursement under the Emdeon Tower, which contains a \$10 million deductible. HLTH has reserved its rights under the Emdeon Tower. The limits of the policies in the MMC Tower are no longer available as a result of (a) payment of the \$5 million in limits under the primary policy issued by Rock River Insurance Company in the MMC Tower; (b) payment of the \$5 million in limits under the first layer excess policy issued by TIG Insurance Company in the MMC Tower; (c) a settlement by HLTH with Zurich, the carrier providing the third layer of \$5 million in coverage in the MMC Tower; and (d) a settlement by HLTH with Agricultural Excess & Surplus Insurance Company (“AESIC”), the carrier providing the top layer of \$5 million in coverage in the MMC Tower. HLTH’s remaining claims in this action are directed only against the insurers in the Synthetic Tower.

20. The policy that Federal issued to Synthetic states:

Only in the event of exhaustion of the Underlying Limit by reason of the insurers of the Underlying Insurance, or the insureds in the event of financial impairment or insolvency of an insurer of the Underlying Insurance, paying in legal currency loss which, except for the amount thereof, would have been covered hereunder, this policy shall continue in force as primary insurance, subject to its terms and conditions and any retention applicable to the Primary Policy, which retention shall be applied to any subsequent loss in the same manner as specified in the Primary Policy. The risk of uncollectability of any Underlying Insurance, whether because of financial impairment of insolvency of any underlying insurer other reason, is expressly retained by the Insureds and is not in any way insured or assumed by the Company.

“Underlying Insurance” is defined in Item 4 of the Declarations of the Federal Policy to mean the

Not Reported in A.2d, 2008 WL 3413327 (Del.Super.)
(Cite as: 2008 WL 3413327 (Del.Super.))

\$10 million primary policy issued to Synetic by National Union Fire Insurance Company of Pittsburgh, Pa. ("National Union") and the \$10 million policy issued to Synetic by Great American. National Union paid the full limits of liability of its insurance policies in the Synetic Tower by paying such amount in legal currency on account of Loss as defined in the policy.

*5 21. On January 11, 2008, HLTH entered into a settlement agreement with AESIC and a settlement agreement with Great American.

22. Under the terms of the settlement agreement with AESIC, AESIC paid less than \$5 million.

23. Under the terms of the settlement agreement with Great American, Great American paid \$10 million.

24. On January 11, 2008, AESIC and Great American were and are affiliated companies. Both AESIC and Great American were represented by the same counsel in this action.

25. The defense costs incurred to date in defending the Indictment exceed the limits of the insurance purchased in the MMC Tower.

26. Old Republic's Excess Directors and Officers Liability and Reimbursement Coverage Policy Number CUG 25835 (the "Old Republic Policy"), which is one of the Synetic policies, contains a provision titled "Allocation," which provides:

... [I]f a Claim against the Insured Persons includes both covered and uncovered matters, the Insured Persons, the Company and the Insurer shall use their best efforts to agree upon a fair and proper allocation of any costs, charges, expenses, settlement, judgment or other loss on account of such Claim between covered Loss reasonably attributable to the Claim against the Insured Persons and uncovered loss. Such allocation between Insured Persons and others shall be based upon the relative exposure of the parties to

such Claim, without regard to whether the liability of any such party is independent of, concurrent with or duplicated by the liability of any other party to such Claim. Such relative exposure shall be determined based upon each party's proportionate liability exposure and other relevant factors.

If the allocation of loss under the Underlying Policies is different than the allocation of loss pursuant to this policy, the allocation of loss under the Underlying Policies shall apply to determine the Insurer's liability attachment under this policy and the allocation of loss pursuant to this policy shall apply to determine the amount of covered Loss excess of the insurer's liability attachment under this policy.

B. PROCEDURAL BACKGROUND ^{FN2}

FN2. The procedural background of the case (including footnotes) has been taken in its entirety and nearly verbatim from the "Joint Statement of Procedural History" submitted, at the request of the Court, by Plaintiffs and Defendants on May 28, 2008. Docket 68.

1. On July 25, 2007, Plaintiffs filed a complaint for declaratory relief and breach of contract in this matter in the Court of Chancery of the State of Delaware (the "Complaint").

2. The Complaint named Agricultural Excess and Surplus Insurance Company n/k/a Great American E & S Insurance Company ("AESIC"), Lloyd's, Clarendon, Federal, Great American Insurance Company ("Great American"), Travelers, Old Republic, Safeco and Zurich American Insurance Company ("Zurich") as defendants.

3. On August 17, 2007, Plaintiffs filed in the Court of Chancery their motion for partial summary judgment against Defendant Zurich, AESIC and Great American to enforce their duties to advance and reimburse defense costs.

Not Reported in A.2d, 2008 WL 3413327 (Del.Super.)
(Cite as: 2008 WL 3413327 (Del.Super.))

4. By stipulation and Order of the Court of Chancery, the matter was transferred to this Court on September 12, 2007.

*6 5. On October 4, 2007, Defendants filed answers to the Complaint, asserting various counterclaims and cross-claims. The counterclaims generally seek declaratory judgments to establish the extent, if any, to which Defendants' policies cover the defense costs requested by Plaintiffs. AESIC and Great American asserted cross-claims against the other Defendants, sought rescission of their policies and filed a third-party complaint against National Union Fire Insurance Company ("National Union").
FN3

FN3. On October 23, 2007, Travelers filed its answer to AESIC's and Great American's cross-claims. Clarendon, Safeco and Lloyd's filed their answers to these cross-claims on October 24, 2007. On November 13, 2007, Zurich and Old Republic filed answers to the cross-claims.

6. By letter dated December 11, 2007, counsel for Plaintiffs informed the Court that Plaintiffs had reached settlements in principle with the three defendants named in Plaintiffs' motion for partial summary judgment, Zurich, AESIC and Great American.

7. On January 3, 2008, this Court granted Plaintiff's motion for leave to file an amended complaint ("Amended Complaint") in order to join New Hampshire Insurance Company ("New Hampshire") as a defendant. Apart from the addition of New Hampshire as a defendant, the allegations in the Amended Complaint are identical to the allegations in the original Complaint.

8. On January 14, 2008, Federal filed its Motion for Partial Summary Judgment on Allocation.
FN4
Various defendants joined in Federal's Motion.

FN4. Clarendon, Travelers, Safeco, Lloyd's and Old Republic joined Federal's Motion.

New Hampshire did not join Federal's Motion.

9. By letter dated January 29, 2008, counsel for Plaintiffs informed the Court that Plaintiffs had executed settlement agreements with Zurich, AESIC, and Great American, thereby rendering moot the Motion for Partial Summary Judgment filed by Plaintiffs on August 17, 2007.

10. On February 29, 2008, Plaintiffs filed a Motion for Partial Summary Judgment to enforce certain defendants' duties to advance and reimburse defense costs.
FN5
The Motion names Federal, Travelers, Clarendon, Lloyd's and New Hampshire.

FN5. New Hampshire, Travelers, Clarendon and Lloyd's joined in Federal's opposition to HLTH's Motion. Old Republic and Safeco did not join in the opposition.

11. On March 31, 2008, New Hampshire answered the Amended Complaint and counterclaimed for declaratory relief. The other defendants remaining in the case have not responded to the Amended Complaint, and Plaintiffs have not responded to any of Defendants' counterclaims. The parties agreed to file a separate stipulation whereby Defendants' answers, defenses and counterclaims to the Complaint shall be deemed to respond to the Amended Complaint. In addition, the parties agreed that Plaintiffs would file any reply to Defendants' counterclaims within seven days following the filing of the aforementioned stipulation.

12. On March 31, 2008, Plaintiffs and Zurich filed a Stipulation to (1) dismiss with prejudice Plaintiffs' claims against Zurich American Insurance Policy No. DOC 2156347 02 (policy period January 30, 1999 to January 30, 2000) and Zurich American Insurance Policy No. DOC 2156347 03 (which replaced Policy No. DOC 2156347 02 and was effective for the policy period of July 23, 1999 to July 23, 2005) and (2) dismiss without prejudice Plaintiff's claims against Zurich with respect to Zurich American Insurance Policy No. DOC

Not Reported in A.2d, 2008 WL 3413327 (Del.Super.)
(Cite as: 2008 WL 3413327 (Del.Super.))

3561126 00 (policy period September 12, 2000 to September 12, 2006). SO ORDERED by this Court on April 1, 2008.

*7 13. On May 2, 2008, Plaintiffs and AESIC filed a stipulation to (1) dismiss with prejudice Plaintiffs' claims against AESIC with respect to Great American E & S Insurance Policy No. NSX2422079 (policy period of January 30, 1999 to January 30, 2000) and (2) dismiss with prejudice AESIC's counterclaim against Plaintiffs. SO ORDERED by this Court on May 5, 2008.

14. Also on May 2, 2008, Plaintiffs and Great American filed a stipulation to (1) dismiss with prejudice Plaintiffs' claims against Great American with respect to Great American Insurance Policy No. DFX0009292 (policy period December 14, 1997 to September 12, 2000, with an extended reporting period to September 12, 2006 for "Wrongful Acts" that occurred prior to September 12, 2000) and (2) dismiss with prejudice Great American's counterclaims against Plaintiffs. SO ORDERED by this Court on May 5, 2008.

15. On May 2, 2008, AESIC and Great American filed a Notice and Order of Dismissal of Crossclaims and Third-Party Complaint without prejudice. SO ORDERED by this Court on May 6, 2008.

16. As a result of the stipulations referenced above in paragraphs 12 through 15, Zurich, AESIC, Great American and National Union are no longer parties to this action.

17. This Court heard oral argument on Plaintiffs' and Defendants' Motions for Partial Summary Judgment on May 5, 2008.

III. THE PARTIES' CONTENTIONS

A. Allocation of Plaintiffs' Directors' and Officers' Defense Costs before Final Disposition of their Criminal Charges

In their Motion for Partial Summary Judgment,

Defendants contend that the law governing the contract requires "an allocation [between the three towers of Plaintiffs' insurance coverage] of the costs of defending covered and uncovered matters."

^{FN6} As the MMC, Syntec and Emdeon towers of coverage all "expressly cover[] wrongful acts committed within a distinct period of time," Defendants argue that a proper allocation at this time will allocate defense costs to the appropriate tower of coverage based on "the timing of the wrongful acts alleged in the [i]ndictment." ^{FN7} Defendants proposed allocation scheme, based on the dates of the alleged overt acts in the indictment, would allocate Plaintiffs' defense costs as follows: 63% to the MMC tower, 23% to the Syntec tower and 14% to the Emdeon tower. ^{FN8} In support of their proposed allocation scheme, Defendants assert that Plaintiffs "acquired an entity [i.e. Syntec f/k/a MMC] that was underinsured" and "may not lawfully shift this uninsured liability to other insurance towers" because the applicable tower of coverage has been exhausted. ^{FN9}

FN6. Defs. Mot. for Partial Summ. J., at 9.

FN7. *Id.* at 10, 11.

FN8. *Id.* at 13.

FN9. *Id.* at 14.

Plaintiffs contend, with respect to allocation among the three towers, that Defendants have put forth an "arbitrary scheme" that incorrectly equates "the definition of 'overt act' under conspiracy law principles" with " 'Wrongful Act' in the Federal Policy." ^{FN10} Moreover, Plaintiffs argue that allocation based on overt acts alleged in an indictment is unrealistic because "conspiracy is a single crime, and it must be defended as such." ^{FN11} Finally, Plaintiffs contend that the absence of "any language in the Federal Policy supporting its allocation theory" bars Defendants from "unilaterally assert[ing]-after a Claim is made-an allocation scheme which alters the coverage." ^{FN12}

Not Reported in A.2d, 2008 WL 3413327 (Del.Super.)
 (Cite as: 2008 WL 3413327 (Del.Super.))

FN10. Pls. Opp'n to Defs. Mot. for Partial Summ. J., at 10, 12.

FN11. *Id.* at 17.

FN12. *Id.* at 18, 21.

B. Exhaustion of Underlying Policy Limits

*8 As a supplementary argument, Defendants contend that since the “Federal [Policy] provides that coverage does not apply until the full amounts of liability on the two underlying policies have been ‘paid in legal currency’ by the underlying insurers,” Plaintiffs have “failed to demonstrate that this simple condition to coverage ... has been satisfied.”^{FN13} In reference to Plaintiffs' settlements with some of its carriers, Defendants argue that Plaintiffs are “expressly required by Federal's excess policy” to “demonstrate the exhaustion of th[e] underlying coverage.”^{FN14} Defendants contend that this type of provision is permissible and enforceable “in order to prevent settlements between an insured and an underlying insurer that attempt to shift risk to higher level insurers that received less premium to cover risk at a higher attachment point.”^{FN15}

FN13. Defs. Opp'n to Pls. Mot. for Partial Summ. J., at 14.

FN14. *Id.* at 17.

FN15. *Id.*

Plaintiffs respond that the underlying policies are in fact exhausted by payment in legal currency up to the full policy limits as required by the contract.^{FN16} In the alternative, Plaintiffs contend that “an excess policy is triggered once the underlying policy is ‘functionally exhausted’ by settlement[] and the loss exceeds the limits of th[e] underlying policy.”^{FN17} Plaintiffs argue that New Jersey and Delaware courts have held that a strict interpretation of this contract provision, i.e., to require full payment of underlying policies before excess coverage is triggered, is both against public policy as “the law favors settlement” and irrelevant because

“Federal would not be required to pay one penny more in insurance than it would have if the underlying insurance company paid its limits in full.”^{FN18}

FN16. Pls. Reply to Defs. Opp'n to Pls. Mot. for Partial Summ. J., at 9-10.

FN17. *Id.* at 11.

FN18. *Id.* at 12, 13.

C. Advancement of Defense Costs

In their Motion for Partial Summary Judgment, Plaintiffs contend that Defendants have a duty to advance defense costs “if any allegation in the underlying case is potentially or possibly covered under the insurance policy.”^{FN19} With respect to the timing of such payments, Plaintiffs assert that “[u]nder the Defendant Insurance Companies' policies, there is no duty to defend but, rather, there is an obligation to pay defense costs as those costs are incurred.”^{FN20} Plaintiffs' main focus with respect to the language in the insurance contract executed by Plaintiffs and Defendants is that “the Defendant Insurance Companies ‘shall advance’ defense costs ‘prior to the final disposition of a claim’ “ and that “ ‘to the extent that it is *finally established* that any such Defense Costs are not covered ... the Insureds ... hereby agree to repay the Insurer such non-covered Defense Costs.’ “^{FN21} Lastly, and in conjunction with their other contentions concerning advancement and amount of payment, Plaintiffs argue that “an insurance company must pay costs incurred to defend uncovered claims if the defense of those claims is ‘reasonably related’ to the defense of covered claims.”^{FN22} In sum, Plaintiffs contend that each of the defendants is under a duty to defend, up to their respective policy limits, the entirety of the criminal conspiracy alleged against Plaintiffs' former directors and officers and to do so as defense costs accrue.

FN19. Pls. Mot. for Partial Summ. J., at 17.

FN20. *Id.* at 19.

Not Reported in A.2d, 2008 WL 3413327 (Del.Super.)
(Cite as: 2008 WL 3413327 (Del.Super.))

FN21. *Id.* at 23 (emphasis in original).

FN22. *Id.* at 25.

*9 In response, Defendants argue that, prior to advancing potentially uncovered defense costs to Plaintiffs, the Court must first substantively address and resolve the question of allocation among the three towers, and further assert that, under supposedly applicable New Jersey law, “the allocation of defense costs need not be established with ‘scientific certainty’ and that if the insurer and insured [can]not reach [an] agreement as to the apportionment of costs, the court should then make the determination.”^{FN23} Defendants propose an allocation of defense costs among the three towers of coverage according to the “timing of the wrongful acts alleged in the [i]ndictment.”^{FN24} Moreover, Defendants argue that the pertinent contract language “require[s] *only* the indemnification or reimbursement of reasonable defense costs” rather than the total advancement of costs asserted by Plaintiffs.^{FN25} Defendants thus contend that “the Court first must address the issue of allocation-which establishes if and to what extent coverage exists-before it may order the insurers to advance defense costs.”^{FN26}

FN23. Defs. Opp’n to Pls. Mot. for Partial Summ. J., at 8.

FN24. Defs. Mot. for Partial Summ. J., at 11.

FN25. Defs. Opp’n to Pls. Mot. for Partial Summ. J., at 9 (emphasis in original).

FN26. *Id.* at 13.

IV. STANDARD OF REVIEW

“Upon cross motions for summary judgment, this Court will grant summary judgment to one of the moving parties.”^{FN27} No genuine issues of material fact exist as a matter of law where opposing parties have each sought summary judgment.^{FN28} Superior Court Civil Rule 56(h) provides:

FN27. *Scottsdale Ins. Co. v. Lankford*, 2007 Del.Super. LEXIS 338, *11

FN28. Super. Ct. Civ. R. 56(h).

Where the parties have filed cross motions for summary judgment and have not presented argument to the Court that there is an issue of fact material to the disposition of either motion, the Court shall deem the motions to be the equivalent of a stipulation for decision on the merits based on the record submitted with the motions.

The questions before this Court are questions of law, and the parties by filing cross motions for summary judgment have in effect stipulated that the issues raised by the motions are ripe for a decision on the merits.

V. DISCUSSION

A. Allocation of Liability Is Not Required Prior to Final Disposition of the Claim^{FN29}

FN29. Defendants have raised the threshold question of choice of law as to whether New Jersey or Delaware law should apply as to court-administered allocation. The Court does not believe that there is a conflict of law on the precise questions at issue under the particular facts of the instant case. Delaware law is that “absent any conflict, the Court may apply general principles that are consistent with the law of either jurisdiction.” *Sun-Times Media Group, Inc. v. Royal & SunAlliance Ins. Co. of Canada*, 2007 WL 1811266, *9-10 (Del.Super. June 20, 2007). Any conflict that Defendants may have identified between New Jersey and Delaware law does not come to bear on the ultimate issue, i.e., whether any allocation of liability is required prior to the final disposition of an underlying claim, of this case. Therefore, this Court will follow its holding in *Sun-Times* and apply consistent rules from both jurisdictions in its decision.

Not Reported in A.2d, 2008 WL 3413327 (Del.Super.)
(Cite as: 2008 WL 3413327 (Del.Super.))

The Synthetic policies contain the following provision:

[E]xcept as hereinafter stated, the Insurer shall advance, at the written request of the Insured, Defense Costs prior to the final disposition of a Claim. Such advanced payments by the Insurer shall be repaid to the Insurer by the Insureds or the Company severally according to their respective interests, in the event and to the extent that the Insured or the Company shall not be entitled under the terms and conditions of this policy to payment of such Loss.^{FN30}

FN30. See *supra* at 7.

This contract language allows for other portions of the contract to alter Defendants' general duty of advancing defense costs by the phrase "except as hereinafter stated." With respect to these exceptions that could deflect Defendants' baseline duty of advancement of defense costs, Defendants rely on the two provisions of the contracts in the Synthetic tower and their analog in the Emdeon tower concerning when coverage begins and ends under each tower, i.e., after the company was acquired/merged and before it was sold/merged. The relevant provisions are reproduced below (the first two were included in the Synthetic tower contracts and the last was included in the Emdeon tower contracts):

*10 In all events, coverage as is afforded under this policy with respect to any Claim made against a Subsidiary or any Director or Officer thereof shall only apply for Wrongful Acts committed or allegedly committed after the effective time that such Subsidiary became a Subsidiary and prior to the time that such Subsidiary ceased to be a Subsidiary.^{FN31}

FN31. See *supra* at 6.

[If Synthetic] (a) ... shall consolidate with or merge into, or sell all or substantially all of its assets to any other person or entity, or group of persons

and/or entities acting in concert ... herein referred to as the Transaction ... then this policy shall continue in full force and effect as to Wrongful Acts occurring prior to the effective time of the Transaction, but there shall be no coverage afforded by any provision of this policy for any actual or alleged Wrongful Act occurring after the effective time of the Transaction.^{FN32}

FN32. See *supra* at 6.

In all events, coverage is afforded under this policy with respect to a Claim made against any Organization and/or any Insured Person thereof shall only apply for Wrongful Acts committed or allegedly committed after the effective time such Organization became an Organization and such Insured Person became an Insured Person, and prior to the effective time that such Organization ceases to be an Organization or such Insured Person ceases to be an Insured Person.^{FN33}

FN33. See *supra* at 7.

The reasoning behind these clauses and the interest they protect for Defendants, Defendants argue, is that "when a company is overtaken, is absorbed, merged into, or taken over by someone else, that risk has shifted so dramatically, that underwriters foresee that they cannot have calculated what could be the appropriate premium."^{FN34}

FN34. Tr. of Oral Argument at 36 (May 5, 2008).

With respect to Defendants' allocation scheme that is based on the above clauses in the contract, the Court finds their proposal unpersuasive. Under Defendants' proposal, defense costs would be allocated according to the alleged overt acts in the federal indictment, and each tower's allocation would be as follows: 63% to the MMC tower, 23% to the Synthetic tower and 14% to the Emdeon tower.^{FN35} Defendants arrive at these percentages by allocating the alleged overt acts, according to the alleged dates of their occurrences as set forth in the indict-

Not Reported in A.2d, 2008 WL 3413327 (Del.Super.)
(Cite as: 2008 WL 3413327 (Del.Super.))

ment, to each tower's coverage period and then dividing by the total. For example, the 274 overt acts alleged to have occurred during the MMC tower's coverage period divided by the 437 total alleged overt acts roughly equals 63%. Defendants concede that each tower of coverage has been triggered by the underlying claim. However, in their allocation scheme as to the extent to which their policies have been triggered, Defendants ask the Court to take at least two leaps in logic: 1) to equate "overt acts" listed in the indictment to "wrongful acts" as described in the insurance contract and 2) to assume that all "overt acts" would require essentially the same amount of defense work. Defendants' proposed allocation scheme is unfair to Plaintiffs, especially considering the inability of Defendants to direct the Court to any contract provision or case that would specifically require it. Plaintiffs are presently expending large sums of money to pay for the defense costs of their former directors and officers in the underlying litigation.

FN35. See *supra* at 14.

*11 However, Defendants cite several New Jersey cases (no Delaware cases are to be found), which mandate court-administered "apportionment" after the underlying claim has been resolved even in the absence of contract language to that effect. In *SL Industries, Inc. v. American Motorists Insurance Co.*,^{FN36} the New Jersey Supreme Court found that a defendant insurer had wrongfully refused to defend a plaintiff insured against an age discrimination claim brought by a former employee. The *SL Industries* Court held that the defendant insurer's duty to reimburse was limited to covered claims and thereby required that an apportionment be performed between covered and non-covered claims.^{FN37} This case set out a rule, as further elucidated in *Hebela v. Healthcare Insurance Co.*,^{FN38} which separates New Jersey law from Delaware on this issue in that, in New Jersey, apportionment between covered and non-covered claims is apparently to be performed by the court no matter how difficult the process may be. However, as *SL Industries* dealt

with apportionment only after the underlying claim had been resolved, the Court is not persuaded that the rule set forth there should apply in the instant case.

FN36. *SL Industries, Inc. v. American Motorists Ins. Co.*, 607 A.2d 1266 (N.J.1992).

FN37. *Id.* at 1280.

FN38. *Hebela v. Healthcare Ins. Co.*, 851 A.2d 75 (N.J.Super.Ct.App.Div.2004).

In *Hebela*, the former Chief Financial Officer of a hospital initiated a wrongful termination claim against his former employer, which was met with a counterclaim from the hospital alleging plaintiff insured's negligence in his duties as CFO. The plaintiff insured was denied coverage initially under a directors' and officers' liability policy issued by defendant insurer and sought to recover his defense costs. The *Hebela* Court held that *SL Industries*, while seemingly allowing for the possibility of an instance where apportionment will not be possible, had "essentially foreclosed the idea that there will be cases in which defense costs cannot be fairly apportioned" and required that case to undergo apportionment even though it would be difficult.^{FN39} As *Hebela* only stands as a practical clarification of the holding in *SL Industries*, it is not helpful.

FN39. *Id.* at 83-84.

In *L.C.S., Inc. v. Lexington Insurance Co.*, a New Jersey court required apportionment of the defense costs of a plaintiff insured between negligence (covered) and intentional tort (uncovered) claims after the insured had settled with an injured bar patron and its insurer had refused to defend during the litigation.^{FN40} *L.C.S., Inc.*, similarly, only stands for a rule recognizing apportionment between covered and uncovered claims after the underlying claim has been resolved.

FN40. *L.C.S., Inc. v. Lexington Ins. Co.*, 853 A.2d 974, 984-985

Not Reported in A.2d, 2008 WL 3413327 (Del.Super.)
(Cite as: 2008 WL 3413327 (Del.Super.))

(N.J.Super.Ct.App.Div.2004).

Finally, in *Morgan, Lewis & Bockius LLP v. Hanover Insurance Co.*,^{FN41} plaintiff, as assignee of the insured, sought to collect its defense costs from the insured who had refused to defend against, inter alia, claims of trademark infringement. The *Morgan, Lewis & Bockius* court, following the logic as set out in *SL Industries, Inc.* and *Hebela*, proceeded to apportion defense costs between covered and uncovered claims.^{FN42} Again, this case follows the logic of the previous three cases cited by Defendants and likewise says nothing about requiring apportionment before the resolution of the underlying claim in the absence of contractual language regarding the same.

FN41. *Morgan, Lewis & Bockius LLP v. Hanover Ins. Co.*, 929 F.Supp. 764 (D.N.J.1996).

FN42. *Id.* at 769-73.

*12 Defendants' reliance on the holdings in *SL Industries, Inc.* and its progeny is misplaced in the instant case. The court in *SL Industries, Inc.* stated a rule requiring "apportion[ment] between covered and non-covered claims [of a single insurer]" so that the insurer would pay "only those defense costs reasonably associated with claims covered under the policy" and how "the lack of scientific certainty [in performing such an apportionment] does not justify imposing all the costs on the insurer by default."^{FN43} Defendants ask the Court to extrapolate the *SL Industries* Court's rule requiring apportionment between covered/uncovered claims after the resolution of the underlying case to a new rule requiring allocation of defense costs across multiple insurers before the resolution of the underlying case. The *SL Industries* Court does not suggest its endorsement of such a rule.

FN43. See *SL Indus., Inc.*, 607 A.2d at 1280.

Moreover, none of the above cases required al-

location to be performed *before* the claim was finally decided, nor did they involve insurance packages as complex and multi-faceted as the one presented in the present case. Indeed, a requirement to allocate insurance liability before a triggering claim has been finally decided actually could create more, rather than less, uncertainty about ultimate proportionate liability for insurance coverage between two or more insurance companies. This Court's concern about judicial economy seems confirmed by the Court's being furnished a copy of a letter by Plaintiffs from the U.S. Department of Justice to Plaintiffs' former directors' and officers' defense counsel.^{FN44} In this letter of May 30, 2008, the U.S. attorney noted several "amendments to the government's acquisition chart," which may change the number of overt acts in the underlying indictment. If, through this letter or through the return of another superseding indictment by the South Carolina grand jury, the number of alleged overt acts were to change, this would negate this Court's allocation of costs among Defendants, assuming this Court were to accept Defendants' proposed 63%-23%-14% allocation scheme.^{FN45} This letter demonstrates the Court's concern about redundant and wasteful litigation when asked to allocate the defense costs of an underlying complex criminal case, yet to be concluded, based on the United States Government's identification of 437 overt acts over an eight-year period.

FN44. Letter of May 30, 2008 from Acting U.S. Att'y for the District of South Carolina Kevin F. McDonald to Pls. Directors' and Officers' Att'ys. Docket 76.

FN45. *Id.*

Also, Defendants could have explicitly included an allocation requirement in their contracts that would require the very allocation that they now ask this Court to order, but they did not.^{FN46} Therefore, in the absence of contract language that would require it, the Court finds that allocation of defense costs prior to the final disposition of an underlying claim is not required.

Not Reported in A.2d, 2008 WL 3413327 (Del.Super.)
 (Cite as: 2008 WL 3413327 (Del.Super.))

FN46. Pls. Opp'n to Defs Mot.s for Partial Summ. J., at 19, n. 14.

Defendants' related argument that Plaintiffs may not "choose in [their] sole discretion to call upon any of the three towers of insurance to pay defense costs" is linked to their request for allocation and requires the explicit contract provisions cutting off the coverage of the insured company in the event of purchase/merger, analyzed *supra* at 20-21, to trump their duty to advance defense costs, analyzed *supra* at 20.^{FN47} Importantly, Defendants do not dispute that the claim stemming from Plaintiffs' former directors' and officers' criminal defense implicates all three towers of coverage; they only dispute the *extent* to which their coverage is implicated. Indeed, Defendants acknowledge, simply from the nature of their request for allocation, that all three towers of insurance have some amount of contractually viable claims that have triggered them.

FN47. Defs. Mot. for Partial Summ. J., at 10.

*13 Perhaps the closest precedent available (though admittedly still quite different from the facts of the present case in that the coverage-triggering event had been resolved prior to the court's apportionment), *Hebela v. Healthcare Insurance Co.* addressed a dispute as to coverage under a directors' and officers' liability policy, which, when the plaintiff insured claimed the triggering of the policy, the defendant insurer refused to defend due to the claim's overlap with an uncovered but intimately related matter.^{FN48} The *Hebela* Court's approach coincides with that of this Court:

FN48. *Hebela*, 851 A.2d at 85.

[The insured] was entitled to the full benefit of the duty to defend which [the insurer] owed him, and to limit the value of that benefit by reducing the amount which was actually expended in defending the counterclaim [which was covered by insurance], because it overlapped the steps taken

in prosecuting the complaint [which was uncovered], would deprive plaintiff of that full benefit.^{FN49}

FN49. *Id.*

If the instant case had but one tower of insurance with the claim being concededly both covered and uncovered in some proportion, a rule of law like that established in *Hebela* might apply. Therefore, the Court holds that Plaintiffs, having purchased additional "run-off reporting coverage" for a valuable consideration, see *supra* 6-7, and with the concession by Defendants that all three towers of coverage have been triggered, may elect to collect payments in advance from any tower with which it currently holds coverage. To hold otherwise would be tantamount to requiring that an allocation be performed at this preliminary stage, which the Court declines to do. This Court expresses no view as to whether allocation will be required at some future time.

Delaware law is similar to New Jersey law on this issue. In *Sun-Times Media Group, Inc. v. Royal & SunAlliance Insurance Company of Canada*, this Court held, when presented with "advancement of defense costs" contract language substantially similar to that in the instant case, that "the personal exclusions [in the contract] do not override a present contractual duty to advance defense costs unless the Defendants can unequivocally now show that all of the allegations in the [underlying] complaint fall within the ... exclusions."^{FN50} In *Sun-Times*, the defendant insurer argued that the plaintiff insured was not entitled to defense costs because the plaintiff's receipt of the payments was "precluded under two exclusions in the applicable policies."^{FN51} While the instant case does not raise issues of personal conduct exclusions, *Sun-Times* applies here in that, since Defendants have conceded that their respective towers of coverage have all been triggered, Defendants now cannot demonstrate that all of the allegations in the indictment fall outside of the coverage periods of their respective towers and therefore must advance defense costs.

Not Reported in A.2d, 2008 WL 3413327 (Del.Super.)
(Cite as: 2008 WL 3413327 (Del.Super.))

FN50. *Sun-Times Media Group, Inc. v. Royal & SunAlliance Ins. Co. of Canada*, 2007 WL 1811266, *11 (Del.Super. June 20, 2007).

FN51. *Id.* at *8.

Interestingly, a New York court in the very recent case of *The Trustees of Princeton University v. National Union Fire Insurance Co. of Pittsburgh, Pa.*^{FN52} faced a similar dispute in which the insured plaintiff sought advancement of defense funds for an underlying claim that was still pending from the defendant insurer. In *Trustees of Princeton University*, the court held on appeal, with respect to the request for allocation of defense costs prior to the resolution of the underlying claim, that:

FN52. *The Trustees of Princeton University v. National Union Fire Ins. Co. of Pittsburgh, Pa.*, 2008 WL 2277830 (N.Y.App. Div. 1st Dept. June 5, 2008).

*14 As the policy obligates [the insurer] to advance all defense costs as they are incurred, subject to a right of recoupment of payment for non-covered costs after the underlying litigation is completed, the court had no obligation at this juncture to rule on the allocation of defense expenses.^{FN53}

FN53. *Id.*

Admittedly, important differences exist between this case and the instant case in that there were not multiple insurance policies from which to collect nor was the insurer's refusal to advance defense costs based on contract provisions concerning termination of coverage in the event of merger/sale. Nevertheless, this Court finds *Trustees of Princeton University* to be analogous and similarly finds no obligation presently to engage in the allocation of defense expenses.

B. The Underlying Policies are Exhausted as a Matter of Law

On the supplementary argument put forward by

Defendants of the necessity of Plaintiffs' demonstration of exhaustion of the underlying policies before Defendants can be compelled to pay costs, Defendants rely on a provision in the contract, which provides the following:

Only in the event of exhaustion of the Underlying Limit by reason of the insurers of the Underlying Insurance, or the insureds in the event of financial impairment or insolvency of an insurer of the Underlying Insurance, paying in legal currency loss which, except for the amount thereof, would have been covered hereunder, this policy shall continue in force as primary insurance, subject to its terms and conditions and any retention applicable to the Primary Policy, which retention shall be applied to any subsequent loss in the same manner as specified in the Primary Policy. The risk of uncollectability of any Underlying Insurance, whether because of financial impairment of insolvency of art underlying insurer other reason, is expressly retained by the Insureds and is not in any way insured or assumed by the Company.^{FN54}

FN54. See *supra* at 9.

Plaintiffs and Defendants have stipulated that Plaintiffs have reached settlement agreements with two of the underlying insurers.^{FN55} In *Stargatt v. Fidelity and Casualty Company of New York* where the sole issue was whether an excess insurance policy may be reached by an insured when the primary policy has been settled for less than its limit, the United States District Court for the District of Delaware held that “[t]he excess insurers will be liable only for covered losses in excess of [the primary policy limit plus the deductible on the excess insurance policy].”^{FN56} The *Stargatt* Court continued, “I believe the reasoning of the *Zeig* case is correct, and I am confident that the Delaware courts would reach the same result.”^{FN57} Indeed, Delaware courts have followed this reasoning.^{FN58}

Not Reported in A.2d, 2008 WL 3413327 (Del.Super.)
(Cite as: 2008 WL 3413327 (Del.Super.))

FN55. See *supra* at 9-10, 12.

FN56. *Stargatt v. Fidelity and Cas. Co. of New York*, 67 F.R.D. 689 (D.Del.1975), *aff'd* 578 F.2d 1375 (3d. Cir.1978)

FN57. *Id.*

FN58. See *Tenneco Automotive Inc. v. El Paso Corp.*, 2001 WL 1641744, *9-10 (Del. Ch. Nov. 29, 2001) (rejecting argument that policyholder could not settle its claims with its insurer for less than its policy limit as “inconsistent with our general policies favoring and encouraging settlement.”)

New Jersey law is in accord with Delaware law on this issue. In *Westinghouse Electric Corporation v. American Home Assurance Company*,^{FN59} thousands of liability claims had been made against the plaintiff insured company for injury to people who had used its products. While the insured reached settlements with some of its underlying insurers, the defendant insurers were excess insurance companies who had not joined in the settlements and who refused to cover the insured's claims by arguing, *inter alia*, that the underlying policy limits had not been exhausted as their contracts had required. *The Westinghouse* Court reasoned that the excess policy was triggered when the underlying policy limit was reached by the total costs incurred by the insured, regardless of whether the total payments to the insured reached those limits, because the excess insurance company could not possibly claim to have a stake in whether the insured actually received all of the underlying insurance limits.^{FN60} The Court believes that the reasoning in *Westinghouse* and *Stargatt* applies equally here.

FN59. *Westinghouse Electric Corp. v. American Home Assurance Co.*, 2004 WL 1878764 (N.J.Super.Ct. Jul. 8, 2004). See also *Zeig v. Massachusetts Bonding & Ins. Co.*, 23 F.2d 665 (2d. Cir.1928).

FN60. *Id.* at *6. See also *UMC/Stamford, Inc. v. Allianz Underwriters Ins. Co.*, 647 A.2d 182, 190 (N.J.Super.Ct.App.Div.1994) (“If there is any dollar difference between the primary layer of coverage and the amount of the settlement, plaintiffs will have to pay that difference before expecting to obtain any reimbursement from excess insurance companies ... It is therefore irrelevant what the exact dollar figure was in the settlement.”).

*15 Defendants cite two cases from California and Michigan, which either distinguish or decline to follow the reasoning in *Stargatt*. However, the decisions in New Jersey and Delaware are clear on the issue of exhaustion of underlying policy limits' position, i.e., that Defendants' liability is completely unchanged whether Plaintiffs have received all of the underlying payments or not. The Court thus declines to accept the reasoning set forth in *Qualcomm, Inc. v. Certain Underwriters at Lloyd's, London*, 2008 WL 763483 (Cal.App. Mar. 25, 2008) or in *Comerica Inc. v. Zurich American Insurance Co.*, 498 F.Supp.2d 1019 (E.D.Mich.2007) as the opinions in both of these cases are contrary to that of *Zeig* and its progeny, including *Stargatt*, and are therefore contrary to the established case law of New Jersey and Delaware.

Settlements avoid costly and needless delays and are desirable alternatives to litigation where both parties can agree to payment and leave other separately underwritten risks unchanged. The Court sees unfairness in allowing the excess insurance companies in the instant case to avoid payment on an otherwise undisputedly legitimate claim. Therefore, to the extent that Plaintiffs' defense costs exceed any loss they may have imposed on themselves by accepting settlements with underlying insurers for less than the policy limit, the Court holds that those underlying policies have been exhausted as a matter of law.

VI. CONCLUSION

Not Reported in A.2d, 2008 WL 3413327 (Del.Super.)
(Cite as: 2008 WL 3413327 (Del.Super.))

For the foregoing reasons, Defendant Federal Insurance Company's "Motion for Partial Summary Judgment on Allocation" is **DENIED** and Plaintiffs' "Motion for Partial Summary Judgment to Enforce [Certain Defendant Insurance Companies'] Duty to Advance and Reimburse Defense Costs" is **GRANTED**.

IT IS SO ORDERED.

Del.Super.,2008.

HLTH Corp. v. Agricultural Excess and Surplus Ins. Co.

Not Reported in A.2d, 2008 WL 3413327
(Del.Super.)

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Superior Court of Washington.
KALAMA CHEMICAL, INC., A Washington Corporation, Plaintiff,
v.
ALLIANZ INSURANCE CO., et al., Defendants.

No. 90-2-05011-4.
Aug. 14, 1995.

MEMORANDUM OF DECISION ON DEFENDANT'S AND PLAINTIFF'S MOTIONS FOR SUMMARY JUDGMENT RE: EXHAUSTION AS TO PASCO SITE (# 7, # 8), DUTY TO DEFEND (# 1), MOTIONS FOR REVISION (# 27 & 29), AND II'S MOTION FOR DISMISSAL OF CROSS-MOTION (# 30)

FLECK, J.

INDUSTRIAL INDEMNITY'S AND KALAMA'S MOTIONS FOR REVISION RE: EXHAUSTION (# 27, # 29)

*1 Industrial Indemnity (hereafter II) initially moved for summary judgment of dismissal as to the Pasco Site on the basis of lack of justiciability (Motion # 8); II now moves for revision (Motion # 27) of Judge Bridge's prior order dated January 5, 1995, regarding exhaustion, pursuant to *Rees v. Viking*, infra. Kalama initially moved for summary judgment to establish indemnity coverage at the Pasco Site (Motion # 7); by cross-motion (Motion # 29), Kalama now moves for revision of Judge Bridge's January 5, 1995 order. II further moves (Motion # 30) for dismissal of Kalama's Motion # 29 on the grounds that Kalama has presented no new authority for its position.

Preliminarily the issue of exhaustion must be addressed. Initially, II asserted that Judge Bridge has determined that exhaustion is a question of fact, and it must therefore be decided by the fact finder. Further, II asserted that her decision is the "law of the case."^{FN1} Kalama takes an opposing position,

stating that Judge Bridge did not hear or determine the issue of *how* Kalama could exhaust the underlying insurance. Kalama asserts that that issue is now before me in a number of motions. After initial briefing on the Duty to Defend and Pasco Site motions, II has now brought a motion under CR 54(b) seeking revision of Judge Bridge's denial of II's motions heard in late 1994 based on the recent decision in *Rees v. Viking Ins. Co.*, 77 Wash.App. 716, 892 P.2d 1128 (1995), which was issued after her ruling.

FN1. II asked that I read the pleadings associated with its motions on the exhaustion issue. I did so, and note II's citation to authority in its reply brief at p. 7, 787 P.2d 1385 on the issue of "law of the case" for the proposition that in Washington, the principle of "law of the case" applies to "parties who raise identical issues on successive appeals of the same case. *MGIC* presents no relevant authority for extending the doctrine to apply to motions raised several times at the trial court level. We see no reason to extend the doctrine here." *MGIC Financial Corp. V. H.A. Briggs Co.*, 24 Wash.App. 8, 600 P.2d 573 (1979). II also cited out of state authority as follows. "The law of the case doctrine does not apply to pretrial rulings such as motions for summary judgment." *Shouse v. Ljunggren*, 792 F.2d 902, 904 (9th Cir.1986). II stated at page 7 of its reply brief: "Thus, this court is free to, and should, weigh the arguments and come to whatever conclusion it feels is right, just and fair[.]" and cited the following from *Robinson v. Parrish*, 720 F.2d 1548, 1550 (11th Cir.1983) (accord, *Whirlpool Corp. v. U.M.C.O. International Corp.*, 748 F.Supp. 1557, 1560-61 (S.D.Fla.1990): "To hold that a [trial] court must rigidly adhere to its own rulings in an earlier stage of a case would

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actually thwart the purpose of the [law of the case] doctrine. New developments or further research often will convince a [trial] court that it erred in an earlier ruling, or the court may simply change its mind." In Washington, even in appeals, the law of the case doctrine is discretionary. *Coffell v. Clallam County*, 58 Wash.App. 517, 794 P.2d 513 (1990). On the other hand, Kalama cites in its prior Response to II's motion at p. 1, fn. 2, 794 P.2d 513, out of state authority to the contrary. (Emphasis added.)

Judge Bridge ruled on two motions brought by II ^{FN2} in which she determined that the plaintiff was not required to prove total horizontal and vertical exhaustion, but rather only vertical exhaustion in the year of the II policy and that the liability of II, if found, would not be limited to the "time on the risk." She also stated that Kalama's motions were not properly before her. She said Kalama's burden under this policy is to prove: 1) that its ultimate net loss was in excess of the retained limit in II's policy, and 2) that it has exhausted the limits of the Schedule A policy (Allianz) and other insurance collectible by the insured for policies maintained by Kalama on the sites during the term of the II policy (and none are known).

FN2. II's motions specifically were a request that the court "dismiss this action against II because Kalama failed to exhaust the limits of all other applicable insurance .. In the alternative, II seeks a ruling that it is not obligated to indemnify Kalama for any alleged property damage at the Kalama or Pasco site occurring outside the effective dates of the II policy [time on the risk]...."

Judge Bridge stated that "summary judgment *at this juncture* is premature because of this outstanding material question of fact" regarding the issue of exhaustion. ^{FN3} She offered her own concerns about Kalama's ability to show exhaustion, given its

settlement with Allianz (a company which insured Kalama in various time periods including this one) without allocating amounts to specific policy periods at the time of the settlement. In her explanation, Judge Bridge also stated that settlement for less than policy limits is not exhaustion. There was no motion specifically addressed to the issue of how underlying policies can be exhausted. (Although Kalama filed its motion for reconsideration, which included arguments contained in current motions in apparent response to some of Judge Bridge's comments or explanations, Kalama's original motions were not timely and neither Kalama's motions nor its motion for reconsideration were argued.) These latter statements were not holdings; even if they were, they are subject under the rules to being revisited by her or by a subsequent judge as described below.

FN3. The June 13, 1995 Clarified memorandum of Opinion contained a typographical error at line 7; it should have read "page 3, lines 12-14 are deleted" rather than lines 12-16.

*2 I discussed with counsel informally on June 9 and then addressed briefly in the memorandum decision on Allocation, issues which arise with multiple judges/multiple decision making as well as legal standards applied under Civil Rule 56. For purposes of this decision, the applicable rules are as follows. Unless summary judgment is granted in toto, it is not a final order for purposes of CR 54(b). It is an interlocutory order and not appealable by right, unless the trial court enters a written finding that there is no just cause for delay. The denial of a motion for summary judgment is not a final judgment, and is thus interlocutory. Likewise, an order under CR 56(d) which specifies facts which are not in dispute is not a final order, and is therefore interlocutory. Moreover, a CR 56(d) order is not actually a judgment, although it is frequently called a "partial summary judgment." See 10 Wright & Miller, *Federal Practice and Procedure*, Civil, § 2737 (1983). The court retains jurisdiction to modi-

Not Reported in P.2d, 1995 WL 17015061 (Wash.Super.)
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fy an order at any time before final judgment. After the Allocation decision, I reviewed the briefing on II's motions on exhaustion, and additional authority cited by II at page 7 of its reply brief supports this interpretation as well. Judge Bridge's discussion of the reasons for her ruling were not intended by her to be the "law of the case,"^{FN4} nor does the Washington authority support this notion regarding summary judgment motions.

FN4. I have also previously indicated to you that the revision of language in her ruling dated January 25, 1995 was to make absolutely clear her decision that Kalama must only exhaust insurance "vertically" and that the repetition of other words in that paragraph was not intended to infer anything regarding the exhaustion issue.

The issue of exhaustion can involve both questions of law and questions of fact. How a policy can be exhausted requires interpretation and construction of the language and therefore is a question of law. Whether a policy has been exhausted may involve questions of fact if genuine issues regarding whether the policy is exhausted are raised when considered in light of the interpretation of the term; otherwise, it may be decided upon the record presented.

The issue of exhaustion involves consideration of the, "coverage," "retained limit," "ultimate net loss," "underlying insurance" and "loss payable," policy provisions. These provisions state:

I. COVERAGE

The Company [II] agrees to pay the ultimate net loss in excess of the retained limit ... which the insured [Kalama] may sustain by reason of the liability imposed upon the insured by law arising out of an occurrence ... for ... (b) Property Damage Liability....

V. RETAINED LIMIT-

LIMIT OF LIABILITY

With respect to Coverage I(a),I(b) or I(c), or any combination thereof, the company's liability shall be only for the ultimate net loss In excess of the insured's retained limit defined as the greater of:

(a) the total of the applicable limits of the underlying policies listed in Schedule A hereof, and the applicable limits of any other insurance collectible by the insured; or....

CONDITIONS

G. *Loss Payable.* Liability of the company with respect to any one occurrence shall not attach unless and until the insured, the company in behalf of the insured, or the insured's underlying insurer, has paid the amount of retained limit.

*3 ...

J. *Underlying Insurance.* If underlying insurance is exhausted by any occurrence, the company shall be obligated to assume charge of the settlement or defense of any claim or proceeding against the insured resulting from the same occurrence, but only where this policy applies immediately in excess of such underlying Insurance, without the intervention of excess Insurance of another carrier.

It is undisputed that the retained limit in this policy is one million dollars, that is, that II agreed to pay all sums Kalama is legally obligated to pay above one million dollars for occurrences during its policy period, up to the limits of this excess policy. There remains an issue regarding how and when the "aggregate" provision applies.

In a letter responding to my request that counsel analyze the exhaustion issue in light of or by analogy to the floating layer theory of underinsured motorist coverage found in *Elovich v. Nationwide Insurance Co.*, 104 Wash.2d 543, 707 P.2d 1819 (1985), II cited the new case of *Rees v. Viking Insurance, supra*, as addressing the exhaustion issue directly. Kalama has responded, again in letter form; subsequently, II filed its motion under CR 54(b) in which it asks me to dismiss Kalama's ac-

Not Reported in P.2d, 1995 WL 17015061 (Wash.Super.)
 (Cite as: 1995 WL 17015061 (Wash.Super.))

tion in light of *Rees*, and Kalama filed its cross-motion.

Rees is distinguishable. The *Rees* case involved automobile coverage for an accident by a permissive driver which was secondary to the insurance held by the owner of the vehicle. The Injured party settled with the primary insurer for an amount under the primary policy limits, sought a finding by the court approving the settlement but also determining that the value of the injury was in excess of the primary limits and then sought coverage from the driver's policy. Division Three recognized the procedure as an "artifice," noting the lack of contract relationship between the party seeking coverage and the insurer as well as the lack of public policy involved in this fact pattern (unlike the situation involved in UIM coverage in which public policy is reflected in a statute). Here, of course, there is a contractual relationship between II and Kalama; this is a critical distinction. Here, Kalama asserts that it has paid the entire retained limits in up to three ways and is still liable to the "injured party" (the government), whereas in *Rees*, the insured's carrier paid a sum less than the policy limits in order to obtain a release from the injured party. In addition, public policy favors settlements generally according to various authority cited by counsel and in environmental cases in particular, as can be seen at a minimum from Insurance Commissioner Senn's regulations with their statement of public policy in favor of such settlements.^{FN5} As long as the excess carrier receives full credit for whatever the retained limits are, it has received the benefit of its bargain, and it is consistent with the public policies of early settlements and efficient use of judicial resources. II has not cited any public policy which is contrary.^{FN6} In oral argument, Mr. Spoonemore asserted that the excess carrier would not receive a part of its bargain (the primary carrier's duty to defend), unless the primary itself was required to pay in order to exhaust (as opposed to the insured paying some or all of the retained limit). Mr. Spoonemore asserted that this would fundamentally change the policy from an excess insur-

ance policy to a primary policy with a large deductible. Who pays the retained limits and the duty to defend are not, however, that intimately connected. Mr. Spoonemore conceded that the primary insurer's obligations including the duty to defend are extinguished when the primary's indemnity limits are paid in full.^{FN7} For example, the primary insurer is not limited in its business decision making from paying its limits at the outset of a claim, thereby not implicating its duty to defend which would then shift to any excess carrier on the claim.^{FN8} This interpretation is consistent with the insurance policy the parties entered into: II would insure for damages in excess of one million dollars up to twenty million dollars. As long as II is given credit for the one million dollars underlying its coverage, its position is fully protected and it is not prejudiced. The applicable terms of the policy are consistent with this interpretation. In the Retained Limits provision, the II policy is triggered when Kalama's ultimate net loss exceeds the underlying limits. Under the Loss Payable provision, the underlying limits can be paid by the primary insurer, the insured or by both. *This very policy section* was cited by II at p. 5, fn. 4, 892 P.2d 1128 of its Brief in Response to Kalama's Motion for Clarification and/or Reconsideration [of Judge Bridge's memorandum of decision on II's motions]:

FN5. The Kalama/II fact pattern involves Kalama's assertion that it has paid, not part, but all of the retained limits of II's policy in up to three different ways. The issue here, then, is whether the insured can pay retained limits in lieu of the primary insurer actually paying the retained limits. The fact pattern is similar to, but not the same as that involved in Judge Dwyer's case of *Northwest Steel Rolling Mills* in which the insured paid a small portion of the retained limits after settlement with the primary insurer. The result was an application of the floating layer concept of insurance authorized under Washington law in UIM coverage. Examples provide some in-

Not Reported in P.2d, 1995 WL 17015061 (Wash.Super.)
 (Cite as: 1995 WL 17015061 (Wash.Super.))

sight regarding why it is also an appropriate and supportable concept in excess coverage environmental cases regardless of whether the insured pays some or pays all of the retained limits. It would be a waste of judicial resources and an unnecessary risk to the insured to expose itself to the unknowns of a trial, if the insured were required, for example, to go to trial in order to access its excess coverage, even if it had an offer to settle for one penny or one dollar short of full primary limits. Likewise, if the damages were ten million dollars, the primary limits were \$100,000 and the excess limits were twenty million, it might be a good business decision to forego the expense associated with pursuing the primary carrier altogether. Similarly, it may be economically sound for the insured to take a percentage of its primary insurance, pay the difference itself to the retained limit of its excess carrier and then proceed under its excess. Finally, if the insured had a small primary policy, it may be economically sensible to pay the primary limits and then proceed under the excess. This in fact is what the II policy authorizes.

FN6. I am aware of II's citation to authority including the *American Home Assurance, Co. v. Cohen*, decision at 124 Wash.2d 865, 881 P.2d 1001 (1994) regarding the starting place for public policy analysis being in applicable legislation. Regulations by the state insurance Commissioner are similar.

FN7. See e.g. Mr. Spoonmore's citation to Appleman's concern about shifting liability to the excess carrier before the primary insurer "has paid its limits and has bought the claim and fulfilled its obligations." See also various arguments and authority cited in the motion re: Duty to Defend and the policy language.

FN8. There was some oral argument regarding an ongoing duty to defend despite settlement. The cases cited are distinguishable for a variety of reasons, including a fact pattern of primary co-insurers, "settlement" without payment, settlement late and then an effort to pro rate defense costs, etc. Where excess insurers' retained limits are exhausted by payment, the primary's duty to defend terminates and the excess carrier assumes the obligation.

*4 Key policy language makes clear that exhaustion of underlying limits is a condition precedent to coverage under the II excess policy. For instance, condition G of the policy states that II's liability shall not attach unless and *until the insured*, the company on behalf of the insured, or the insured's underlying insurer *has paid the amount of the retained limit....* (Emphasis added.)

At footnote 5 on page 7 of the same brief, II cites additional authority as follows:

See also *Span Inc. v. Associated International Insurance Co.*, 277 Cal.Rptr. 828, 835, 227 Cal.App.3d 463, 475 (Cal.App.1991) (declaring that the policy's "in the event of reduction or exhaustion" language unambiguously contemplates "exhaustion" of the underlying insurance only by *payment of the underlying limits, either by the insured or its primary carrier.*) (Emphasis added.)

There is no insurance policy provision that requires that only the *underlying insurer* pay the full policy limits as a condition precedent to reach the excess coverage; rather, the policy specifically authorizes payment by the insured and uses the term "exhaustion" without specifying how exhaustion is to occur. As stated in *Boeing v. Aetna*, 113 Wash.2d 869, 784 P.2d 507 (1990), "[t]he undefined term 'as damages' does not stand exclusionary guard for the industry and represent a vast exclusion from coverage. The term damages is to be given its plain ordinary meaning and not the technical meaning advocated by insurers." Similarly, the term "exhaustion" is undefined. If the insurer wanted to

Not Reported in P.2d, 1995 WL 17015061 (Wash.Super.)
 (Cite as: 1995 WL 17015061 (Wash.Super.))

require that full policy limits be paid *by the underlying insurer only*, it could have written such a provision. However, instead, the term employed is "exhaustion." There is no reason in the policy or in terms of public policy why the manner in which a primary policy is exhausted could matter from the excess insurer's standpoint. No argument has been offered that full payment of the policy limits by the primary carrier only is a factor in terms of setting the rate. In addition, there is no public policy that would suggest such an interpretation; contrary public policy is noted above. Finally, the policy provision itself identifies the insured as a potential payor of the retained limit, which then triggers the excess insurer's liability.

As Judge Dwyer, I believe, noted in one of his decisions cited where the policy did not define "exhaustion," any ambiguity is not associated with the word itself, but rather with how exhaustion can be achieved. See also *Brown v. Lumbermens Mutual Casualty Co.*, 326 N.C. 387, 390 S.E.2d 150, 154 (N.C.1990) In addition, in *Northwest Steel Rolling Mills, Inc. v. Fireman's Fund Insurance Co.*, No. C86-376C, Oral Decision (W.D.Wash. Feb. 25, 1991), Judge Dwyer noted in his *Order on Plaintiff's Motion for Determination that Proposed Settlement Exhausts Policies of Defendant Fireman's Fund* that there is no prejudice to the insurer in finding exhaustion as long as the full amount of the retained limits is credited against the insured, and also noted the additional considerations of "the desirability of settlement (which would be made more difficult by a contrary holding), and the construction of insurance policy provisions, if ambiguous, in favor of the insured," citing to *Britton v. Safeco Insurance Co.*, 104 Wash.2d 518, 528, 707 P.2d 125, 132 (1985).

*5 Applying the principles of contract interpretation and construction identified in the "Owned Property" and "Pollution Exclusion" decisions, there is no evidence that the provisions of the policy which implicate exhaustion were negotiated by the parties, nor is there extrinsic evidence re-

garding the parties' mutually manifested intent on the issue of exhaustion. Reading the policy as a whole, including the loss payable provision with its specific language regarding the ability of the insured to pay the retained limits as one of the triggers to the excess carrier's liability, there is no ambiguity regarding exhaustion. II's liability is not implicated until the primary policy is "exhausted;" it is exhausted when the retained limits have been paid by the primary insurer, by the insured, or by the company on behalf of the insured. Even if the undefined term is ambiguous, the sound reasoning in Judge Dwyer's *Northwest Steel Rolling Mills Order* on this issue should be applied here to resolve the issue of "how" the underlying policy may be exhausted. The answer is that it may be exhausted by a method other than the underlying insurer paying the full amount up to II's retained limits. This policy, apparently consistent with others, does require payment in order to trigger the excess carrier's liability; as long as the insured or primary carrier pays an amount equivalent to the retained limit, then II is not prejudiced based on the policy it sold.

It appears undisputed that allocation of settlement proceeds involving the primary carrier can constitute exhaustion (although the parties clearly dispute *when* such allocation should occur). II asserts that Kalama made a fatal mistake by not fully allocating at the time it settled with Allianz, and that any attempt at allocation after the fact should not be considered for purposes of determining the exhaustion issue. Kalama asserts that there is no requirement that it allocate at the time of settlement and acknowledges that delaying allocation until after settlement allows it the possibility of maximizing its recovery.

Kalama has allocated one million dollars of the Allianz settlement to the 1982/1983 II policy year according to the uncontroverted declaration of Mr. Macomber dated February 2, 1995. This constitutes either payment by the insured or payment by the underlying insurer, and triggers the excess coverage at least as to the Kalama site. The time of the alloc-

Not Reported in P.2d, 1995 WL 17015061 (Wash.Super.)
 (Cite as: 1995 WL 17015061 (Wash.Super.))

ation is not critical, as long as there remain funds from the Allianz settlement which have not previously been allocated to other claims and as long as there is not double recovery.^{FN9} There is nothing in II's policy which indicates when payment needs to occur, nor is there anything in the policy which provides that the insurer has the right to state how the insured's settlement with the underlying insurer should be allocated between sites or covered periods. In addition, there is no legal authority cited for this requirement of simultaneous allocation.^{FN10}

FN9. Similarly, in deciding Kalama's Motion regarding defense costs, Judge Bridge in her Order dated March 23, 1994, stated that the primary carrier had not offered any authority for its position that Kalama was required to allocate settlement proceeds from other insurers to defense costs and indemnification. She stated, "(p)laintiffs do not seek a double recovery, and moreover, public policy is contrary to Allianz's position because the necessity for allocation would have limited settlement, contrary to the policy of encouraging parties to settle early and rewarding those who do achieve early settlements."

At oral argument, II asserted that allowing an insured to allocate after a settlement with an underlying insurer would facilitate the insured's manipulation of multiple insurers for settlement purposes as well as facilitate the allocation and "reallocation" of the same dollars, essentially in a dishonest manner. However, the public policy in favor of early settlements and the rule of interpretation that insurance contracts must be liberally construed in favor of the insured support not imposing a requirement of allocation at the time of settlement (when none is required by the terms of the policy), provided that there is no previous allocation which consumes all of the funds and

provided that there is no double recovery.

FN10. Kalama has also paid more than two million dollars in response costs at the Kalama site; it is not clear however for what time period or property damage or particular damages this applies. In addition, there is also the payment associated with the Garfield site.

*6 The issue of interpretation and construction of the "aggregate" language must be addressed in order to resolve the Pasco Site and Duty to Defend issues. The policy between II and Kalama states in *Schedule A-Schedule of Underlying Policies* that the underlying bodily injury and property damage combined single limit CGL insurance with Allianz for the 1981/1982 policy period is one million dollars each occurrence and one million dollars aggregate when applicable. II asserts that in order to understand whether the policy between II and Kalama was aggregating or non-aggregating, we must turn to the Allianz policy because the printed portion of the II policy says "aggregate when applicable." II then reviews endorsement 4 to the Allianz policy which says under coverage for bodily injury liability and property damage liability, the limits of liability are one million dollars each occurrence and one million dollars aggregate. Under the narrative description, II argues that subparagraph (b) describes the only four instances where the aggregate applies (without so stating), in part because of the conjunctive "and" contained in the body of subparagraph (b).^{FN11} Kalama asserts that the language following the four subparts to subparagraph b ("Such aggregate limit shall apply separately: ...") means that the aggregate limit applies separately to whatever it is that is described in the four subparagraphs, that is, that this is an exception to the overall aggregate limit of one million for each year and that these are the only exceptions. Since it is possible to read the Allianz policy in this manner and since both sides concede that Kalama does not fall within any of the four subparts, then

Not Reported in P.2d, 1995 WL 17015061 (Wash.Super.)
 (Cite as: 1995 WL 17015061 (Wash.Super.))

the one million dollar aggregate should apply, Kalama asserts.

FN11. "... commencing from its effective date *and* which is described in any of the numbered subparagraphs below .."

The task is to determine what the parties to *this* policy between II and Kalama intended in terms of the trigger for II's coverage. There is no extrinsic evidence that the parties negotiated this item. There is no extrinsic evidence about manifested mutual intent. The only documentary evidence is the representation in the II file from Kalama's agent that the Allianz policy was "\$1,000,000 each occurrence and aggregate" which serves as notice from Kalama to II of Kalama's understanding of its primary insurance policy. The language on Schedule A to II's own policy is that it is "\$1,000,000 occurrence" and "\$1,000,000 aggregate when applicable" with the numbers typewritten and the words in preprinted form. How could II intend something about which it was apparently completely unaware, that is, any particular language in the Allianz policy? II's proposed interpretation of its policy which imposes a significant limit on its coverage is certainly not clear from the language of its own policy, nor is it clear from reading the disputed language of the Allianz policy. In applying the rules of interpretation and construction set out in the Owned Property and Pollution Exclusion decisions, insurance contracts must be liberally construed in favor of the insured, the entire contract must be construed together to give effect to each clause, the policy should be given a fair, reasonable and sensible construction as would be given by the average person purchasing insurance even if the insured is a large corporation with company counsel. The interpretation must be reasonable and must take into account the purpose of the insurance at issue. If there are ambiguities which cannot be resolved, they must be resolved against the drafter-insurer and in favor of the insured. Looking at the II policy with these considerations in mind, if there is any ambiguity, it exists because of the preprinted words "when applicable"

next to the word "aggregate." Applying the principles of interpretation and construction noted above, the fair and reasonable construction as would be understood by the average person purchasing *this excess coverage policy* is that it was implicated when the one million dollars aggregate had been reached in the Allianz policy. The purpose of this coverage is to provide an umbrella or excess layer of insurance, once the underlying policy limits have been reached. If II had wanted to provide the very limited coverage for which it now argues, it could have clearly written its policy to so provide.^{FN12} However, it is not a reasonable interpretation of the II policy to have the pre-printed words "when applicable" with no other explanation or reference "stand exclusionary guard" for coverage here by requiring the average purchaser of this excess coverage to refer back to an endorsement on the primary policy and then to read subparagraph (b) contained there as providing, without clearly so stating, that under four rather esoteric circumstances, the policy will be an aggregate policy, but otherwise, the insured has broad per occurrence coverage (even though the middle separated section (not the "fine print") simply states under "limits of liability," "\$1,000,000 each occurrence \$1,000,000 aggregate"). Such an intention needs to be far more explicitly stated in the II policy.^{FN13} I interpret the II policy to be implicated when the insured has incurred damages as defined in II's policy of one million dollars, that is, that the policy is an aggregate policy.

FN12. Here II's position is that the words "when applicable" following the word "aggregate" operate (like an exclusion) to limit or exclude the coverage under its policy. In *Transcontinental Insurance v. Utility Systems*, 111 Wash.2d 452, 760 P.2d 337 (1988), in interpreting an exclusion the Supreme Court declined to give meaning to the words in the exclusion "subject to the terms" because they conflicted with coverage language and would render the declarations page and the en-

Not Reported in P.2d, 1995 WL 17015061 (Wash.Super.)
 (Cite as: 1995 WL 17015061 (Wash.Super.))

dorsement meaningless.

FN13. II argues that the court should apply the rule of construction to the underlying Allianz policy, that ambiguous terms should be construed in favor of the insured or of coverage, thereby construing it as a per occurrence policy, thus providing greater coverage under *that policy*. The concurrent effect would of course be to find very limited coverage under the excess policy, which is the policy at issue before me. This result would turn the purpose of that particular rule of construction on its head. Whether it is by applying the language of *Berg* that the principles should not be applied as absolutes, but as suggestive working rules only, or whether it is simply by focusing on the II policy and its construction, I believe that the suggested application of that rule of construction is inappropriate. Moreover, no authority has been cited for its application in a similar situation.

*7 Based on the un rebutted record, I find that the only underlying policy, issued by Allianz, has been exhausted not only by Kalama's allocation of one million dollars from the Allianz settlement to the Kalama site, but also by the Garfield site settlement. This does not address whether the payment by Kalama of over two million dollars at the Kalama site (without indicating to which period or occurrences the payments applied) constitutes exhaustion.^{FN14}

FN14. II asserts that Kalama has not shown receipts, inferring that the Macomber declaration requires corroboration. There is also a dispute regarding whether the expenditures made thus far, which are largely for investigation, can be considered as applying to exhaust retained limits, or indemnity requirements, as opposed to being defense costs. Kalama asserts they can be both and that Judge Bridge has previ-

ously so found. II provides memoranda in which Kalama has previously taken the position that such costs are defense costs, and Kalama has provided additional materials disputing that characterization of its prior positions. Particularly in light of Judge Bridge's ruling that they can be both, Kalama's position may not be inconsistent. I don't believe it is necessary to reach this issue at this time.

II's MOTION FOR SUMMARY JUDGMENT RE:
 PASCO SITE (# 8)

Defendant Industrial Insurance moves for summary judgment dismissing plaintiff's claims regarding the Pasco site. Defendant asserts that there is no justiciable dispute between the parties here with respect to the Pasco claims. Defendant asserts that plaintiff's claims with respect to Pasco are premature and speculative, in that Kalama's contributive share of liability for damages has not been established at the Pasco site. II does not seek a determination or adjudication of the merits of Kalama's claim for coverage. II seeks a dismissal of Kalama's Pasco site claims, asserting that Kalama's present costs do not currently exceed onemillion dollars and therefore II's coverage is not yet implicated, and further that future costs are speculative and unpredictable.

Kalama responds that II has misapplied the doctrine of justiciability, that the underlying primary policy has been exhausted, and that the Pasco site claim represents an actual dispute between the parties which is substantial and capable of a final judicial determination. Kalama asserts that cleanup at Pasco will probably exceed fifty million dollars, and that Kalama is jointly and severally liable as a "potentially liable party." Kalama asserts that it is liable for cleanup at Pasco pursuant to the Enforcement Order issued by the DOE on October 21, 1994, that site investigation continues and that interim and final remedial measures are being developed for submittal to the DOE for approval. Kalama asserts that II's policy provides coverage

Not Reported in P.2d, 1995 WL 17015061 (Wash.Super.)
 (Cite as: 1995 WL 17015061 (Wash.Super.))

for claims that exceed one million dollars in the aggregate, that the Pasco site claim meets the requirements of justiciability and in addition, involves issues of overriding public concern. Kalama further asserts that the contingent events which II alleges must precede justiciability are inapplicable, in that the DOE has already determined Kalama's liability at Pasco.

II replies that the aggregate limits of the underlying Allianz policy do not apply to this situation, the underlying policy is not exhausted, Kalama's liability is based on speculation and conjecture, the controversy is not an issue of overriding public import, Kalama's judicial economy argument violates fundamental fairness, and II's policy covers only damages paid, not anticipated.

II's motion is based on the notion of lack of justiciability, which in turn, is based on its assertion that the Allianz policy is non aggregating except in a few circumstances which don't apply to the parties here. The rules to determine whether a controversy is justiciable have been cited by both sides. They are: 1) actual, present and existing dispute, or the mature seeds of one, as distinguished from a possible, dormant, hypothetical, speculative or moot disagreement, 2) between parties having genuine and opposing interests, 3) which involves interests that must be direct and substantial, rather than potential, theoretical, abstract or academic, and 4) a judicial determination of which will be final and conclusive. These elements must coalesce, otherwise the court steps into the prohibited area of advisory opinions. *Diversified Industries Development Corp. v. Ripley*, 82 Wash.2d 811, 814-15, 514 P.2d (1973); *Walker v. Munro*, 124 Wash.2d 402, 411, 8789 P.2d 920 (1994); *Arnold v. Retirement Systems*, 74 Wash.App. 654, 875 P.2d 665 (199_). The Declaratory Judgment Act is remedial in nature, and is subject to liberal construction and administration. RCW 7.24.120; *Clallam County Deputy Sheriff's Guild v. Board of Clallam County Commissioners*, 92 Wash.2d 844, 601 P.2d 943, 945 (1979), and *Arnold, supra*. Although no Wash-

ington authority has been cited on the issue of justiciability between parties to an insurance contract, Kalama has cited the case of *ACandS Inc. v. Aetna Casualty & Surety Co.*, 666 F.2d 819 (1981) for the following proposition:

*8 Declaratory suits to determine the scope of insurance coverage have often been brought independently of underlying claims, albeit the exact sums to which the insurer may be liable to indemnify depends upon the outcome of the underlying suits....The inescapable indication of the actuality of this controversy is that a liability insurer's indemnification agreement carries with it not only an obligation to pay judgments against the insured, but also in the real world to pay settlement amounts. Indeed, liability insurers owe fiduciary obligations to their insured with respect to the consideration of settlement offers and the conduct of settlement negotiations. It would turn the reality of the claims adjustments process on its head to hinge justiciability of an insurance agreement on the maturization of a suit to a judgment when the overwhelming number of disputes are resolved by settlements.

In Judge Bridge's earlier determination of this issue on April 13, 1993, in the Monroe site claims, she cited language from the Supreme Court in *Maryland Casualty Co. v. Pacific Coal & Oil Co.*, 312 U.S. 270, 61 S.Ct. 510, 85 L.Ed. 826 as follows:

The difference between an abstract question and a "controversy" contemplated by the Declaratory Judgment Act is necessarily one of degree, and it would be difficult, if it would be possible, to fashion a precise test for determining in every case whether there is such a controversy. Basically, the question in each case is whether the facts alleged, under all the circumstances, show that there is a substantial controversy, between the parties having adverse legal interests, of sufficient immediacy and reality to warrant the issuance of a declaratory judgment. [citing also to 10 Wright & Miller, *Federal Practice and Procedure*, Civil, § 2757 (2d ed.1983).

Not Reported in P.2d, 1995 WL 17015061 (Wash.Super.)
 (Cite as: 1995 WL 17015061 (Wash.Super.))

Judge Bridge further noted that the proper trigger of coverage is the "likelihood that limits of primary coverage will be exceeded, i .e., the reasonable probability that excess layers will be invaded by reason of damage sustained by this insured within the policy term(s) which exhausts primary coverage." She then reviewed the status of the pertinent sites: all but one had damages only in the tens of thousands of dollars. She determined that the most clear estimates on all sites showed that they were well below the one million dollar limit per occurrence of the Allianz policies (and they were also far less than one million dollars in the aggregate). The Monroe site claims were also at a later stage, either settled, old or dormant. Pasco, on the other hand, is a site on the National Priorities List, is the subject of an enforcement order against Kalama and other potentially liable parties who are jointly and severally liable for the response action at Pasco. Kalama's expert has given an opinion that "extensive and costly remedial measures will, more probably than not, be required at the Pasco site" and that the "cost of these remedial measures will likely exceed fifty million dollars." II's expert has given an opinion that no clean up would be an appropriate response, although he does not give an opinion that that will be the response of the regulators. ^{FN15} Kalama is jointly and severally liable at Pasco, but even if the standard is what is Kalama's likely share of the total liability, the evidence offered from Mr. Hale's declaration dated November 9, 1994, that he expects Kalama to pay a 2-5% share, or one million seventy hundred fifty thousand (\$1,750,000), (average of 3.5%) of Mr. Lang's estimate of fifty million dollars exceeds the retained limits (even if the policy was non-aggregating). I have found that the policy between II and Kalama is properly interpreted to mean that II will pay amounts Kalama is legally obligated to pay above the one million dollar retained limits of its policy. Kalama has allocated one million dollars to this policy year at the Kalama site (as well as has paid over two million dollars itself for response costs for some period of time), and has received over a million dollars (\$1.6 million) from II for the

Garfield site. Mr. Lang's expert opinion regarding clean-up costs is sufficient to oppose II's motion for summary judgment of dismissal based on lack of justiciability. Kalama's liability at the Pasco site is not too speculative. The issue between Kalama and II is justiciable. II's motion to dismiss Kalama's claims is denied.

FN15. For example, at page 148, line 8 of Dr. Steiner's deposition: "Q: ... your opinion is not that it is not likely that the regulators will require ___ or no remediation it's simply that in your view it doesn't need it, is that correct? A: Yes, that's my opinion."]

KALAMA'S MOTION FOR SUMMARY JUDGMENT RE: PASCO SITE (# 7)

*9 Plaintiff Kalama moves for summary judgment to establish Industrial Indemnity's indemnity coverage for Kalama's liability on the Pasco site claim under II's excess coverage policy. Kalama asserts that there is no dispute of material fact with respect to the elements necessary to require II to afford indemnity coverage to Kalama for the Pasco site claim.

Kalama asserts that the incidents in question were the release of hazardous chemicals from not later than 1974, proceeding through II's policy period and continuing to present. Kalama asserts that leakage from drums moved through the soil at Pasco, creating a single continuous occurrence, which nevertheless caused new damage each year from 1974 as the contamination moved through the soil as liquid or vapor into the groundwater. Kalama asserts that such groundwater contamination was first determined to exist in 1985 and that such leakage was not expected or intended.

Kalama's recital of the facts asserts that it shipped drummed waste containing toluene, benzene, benzoic acid, copper and phenol to the Pasco Municipal Landfill, which contaminants have been detected in the groundwater. In October of 1991, Kalama was advised by the Washington State De-

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(Cite as: 1995 WL 17015061 (Wash.Super.))

partment of Ecology (hereinafter "DOE") that it was a potentially liable party (hereinafter "PLP") at the Pasco site. Notice of such potential liability was given to II on December 20, 1991. Phase I of the cleanup process has been approved and agreed to by all PLPs. The DOE ordered Kalama to participate in Phase II (Remediation Investigation and Feasibility Study) and notified Kalama in January, 1992, that it is subject to "generator liability" jointly and severally with the other PLPs. Kalama's expert estimates that the cost of remediation is likely to exceed fifty million dollars.

Kalama asserts that pursuant to the foregoing fact pattern, Kalama will incur and is legally obligated to pay damages for cleanup imposed by law, and that such cleanup costs constitute "damages" under the terms of CGL policies. Kalama further asserts that pursuant to Judge Bridge's prior order with respect to the Monroe site, Kalama does not have to "fingerprint" its waste as a cause of property damages. Kalama asserts that the pollution exclusion provision of II's policy does not preclude coverage, because discharge was "sudden and accidental."

II responds that Kalama's motion is premature and therefore unjusticiable because the investigation into the cause and extent of contamination at the Pasco site will not be completed for at least two years, and Kalama's assumptions regarding remediation (if any) and its share of attendant costs are speculative. II argues that II's policy is not triggered until Kalama exceeds onemillion dollars in expenses, and that Kalama has failed to establish such obligation has been incurred. II asserts that factual disputes which existed in late 1994 still exist, that a jury could conclude that contact with the soil at the dump was clearly expected and was not an occurrence, and that even if the groundwater is found to be contaminated, it is not an occurrence because the groundwater was not affected until after II's policy period had elapsed. II asserts in support of this contention that the Pasco landfill discontinued dumping of industrial waste in 1975,

that no dioxin or organic contamination appeared in 1984 tests of the groundwater, and that the 1985 tests showed organic compounds normally associated with municipal landfills in 1984 tests of groundwater.

*10 Kalama replies that based on the language of the policy and uncontroverted facts, the elements for coverage are met. Kalama notes that the only elements that II disputes relate to the element of an "occurrence" and to the speculative nature of Kalama's liability, and that II reasserts arguments on exhaustion and justiciability.

The standards for summary judgment have been previously set forth in the memorandum of opinion on Kalama Site. The Washington courts have frequently cited the U.S. Supreme Court's decision in *Celotex v. Catrett*, 477 U.S. 319, 106 S.Ct. 2548, 91 L.Ed.2d 265 (1986), for the proposition that there must be genuine issues of material fact, not merely a "scintilla of evidence" in order to avoid summary judgment.

The earlier decisions relating to exhaustion and justiciability address some arguments presented here. Kalama is under an order as a potentially liable party on a site listed on the National Priorities List. Kalama is liable now pursuant to an agreement for Phase I of the clean-up process and is ordered by the DOE to participate in the remedial investigation and feasibility study. There is no requirement that Kalama's wastes cause particular damage; it is sufficient if Kalama sent waste to the site of a type which has been found to have caused property damage to that site. There is no requirement that groundwater contamination occur; since this is non-owned property, it is sufficient that the soil was damaged, a fact which is uncontroverted. The only disputes relate to whether the Pasco site pollution constitutes an occurrence (whether the property damage was expected and intended) and whether the damages for which Kalama is liable are speculative. The bulk of II's "expected and intended" argument has been that, based on Kalama's experiences with on-site, approved wastewater disposal at

Not Reported in P.2d, 1995 WL 17015061 (Wash.Super.)
 (Cite as: 1995 WL 17015061 (Wash.Super.))

Beaufort and the accidents which had occurred at the Kalama site, the company must have known that property damage would occur at the Pasco site. II also cited to newspaper articles from 1979 through 1981 including references to drummed wastes at disposal sites in support of this position. Although this determination appears closer than in the determination with respect to the Kalama site, there nevertheless is a genuine issue of material fact with respect to whether the pollution was "unexpected and unintended," that is, whether Kalama "must have known" of the pollution during II's policy period.

The only other disputes relate to the argument regarding speculation: will Kalama be liable (which is determined by the exhaustion/aggregation and justiciability decisions) and the cost of cleanup. Because of the earlier decisions relating to exhaustion and aggregation, the amount of the costs is not an issue. As previously noted, Dr. Steiner's testimony does not controvert Mr. Lang's testimony regarding the government's requirement of cleanup (nor does it controvert his testimony regarding cost); rather, his testimony is limited to the opinion that the site will clean itself up and does not address whether the DOE will require cleanup. While the actual extent of the damages and Kalama's share of such cost remain unresolved at this time, nevertheless on this record, the matter is justiciable.^{FN16}

FN16. The drummed waste was sent to Pasco in 1973 and 1974. At the outset of this process involving cleanup, Kalama apparently didn't believe it had even sent waste to Pasco. Kalama purchased Beaufort in 1976, the articles on waste sites were in 1979 through 1981 and the accidents and continuous and repeated exposure to conditions at Kalama range from 1977 to 1983.

*11 Because of the outstanding issues relating to whether the damage at Pasco was expected or intended, Kalama's motion for partial summary judgment to establish indemnity coverage at the Pasco

site is denied.

KALAMA'S MOTION FOR SUMMARY JUDGMENT ON DUTY TO DEFEND (# 1)

Kalama moves for partial summary judgment against defendant Industrial Indemnity that II has a duty to defend Kalama under II's policy No. JU 839-7860. Kalama asserts that II's excess coverage policy covers two environmental claims:

1. The claim by the U.S. Environmental Protection Agency relating to the Kalama Washington facility;
2. The claim by the Washington State Department of Ecology relating to the Pasco Sanitary Landfill.

Kalama asserts its settlement on May 19, 1994 with Allianz Insurance, the issuer of a one million dollar underlying primary coverage policy, triggered II's excess coverage policy under II's exhaustion prong. Kalama further asserts that Allianz's duty to defend (determined by prior court order dated August 26, 1992) then passed to II and that the same principles which governed Allianz's duty to defend also apply to II's duty to defend. Plaintiff asserts that II has breached its duty to defend, and that II now owes to plaintiff all defense costs incurred by plaintiff since May 19, 1994, as well as all future defense costs relating to the Kalama and Pasco site claims. Kalama asserts that the II policy does not define "exhaustion" and that word must therefore be construed in the light most favorable to Kalama, that the DOE claim creates a potential for coverage at the Pasco site, that no genuine issue of material fact exists regarding exhaustion, and that II has breached its duty to defend Kalama with respect to the Pasco site. Kalama asserts that the investigation at the Pasco site is currently in Phase II, in which remediation measures will be developed for approval and proportionate liability will be assessed among the potentially liable parties, which Kalama asserts is a critical phase, during which II is obligated to defend Kalama's interest to minimize cleanup costs.

Not Reported in P.2d, 1995 WL 17015061 (Wash.Super.)
(Cite as: 1995 WL 17015061 (Wash.Super.))

II responds that facts remain in dispute regarding whether the underlying primary insurance is exhausted, asserting that Judge Bridge's order of November 30, 1994, referred to outstanding material questions of fact regarding exhaustion. II further asserts that plaintiff did not notify it of the settlement with Allianz within thirty days of such settlement. II asserts that Allianz issued six consecutive policies and that Kalama did not exhaust all of Allianz's primary policies, citing to Judge Bridge's reference to "other insurance collectible by the insured."

Kalama replies that the present record is more complete than that on which Judge Bridge relied in November of 1994 and that II does not contest that facts exist which raise the potential for coverage. With respect to notice, Kalama asserts that II attended the settlement conference at which the settlement with Allianz was reached, and further, even assuming II's late notice claim was valid, II cannot prove it is prejudiced by such late notice. Kalama asserts that Judge Bridge rejected II's claim that other policies in other policy periods must be exhausted, and that the issue of whether this one underlying Allianz policy had been exhausted was not before Judge Bridge.

*12 "Insurers have a duty to defend any complaint alleging facts which, if proven, would render the insurer liable for indemnification of the Insured." *Viking Ins. Co. v. Hill*, 57 Wash.App. 341, 346, 787 P.2d 1385 (1990). The duty to defend here would arise if Kalama faces a "suit" arising out of alleged releases or continuing events during the 1982/1983 policy period which are potential occurrences giving rise to claims for damages potentially covered under the II policy. The excess coverage policy in this case has several pertinent provisions relating to when II's duty to defend arises. They include Section II, Defense Settlement, which requires II to "defend any suit" which is not covered by the "underlying policies" (here, only Allianz) but which is covered by the terms and conditions of the II policy, even if the suit is "groundless, false or

fraudulent." In Section V, Retained Limit, II agreed that if the underlying insurance (here, Allianz) was exhausted, then II's policy would "continue in force as underlying insurance." In addition, Condition E, Assistance and Cooperation, provides that if the aggregate limits of the underlying insurance are exhausted, II does not have to "assume charge of the settlement or the defense" unless it falls within Section II, Defense Settlement or Section V, Retained Limit. In paragraph J, regarding underlying insurance, II agreed to defend any claim or proceeding against Kalama arising from the same occurrence which exhausted the primary coverage. Kalama has exhausted the underlying policy as noted previously: (1) by its allocation of one million dollars of the Allianz settlement proceeds to the Kalama site; (2) by the Garfield site settlement; and potentially (3) by its payment of over two million dollars on this aggregating policy at Kalama for some period of time. (This payment includes investigative costs (which may be both defense and indemnity expenditures according to Judge Bridge's earlier order with another insurer) as well as interim corrective measures which are clearly indemnity payments.) The RCRA complaint by the U.S. Environmental Protection Agency for the Kalama site is a "suit." The pleadings, including the Order by the Washington State Department of Ecology for the Pasco site, likewise constitute a "suit." As has been found in earlier decisions, the releases during the policy period and the potential continuing property damage from earlier releases constitute potential occurrences at the Kalama site. The un rebutted continuing property damage (soil, as well as potentially groundwater) at Pasco constitutes a potential occurrence. The Kalama site RCRA claim and the Pasco site DOE claim are claims for damages and investigative expenses as well as interim corrective measures have been undertaken; at Pasco, the required corrective measures and investigation of the nature and extent of contamination arising out of releases there to determine corrective measures are sufficient to constitute potential damages. Because the underlying policy is an aggregating policy which is exhausted, and because there is the potential for

Not Reported in P.2d, 1995 WL 17015061 (Wash.Super.)
(Cite as: 1995 WL 17015061 (Wash.Super.))

coverage by II due to allegations of occurrences in the II policy year giving rise to an obligation by Kalama to pay damages, II has a duty to defend for both sites.^{FN17}

FN17. There is no duty for Kalama to exhaust all Allianz policies; rather there is only an obligation to exhaust the Allianz policy underlying II in this 1982/1983 policy year.

*13 II asserts that it has not received proper written notice of the exhaustion of the underlying policy, thus implicating coverage here. Mr. Thonn did acknowledge in oral argument that he “would assume that that could be cured but it hasn’t been cured to date.” Mr. Hale argues that he in fact gave actual notice to II’s attorneys, face to face, within minutes of settling with Allianz, and that pleadings constitute “written notice” if his contact with counsel is technically insufficient. Moreover, he argues that prejudice must be shown and none is argued. It appears that Kalama has substantially complied with the notice provision by giving almost simultaneous notification in person of the settlement; the pleadings also provide the writing. In any event, no prejudice has been asserted from the lack of some specific notification document.

The potential for coverage exists as to both sites and II’s duty to defend under its policy has arisen.

Wash.Super.,1995.
Kalama Chemical, Inc. v. Allianz Ins. Co.
Not Reported in P.2d, 1995 WL 17015061
(Wash.Super.)

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UNITED STATES DISTRICT COURT
WESTERN DISTRICT OF WASHINGTON
AT SEATTLE

NORTHWEST STEEL ROLLING MILLS,
INC., a Washington corporation,

Plaintiff,

v.

FIREMAN'S FUND INSURANCE COMPANY,
a foreign insurance company;
et al.,

Defendants.

NO. C86-376WD

ORDER ON PLAINTIFF'S
MOTION FOR DETERMINA-
TION THAT PROPOSED
SETTLEMENT EXHAUSTS
POLICIES OF DEFENDANT
FIREMAN'S FUND

Plaintiff has moved for an order determining that the proposed settlement between plaintiff and defendants Fireman's Fund Insurance Company and American Insurance Company (collectively "Fireman's Fund") exhausts all coverage under said defendants' policies and triggers certain obligations of the excess insurance companies. The motion has been stricken as to one excess carrier, Granite State Insurance Company, with whom plaintiff has settled. The question remains for decision as to defendants Continental Casualty Company ("Continental") and Washington Insurance Guaranty Association ("WIGA"). All materials filed in support of or opposition to the motion have been fully considered.

The Fireman's Fund policy language states that "the Company shall not be obligated to pay any claim or judgment or to defend any suit after the applicable limits of the Company's

1 liability have been exhausted by payment of judgments or settlements." Thus, the excess carriers
2 had notice, by the explicit language of the policies, that "settlements" could work to exhaust
3 Fireman's Fund's liability.

4 The settlement in question provides that Fireman's Fund will pay a total of \$1,900,000 on
5 aggregate policy limits of \$2,150,000. The excess carriers will have the benefit of the full
6 \$2,150,000 policy coverage level -- plaintiff will absorb the \$250,000 difference. The plaintiff in fact
7 has paid \$2,165,905 on the claims that are the subject of this suit. There is nothing to suggest
8 that plaintiff's settlement with Fireman's Fund is other than a good faith compromise of the
9 differences between those parties.

10 Continental and WIGA argue that the primary carrier must pay the full aggregate coverage
11 amounts before the limits can be deemed "exhausted." But they have failed to show any prejudice
12 to them if the insured settles with the policy carrier for an amount below the policy limits, and
13 absorbs the difference, in a disputed coverage case. Whether the entire \$2,150,000 is paid by the
14 primary carrier, or \$1,900,000 by that carrier and \$250,000 by the insured, the result for the excess
15 carrier is identical.

16 In point is Stargatt v. Casualty Co. of N.Y., 67 F.R.D. 689 (D. Del. 1975), where the insured
17 settled for a percentage of the primary carrier's limits considerably lower than that involved here.
18 The court there held that "[t]he plain meaning of 'exhausted' is 'entirely used up,' and the
19 coverage of the primary policy has been entirely used up by the settlement." Id. at 690. See also
20 Zelg v. Massachusetts Bonding & Ins. Co., 23 F.2d 665 (2d Cir. 1928).

21 There is no Ninth Circuit or Washington case exactly in point on the issue of "exhaustion"
22 of policy limits in the primary/excess carrier context, but Elovich v. Nationwide Ins. Co. of N.
23 America, 104 W.2d 543, 707 P.2d 1319 (1986), is comparable. In that case the Washington
24 Supreme Court, interpreting the state's underinsured motorist statute, held that a settlement for
25 less than the policy limits triggered the coverage of the UIM excess carrier.
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The holding of Stargatt, supra, fits the language of the policies and supports two other important considerations: the desirability of settlement (which would be made more difficult by a contrary holding), and the construction of insurance policy provisions, if ambiguous, in favor of the insured. See Britton v. Safeco Ins. Co., 104 Wn.2d 518, 528, 707 P.2d 125, 132 (1985).

WIGA's arguments that the motion calls for an advisory opinion, and that the issue is not raised in the pretrial order, are not meritorious. The motion presents a genuine controversy that is ripe for decision. It arises from a settlement reached after the pretrial order was written.

For the reasons stated, the motion is granted, and the court rules that the settlement between plaintiff and Fireman's Fund exhausts the coverage under the primary policies in question and triggers the obligations of Continental and WIGA, as excess carriers, to defend plaintiff under the terms of their policies that apply to the same years as the Fireman's Fund Insurance Company and American Insurance Company policies.

The clerk is directed to send copies of this order to all counsel of record.

Dated: January 16, 1991.


William L. Dwyer
United States District Judge

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(Cite as: 2006 WL 1982789 (S.D.N.Y.))



Only the Westlaw citation is currently available.

United States District Court,
S.D. New York.

John S. PEREIRA, Trustee of Trace International Holdings, Inc., in his capacity as judgment creditor in *Pereira v. Cogan, et al.*, 00 Civ. 619(RWS), Plaintiff,
v.

NATIONAL UNION FIRE INSURANCE COMPANY OF PITTSBURGH, PA., Gulf Insurance Company, and Executive Risk Indemnity Inc. Defendants.

No. 04 Civ. 1134(LTS).
July 12, 2006.

Leboeuf, Lamb, Greene & Macrae, LLP, By: John P. Campo, New York, NY, for Plaintiff.

D'Amato & Lynch, By: Ronald H. Alenstein, New York, NY, for Defendant National Union Fire Insurance Company of Pittsburgh, PA.

Drinker, Biddle & Reath, LLP, By: Kathleen A. Donohue, New York, NY, for Defendant Gulf Insurance Company.

Kornstein, Veisz, Wexler & Pollard, LLP, By: Marvin Wexler, New York, NY, for Defendant Executive Risk Indemnity Inc.

OPINION AND ORDER

SWAIN, J.

*1 Plaintiff John S. Pereira (the "Trustee"), as Trustee of Trace International Holdings, Inc. ("Trace"), brings this action to collect insurance proceeds allegedly due to him by virtue of a judgment entered against Defendants' insureds by this Court in *Pereira v. Cogan*, 00 Civ. 619(RWS) (the "Underlying Action"). Defendant insurance companies National Union Fire Insurance Co. of Pittsburgh ("NUFIC"), Gulf Insurance Co. ("Gulf"), Executive Risk Indemnity, Inc. ("Executive"), (collectively "Defendants") move, on a number of grounds, to dismiss the Complaint pursuant

to Federal Rule of Civil Procedure 12(b)(6). Andrea Farace ("Farace") and Phillip Smith ("Smith") move to intervene in the action and for a preliminary injunction. The Court has jurisdiction of the instant action pursuant to 28 U.S.C. § 1334(b).

The Court has considered carefully the parties' oral and written arguments. For the following reasons, the Court grants in part and denies in part Gulf's and Executive's motion to dismiss, denies, in its entirety, NUFIC's motion to dismiss, and grants Farace's and Smith's motion for intervention but denies their application for a preliminary injunction.

BACKGROUND

The following facts alleged in the Complaint are taken as true for the purposes of the instant motions to dismiss the complaint for failure to state a claim. On or about July 21, 1999, Trace filed a petition for reorganization under Chapter 11 of the Bankruptcy Code in the United States Bankruptcy Court for the Southern District of New York. (Compl.¶ 10.) As part of the bankruptcy case, an Official Committee of Unsecured Creditors (the "Creditors Committee") was formed. On or about October 18, 1999, the Creditors Committee, with permission of the bankruptcy court, commenced the Underlying Action as an adversary proceeding on behalf of the Trace estate against current and former officers and directors of Trace. (Id.¶¶ 11-12.) In the adversary proceeding, the Creditors Committee alleged that the officers and directors had violated their fiduciary duties to Trace and sought monetary relief for those violations. (Id.¶ 13.)

Trace had purchased and maintained directors and officers ("D & O") liability insurance from the Defendants and Reliance National Company ("Reliance").^{FN1} (Id.¶ 14.) The Defendants and Reliance provided D & O coverage to indemnify the directors and officers from liabilities and reasonable litigation expenses incurred in connection with the adversary proceeding in the following manner: NUFIC provided the primary layer up to \$10 million; Reliance provided the first excess layer above \$10 million and up to \$20 million; Gulf provided

Not Reported in F.Supp.2d, 2006 WL 1982789 (S.D.N.Y.)
(Cite as: 2006 WL 1982789 (S.D.N.Y.))

the second excess layer above \$20 million and up to \$30 million; Executive provided the third excess layer above \$30 million and up to \$40 million; Reliance provided a fourth and final excess layer above \$40 million and up to \$50 million. (Id.¶¶ 14-19.)

FN1. Reliance is not named as a Defendant in this action because it is currently in liquidation. (Compl.¶ 29.)

On the motion of certain Defendants, this Court (Sweet, J.) withdrew the reference of the Underlying Action from the bankruptcy court. (Id.¶¶ 20-21.) On or about January 24, 2000, the bankruptcy case was converted from a Chapter 11 reorganization to a liquidation under Chapter 7 of the Bankruptcy Code, and the Trustee was appointed as trustee for Trace's estate. (Id.¶ 22.) The

Marshall S. Cogan ("Cogan")	\$44,374,824.16
Andrea Farace ("Farace")	\$27,308,841.12
Frederick Marcus ("Marcus")	\$37,360,290.70
Robert H. Nelson ("Nelson")	\$38,321,643.30
Philip Smith ("Smith")	\$21,392,974.45
Karl Winters ("Winters")	\$21,350,774.60 ²

FN2. On June 30, 2005, the Judgment was vacated as against Frederick Marcus, Andrea Farace, and Philip Smith and the matter was remanded for a new trial as to those three defendants. *See Pereira v. Farace*, 413 F.3d 330 (2d Cir.2005). In a letter dated July 20, 2005, Defendant Executive argues that, by virtue of this Second Circuit decision, the entire case is rendered moot. While the Second Circuit's decision moots the claims in this action for indemnity as to the now-vacated judgments against defendants Marcus, Farace and Smith, it does not affect the underlying judgment entered against the non-appealing and the settling defendants in the Underlying Action, and the case is not moot as to the Trustee's claims for payment of those elements of the Judgment.

(Id.¶ 25.) The Judgment is exclusive of pre-judgment interest from June 15, 2003, through June 25, 2003, and post-judgment interest. (Id.¶ 26.) On July 8, 2003, the Trustee served notice of the Judgment on Defendants and Reliance, pursuant to Section 3420(a)(2) of the New York Insurance Law. (Id.¶ 27.) The Judgment exceeded the limits of each Defendant's respective insurance coverage.^{FN3} (Id.¶ 30.) At the time the Complaint was written, Defendants had not paid any portion of the Judgment. (Id.¶ 28.)

Trustee, after being substituted for the Creditors Committee as the plaintiff in the Underlying Action, amended the complaint and prosecuted the litigation through trial and judgment. (Id.¶ 23.) In connection with the Underlying Action, NUFIC advanced some or all of the legal fees for the officers and directors. (Id.¶ 24.) The Trustee is unaware of these amounts and whether they were reasonable or appropriate under the NUFIC D & O insurance policy. (Id.)

*2 On June 25, 2003, after trial, this Court (Sweet, J.) entered judgment in the Underlying Action ("the Judgment") against the following directors and officers in the following amounts:

FN3. The Judgment exceeds Defendants' respective insurance coverage layers even after excluding the amounts assessed against Frederick Marcus, Andrea Farace, and Phillips Smith.

The Trustee alleges that he is entitled to recover the full extent of coverage under the insurance policies. (Id.¶ 31.) As part of his claim for relief, the Trustee also seeks proof by NUFIC that its payment of defense costs to the Trace officers and directors in connection with the Underlying Action was appropriate and reasonable. (Id.¶ 24.)

Not Reported in F.Supp.2d, 2006 WL 1982789 (S.D.N.Y.)
(Cite as: 2006 WL 1982789 (S.D.N.Y.))

DISCUSSION

In evaluating a motion to dismiss a complaint pursuant to Rule 12(b)(6), the Court must take as true the facts alleged in the plaintiff's complaint and draw all reasonable inferences in his favor. *W. Mohegan Tribe & Nation v. Orange County*, 395 F.3d 18, 20 (2d Cir.2004); *Hernandez v. Coughlin*, 18 F.3d 133, 136 (2d Cir.1994). The Court must not dismiss a complaint "unless it appears beyond doubt that the plaintiff can prove no set of facts in support of his claim which would entitle him to relief." *Conley v. Gibson*, 355 U.S. 41, 45-46 (1957).

On a motion to dismiss, the court may consider "any written instrument attached to the complaint as an exhibit or incorporated in the complaint by reference, as well as documents upon which the complaint relies and which are integral to the complaint." *Subaru Distribs. Corp. v. Subaru of Am., Inc.*, 425 F.3d 119, 122 (2d Cir.2005). This includes documents "that the plaintiff [] either possessed or knew about and upon which [it] relied in bringing the suit." *Rothman v. Gregor*, 220 F.3d 81, 88-89 (2d Cir.2000). In his Complaint, the Trustee refers to the D & O liability insurance purchased from Defendants for the Trace officers and directors. (Compl.¶ 14.) The Court finds that the relevant insurance policies of Defendants are integral to the Complaint and that Plaintiff knew about these policies and relied on them in bringing the instant action. The Court will therefore consider these policies in making its determination on the motions to dismiss. (See Lisa B. Lance Aff. in Supp. of Executive's Mot. to Dismiss, "Lance Aff.," Exs. A, "NUFIC Policy," C, "Gulf Policy," D, "Executive Policy.") The Court will also take judicial notice of the pleadings, orders, and judgments in prior litigation related to this instant case. See *Patrowicz v. Transamerica Homefirst, Inc.*, 359 F.Supp.2d 140, 144 (2d Cir.2005).

Motions to Dismiss

*3 Defendants Gulf and Executive make their motion to dismiss on five grounds, each of which they contend applies equally to both insurers. Gulf's brief addresses two of the grounds and Executive's brief addresses the other three. Defendant NUFIC makes its

own motion on independent grounds. The Court will first address Gulf's and Executive's motion to dismiss and then address NUFIC's motion to dismiss.

Gulf's/Executive's Motion to Dismiss

(1) Nature of Judgment Against Trace Officers and Directors

Gulf argues that the complaint should be dismissed, contending that the damages awarded against the Trace officers and directors in the prior litigation are not recoverable as a matter of law under its insurance policy because the underlying claims and judgment were equitable in nature. Gulf cites the New York law^{FN4} principle that, as a matter of public policy, "[o]ne may not insure against ... the orders of a court sitting in equity." (See Gulf's Reply in support of Mot. to Dismiss at 4 (citing, e.g., *Debruyne v. Clay*, No. 94 Civ. 4704(JSM), 1999 WL 782481 at *14 (S.D.N.Y. Oct. 1, 1999)). However, an examination of the relevant authorities (including those cited by Gulf) reveals that the cited principle does not preclude the claims asserted in this action. The "equitable" judgments as to which insurance coverage is precluded are ones involving the restitution of ill-gotten gains or the return of property wrongfully in the possession of the defendant. See *Reliance Group Holdings, Inc. v. Nat. Union Fire Ins. Co.*, 594 N.Y.S.2d 20 (N.Y.App.Div.1993). *Reliance*, a decision upon which the *Debruyne* court relied, held that an insurance company could not insure "against the risk of being ordered to return money or property that has been wrongfully acquired." *Reliance Group Holdings Inc.*, 594 N.Y.S at 24. In that case, the corporation which had bought the D & O insurance was also in possession of the proceeds of illegal activity and had benefitted from that activity and therefore could not recover its indemnification costs under the policy. *Id.* at 25. See also *Level 3 Commc'ns, Inc. v. Fed. Ins. Co.*, 272 F.3d 908, 910 (7th Cir.2001) (finding that an insurance company does not insure against the restoration of an ill-gotten gain).

FN4. New York substantive law applies as most of the parties have their principal place of business in New York and the prior litigation in

Not Reported in F.Supp.2d, 2006 WL 1982789 (S.D.N.Y.)
(Cite as: 2006 WL 1982789 (S.D.N.Y.))

this case involved events principally occurring in New York. *See Wells Fargo Asia Ltd. v. Citibank, N.A.*, 936 F.2d 723, 726 (2d Cir.1991) (finding that, under federal law, the substantive law of the jurisdiction having the greatest interest in the litigation will be applied). The parties also do not object to the application of New York law.

Here, while Judge Sweet found that the fiduciary claims against the officers and directors and the subsequent monetary relief were equitable in nature, he noted that only Cogan personally possessed any of the disputed funds. *See Pereira v. Cogan*, 294 B.R. 449, 544-46 (S.D.N.Y.2003), *vacated and remanded*, 413 F.3d 330 (2d Cir.2005).^{FN5} Because the Gulf and Executive policies do not specifically exclude “equitable” claims to any extent greater than would be the case under the general principles of New York law discussed above,^{FN6} the insurers’ motion on this ground is granted only to the extent the Trustee’s claims seek coverage for the portions of the Judgment representing the return of monies wrongfully obtained by Cogan and Nelson. This result is, moreover, consistent with the Second Circuit’s determination in *Pereira v. Farace*, 413 F.3d 330, 339 (2d Cir.2005), on the appeal of Judge Sweet’s decision, which rejected the notion that Plaintiff’s fiduciary claims against the appealing defendants were equitable in nature.

FN5. Nelson personally received a small part of the monies upon which his liability under the Judgment is predicated, including loans from Trace in the amount of \$600,000. *See Cogan*, 294 B.R. at 494.

FN6. Under New York law, “exclusionary clauses in insurance contracts are construed strictly to give the interpretation most beneficial to the insured.... An insurer claiming that a loss is excluded by a policy term has the burden of demonstrating that the term expressly excludes the loss-exclusions are not extended by interpretation or implication.” *In re Donald Sheldon & Co., Inc.*, 186 B.R. 364, 369 (S.D.N.Y.1995). Gulf’s insurance policy incor-

porates the terms and conditions of the primary policy issued by NUFIC subject to any additional terms in its own policy. (*See Lance Aff. Ex. C, § I A-C.*) The NUFIC Policy provides that it will “pay the Loss of each and every Director or Officer of the Company arising from a Claim first made against the Directors or Officers.” (*Id.*, Ex. A, § 1.) The policy defines “Loss” broadly to include “damages, judgments, settlements....” (*Id.*, Ex. A, § 2(g).) “Claim” is defined as “a written demand for monetary or non-monetary relief.” (*Id.*, Ex. A, § 2(a).) Endorsement 7, which also deals with claims, defines “claim” as “a written demand for monetary damages or equitable relief.” (*Id.*, Ex. A, Endorsement 7 at 2.) Executive’s Policy also incorporates the definitions and claims of the underlying insurance, which would include the NUFIC policy (*See Lance Aff. Ex. D, Item 4, “Schedule of Underlying Insurance,” and § IV.*)

(2) Exclusionary Argument based on “Prior and Pending Litigation” Clause of Policy

*4 Gulf argues that its policy excludes coverage of the Judgment against the Trace directors and officers because of a prior litigation exclusionary clause.

In making its argument, Gulf relies on Endorsement No. 1 to its policy, which reads in its entirety,

In consideration of the payment of premium, it is hereby understood and agreed that the Insurer shall not be liable to make any payment for Loss in connection with any Claim made against any of the Insureds based upon, arising out of, directly or indirectly resulting from, in consequence of, or in any way involving any Claim, demand, cause of action, legal or quasi-legal proceeding or administrative proceeding pending, or orders, decrees or judgments entered, against the Directors and Officers or the Insured Company on or prior to 07-06-1998, or any fact, circumstance or situation underlying or alleged therein.

(Lance Aff., Ex. C, Endorsement No. 1.)^{FN7}

Not Reported in F.Supp.2d, 2006 WL 1982789 (S.D.N.Y.)
(Cite as: 2006 WL 1982789 (S.D.N.Y.))

FN7. Executive's policy has a similar prior litigation exclusionary provision. (See Lance Aff. Ex. D, Endorsement No. 3.)

Under New York law, "an insurance contract is interpreted to give effect to the intent of the parties as expressed in the clear language of the contract." *Vill. of Sylvan Beach v. Travelers Indem. Co.*, 55 F.3d 114, 115 (2d Cir.1995). In this respect, "[w]hen a contract is not ambiguous, the court should assign the plain and ordinary meaning to each term and interpret the contract without the aid of extrinsic evidence." *Zunenshine v. Executive Risk Indem., Inc.*, No. 97 Civ. 5525(MBM), 1998 WL 483475, at *3 (S.D.N.Y. Aug. 17, 1998) (citations omitted). In the context of insurance agreements, "the insurer generally bears the burden of proving that the claim falls within the scope of an exclusion.... 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." *Vill. of Sylvan Beach*, 55 F.3d at 115 (citations omitted). The "insurer may rely on the facts as alleged in the complaints to demonstrate that an exclusion applies." *Zunenshine*, 1998 WL 483475, at *4 (citations omitted). In determining whether a prior litigation clause excludes coverage, courts "have focused on whether there was a sufficient factual nexus between the two lawsuits." *Id.* (citations omitted). "The coverage does not depend upon the pleader's art but rather upon 'underlying' facts. *Id.*

Gulf argues that the Judgment for which the Trustee here seeks coverage is excluded from the scope of the insurance contracts by reason of the pendency of a civil complaint, captioned *Anthony Barbuto v. Trace Int'l Holdings, Inc.*, No. 15175, ("Barbuto"), in the Court of Chancery, New Castle County, Delaware. (See Decl. of Blair Nespole in Supp. of Gulf's Mot. to Dismiss, "Nespole Decl.," Ex. G.), at the time the relevant insurance documents were issued.^{FN8} A review of the *Barbuto* complaint and comparison of it with the complaint and amended complaints in the Underlying Action reveals a substantial, but not perfect, overlap of specific factual claims of improper declaration and pay-

ment of dividends, excessive compensation, breach of fiduciary oversight duties and other matters. While it is clear that certain of the claims would be excluded under the plain language of the prior litigation provisions of the insurance contracts, it cannot, however, be said that there are no circumstances under which the Trustee would be able to prevail against a claim that all of the factual circumstances underlying the Judgment "ar[ose] [] out of, ... in consequence of, or in any way involv[ed]" the factual circumstances underlying the claims asserted in *Barbuto*. Defendants' motion to dismiss the complaint is, accordingly denied insofar as it is premised on the prior litigation exclusion provisions of the insurance contracts.

FN8. The Court takes judicial notice of the *Barbuto* complaint as a fact "capable of accurate and ready determination by resort to sources whose accuracy cannot be reasonably questioned." Fed.R.Evid. 201(b)(2) (West 2005). See *Bensalem Township v. Int'l Surplus Lines Ins. Co.*, No. 91 Civ. 5315, 1992 WL 142024, at *2 (E.D. Pa. June 15, 1992) (in context of prior litigation exclusion argument, court took judicial notice under Federal Rule of Evidence 201(b)(2) of state court complaint.), *rev'd on other grounds*, 38 F.3d 1303 (3d Cir.1994). Furthermore, from his motion papers, it is clear that Plaintiff is aware of the this complaint and its content and does not appear to object to its consideration in the pending motion to dismiss. (See Pl's Mem. in Opp. to Mot. to Dismiss by Gulf and Executive, "Opp. to Gulf and Executive," at 20-22.)

(3) Representation Made in Application for Insurance Policies

*5 Executive argues that its and Gulf's policies are void as matter of law as to all Trace officers and directors because Cogan, who was then the Chief Executive Officer of Trace, signed a false representation concerning potential liability claims against these officers and directors in connection with the issuance of the policies. Under New York law, an insured's policy is void if the insured made misrepresentations to the company and

Not Reported in F.Supp.2d, 2006 WL 1982789 (S.D.N.Y.)
(Cite as: 2006 WL 1982789 (S.D.N.Y.))

this misrepresentation was material to the issuance of the policy. See *Chicago Ins. Co. v. Kreitzer & Vogelmann*, 265 F.Supp.2d 335, 342-43 (S.D.N.Y.2003). "The failure to disclose is as much a misrepresentation as a false affirmative statement." *Id.* at 343. Moreover, "[e]ven if a misrepresentation was made innocently or without the intent to deceive, it is sufficient to void the policy if it is material." *Id.* (citing *Kulikowski v. Roslyn Sav. Bank*, 503 N.Y.S.2d 863, 854 (N.Y.App. Div 1986)). A misrepresentation is material if the insurer can show "that the misrepresentation induced it to accept an application that it might otherwise have refused." *Id.* at 343. Further, a material misrepresentation can void the policies of co-insured employees of a corporation whose president made the misrepresentation in the warranty. See *INA Underwriters Ins. Co. v. D.H. Forde & Co., P.C.*, 630 F.Supp. 76, 77 (W.D.N.Y.1985).

Here, Cogan delivered representations, dated August 18, 1998, and August 7, 1998, to Gulf and Executive respectively, in connection with applications for excess insurance coverage. Both statements read, in pertinent part, "[t]his will confirm that we are not aware of any acts, errors or omissions which could give rise to a claim as respects the [relevant] layer of our Directors and Officers Liability program." (See *Lance Aff.*, Exs. C, G.) Relying on Judge Sweet's determinations concerning longstanding breaches of fiduciary duty and excessive compensation dating back to 1993 as well as the pendency of the *Barbuto* action at the time, Executive contends that there can be no dispute that Cogan's representations concerning the possibility of claims that could give rise to liability under the policies were false when made. (See Executive's Mot. to Dismiss at 9-15.) However, at this early stage, there is a question of fact as to whether Cogan made a misrepresentation. Even under the policies' broad definition of "Claim" as any written demand for relief,^{FN9} the Court cannot conclude on the current record that Cogan was aware of the existence of any acts that would give rise to claims that would reach the excess coverage in the Gulf and Executive policies.^{FN10} The *Barbuto* complaint does not specify an amount of damages as part of its claim for relief.^{FN11} So, even if the Court imputes knowledge of the *Barbuto* litigation to Cogan, it is possible that he

may have believed that any judgment from that action could not have reached Gulf's or Executive's excess coverage. Further, any determination after the fact by Judge Sweet as to Cogan's breaches of fiduciary duty and excessive compensation is not dispositive of the question as to whether Cogan made a misrepresentation when he signed the statements in 1998.

FN9. See *supra* note 6.

FN10. It is important to note here that the language of the representations focuses on the signatory's state of mind ("we are not aware of any facts") rather than on the objective state of affairs (e.g. "There are no acts"). Compare with *Chicago Ins. Co.*, 265 F.Supp.2d at 339 (policy simply asked whether any lawyer had been the subject of reprimand or disciplinary action not whether signatory was aware of such fact).

FN11. Plaintiff contends that the litigation involved damages in the amount of \$1 million or \$2 million dollars at most. (See Oral Argument Tr. at 44.)

*6 Even if it were indisputable that Cogan made a misrepresentation, there would also be a question of fact as to whether this misrepresentation was material. Executive recognizes that materiality is generally an issue of fact but argues that this case is an instance "where the facts misrepresented are so serious that one would know them to be of substantial concern to the insurers, [such that] they may be found to be material as a matter of law." (Executive's Mot. to Dismiss at 9, quoting *Ris v. Nat'l Union Fire Ins. Co.*, No. 86 Civ. 9718(RO), 1989 WL 76199, at *2 (S.D.N.Y. July 6, 1989).) However, on the current record, the Court cannot conclude as a matter of law that the companies would not have provided coverage upon disclosure of this misrepresentation. Plaintiff argues that the *Barbuto* litigation was already a matter of public record prior to the policies being issued and that Gulf, specifically, was sent documents which disclosed the pendency of this action. (See Oral Argument Tr. at 38; Pl.'s Opp'n. to Gulf's and Executive's Mot. to Dismiss at 11.) It may be, then, that the companies decided to provide coverage despite the exist-

Not Reported in F.Supp.2d, 2006 WL 1982789 (S.D.N.Y.)
(Cite as: 2006 WL 1982789 (S.D.N.Y.))

ence of that action. This scenario lends support to the hypothesis that the companies, already aware of the possible liabilities, would have provided coverage even if Cogan had not signed the representations. The motion to dismiss is denied insofar as it is premised on the alleged misrepresentation in Cogan's written statements.

(4) Personal Profit Exclusion

Executive argues that a personal profit exclusion in the NUFIC policy ^{FN12} excludes coverage of the money damages sought by Plaintiff. (Executive's Mot. to Dismiss at 19-21.) The language reads,

FN12. Both the Gulf and Executive policies incorporate the terms of the NUFIC policy. *See supra* note 6.

The Insurer shall not be liable to make any payment for Loss in connection with a Claim made against an Insured: (a) arising out of, based upon or attributable to the gaining in fact of any profit or advantage to which an Insured was not legally entitled...

(Lance Aff. Ex. A, § 4(a).) ^{FN13} Executive argues that the quoted language precludes coverage of the Judgment as against Cogan as well as the other officers and directors. Plaintiff concedes that the exclusion may limit coverage attributable to Cogan because he personally profited from his ill gotten gain. Plaintiff contends, however, that the language does not bar coverage of the damages assessed against the other directors and officers. (*See* Pl.'s Opp'n. to Gulf's and Executive's Mot. to Dismiss at 14-16.)

FN13. "Insured" includes any director or officer of Trace. (*See* Lance Aff. Ex. A, § 2(e)(1).)

Executive argues that the plain meaning of the provision supports application of the exclusion to preclude coverage of all defendants because the language excludes any damages against "an" Insured (that is, any Trace director or officer) that arise out of or are attributable to "an" Insured's (that is, any Trace director's or officer's) ill-gotten gain. (*See* Executive's Mot. to Dismiss at 21.) In this instance, the bulk of the damages assessed against the non-Cogan defendants (the "Loss") did re-

late to the ill-gotten gain of an Insured, namely Cogan. ^{FN14} That said, when read in context with the other Section Four provisions, the Court cannot conclude as a matter of law that the language was intended to exclude coverage as to the non-Cogan defendants. Section 4(c) of the NUFIC policy provides that "The Wrongful Act of a Director or Officer shall not be imputed to any other Director or Officer for the purpose of determining the applicability of the foregoing exclusions 4(a) through 4(c)." (Lance Aff. Ex. A, § 4(c).) This appears to render the personal profit exclusion truly personal as to each officer. At the very least, it raises sufficient ambiguity to preclude a determination as a matter of law at this stage that there is no recovery to be derived from the coverage of those officers who did not profit personally. *See In re Donald Sheldon & Co.*, 186 B.R. 364, 369 (Bankr.S.D.N.Y.1995) (on summary judgment motion, exclusion related to personal gain provision not conclusive because language susceptible to multiple interpretations), *aff'd*, 182 F.3d 899 (2d Cir.1999); *Vill. of Sylvan Beach v. Travelers Indem. Co.*, 55 F.3d 114, 115 (2d Cir.1995) ("[t]o negate coverage by virtue of an exclusion," the exclusion must be stated in "clear and unmistakable language").

FN14. It is important to note here, however, that Judge Sweet did not impute Cogan's wrongdoing to the other officers and directors, but found, rather, that those individuals were liable for their own wrongdoing in allowing Cogan to take money and, in the process, damage Trace. *See Pereira v. Cogan*, 294 B.R. 449, 463 (S.D.N.Y.2003).

(5) Exhaustion of Underlying Excess Layers of Coverage

*7 Executive argues that it is not responsible for providing any coverage because the excess layers below have not and will not be exhausted. (Executive's Mot. to Dismiss at 22-24.) Executive points to language in its policy providing that it will supply coverage only after the underlying policies have been exhausted:

The Company shall provide the Insured with insurance excess of the Underlying Insurance ... only after all Underlying Insurance has been exhausted by actual pay-

Not Reported in F.Supp.2d, 2006 WL 1982789 (S.D.N.Y.)
(Cite as: 2006 WL 1982789 (S.D.N.Y.))

ment of claims or losses thereunder.

(Lance Aff. Ex. D, § I (emphasis in original).)

In the event of the depletion of the limits of liability of the Underlying Insurance solely as the result of actual payment of claims or losses thereunder by the applicable insurers, this policy shall ... apply to claims or losses as excess insurance over the amount of insurance remaining under such Underlying Insurance.

(*Id.*, § IV (emphasis in original).)^{FN15} Executive contends that the plain meaning of these provisions is that it does not have to provide any coverage unless and until the underlying insurance policies have been exhausted by actual payment. In this instance, the Complaint alleges that Reliance, the first layer of excess coverage, is in liquidation and therefore unable to pay. Executive argues that, consequently, neither Gulf nor Executive is under any obligation to pay and the Complaint should be dismissed as against them because Reliance's layer will never be exhausted by actual payment. (*See* Executive's Mot. to Dismiss at 22-23.)

FN15. Gulf's policy has a nearly identical provision. (*See* Lance Aff. Ex. C at 2.)

Though Executive's interpretation of the relevant provisions may be reasonable, the Court cannot conclude that it is the only reasonable interpretation. *See In re Donald Sheldon & Co., Inc.*, 186 B.R. at 369. In this connection, the Court notes that the Second Circuit has rejected a similar argument that an insurance policy provision required actual exhaustion of previous layers of insurance as a condition precedent for payment of the excess coverage. *See Zeig v. Mass. Bonding & Ins. Co.*, 23 F.2d 665 (2d Cir.1928). In that case, the pertinent language of the provision read that excess coverage "shall apply and cover only after all other insurance herein referred to shall have been exhausted in the payment of claims to the full amount of the expressed limits of such other insurance." *Id.* at 665. In *Zeig*, the claims against the policies providing coverage below the excess policy floor had been settled for less than the face amount of those policies, and the claim at issue was asserted against the excess insurer only to the extent of the level of liability that was within the scope of

that policy. The court found that interpreting this language to require that the underlying insurance had to be exhausted by actual collection was "harmful to the insured and of no rational advantage to the insurer [and] ought only to be reached when the terms of the contract demand it." *Id.* at 666. The Second Circuit concluded that it could "see nothing in the clause before [it] to require a construction so burdensome to the insured, and must accordingly reject such an interpretation." *Id.* This Court finds that the same reasoning is relevant to this case. Interpreting the policy to excuse the excess insurers from providing coverage within their respective layers on account of the unrelated insolvency of an intermediary insurer would work a similar hardship on the insureds, who have already been deprived of a layer of coverage by the insolvency, and provide a windfall to the excess insurers. Thus, it cannot be said that the excess insurers' interpretation of the policy is the only reasonable one and the motion to dismiss on this ground is denied.

NUFIC's Motion to Dismiss

*8 NUFIC moves to the dismiss the complaint on the grounds that its \$10 million policy limit has already been exhausted by payment of attorney costs in connection with the Underlying Action. Under the terms of its policy, NUFIC's limit of liability is reduced by the amount incurred in legal fees. (*See* NUFIC Mot. to Dismiss at 8-9 .) The policy provides that "[d]efense costs are part of Loss and as such are subject to the Limit of Liability for Loss." (*See* Lance Aff. Ex. A, § 5.) NUFIC submits an affidavit from Elizabeth Wacik, a coverage director for NUFIC, in which she states that the legal bills relating to the Underlying Action exceeded the \$10 million policy limit and that, as a result of these payments, the policy has been exhausted. (*See* Elizabeth Wacik Aff. in Supp. of NUFIC's Mot. to Dismiss.) However, the question of exhaustion is a factual issue that cannot be resolved at this stage. In this connection, the Court notes that the Wacik affidavit is not properly before the Court on the instant motion to dismiss. Accordingly, the Court cannot conclude on the current record that there is no set of facts upon which Plaintiff would prevail against a claim that the NUFIC coverage layer has been exhausted.

Not Reported in F.Supp.2d, 2006 WL 1982789 (S.D.N.Y.)
(Cite as: 2006 WL 1982789 (S.D.N.Y.))

NUFIC also moves to dismiss the portion of the Complaint that seeks proof that its advance of defense costs to the Trace officers and directors in connection with the Underlying Action was appropriate and reasonable. NUFIC argues that the terms of its policy do not give Plaintiff standing to object to the reasonableness of the defense costs. (See NUFIC Mot. to Dismiss at 4-8.) The Court disagrees. The relevant provision of the policy provides that “ ‘Defense Costs’ means reasonable and necessary fees, costs and expenses consented to by the Insurer.” (Lance Aff. Ex. A, § 2(d).) While this language may be read to indicate that the Insurer alone determines whether an expense is reasonable and necessary, and whether it will consent to the payment, this interpretation is not the only reasonable one. See *In re Donald Sheldon & Co.*, 186 B.R. 364, 369 (Bankr.S.D.N.Y.1995). One could also reasonably interpret this language to read that the Insurer must consent to the payment and that it must be objectively reasonable. The Court therefore cannot conclude as a matter of law at this stage that the Trustee does not have standing to question the reasonableness of the payments of defense costs. Accordingly, the Court denies NUFIC's motion to dismiss the portion of the Complaint that seeks proof that the defense costs were reasonable and appropriate.

Motion for Intervention and Preliminary Injunction

Motion for Intervention

Farace and Smith (“the Intervenors”) move to intervene in the instant action by right or, in the alternative, for permission to intervene.

Rule 24(a) permits intervention as of right upon a timely application:

(1) when a statute of the United States confers an unconditional right to intervene; or

*9 (2) when the applicant claims an interest relating to the property or transaction which is the subject of the action and the applicant is so situated that the disposition of the action may as a practical matter impair or impede the applicant's ability to protect that interest, un-

less the applicant's interest is adequately represented by existing parties.

Fed.R.Civ.P. 24(a) (West 2006). The Intervenors do not contend that they have any statutory right to intervene. Instead, they argue that they should be allowed to intervene pursuant to subsection (a)(2). To succeed on a motion under Rule 24(a)(2), an intervenor must “(1) timely file an application, (2) show an interest in the action, (3) demonstrate that the interest may be impaired by the disposition of the action, [and] (4) show that the interest is not protected adequately by the parties to the action.” *Brennan v. N.Y.C. Board of Education*, 260 F.3d 123, 128 (2d Cir.2001) (internal quotations and citation omitted). The Court finds that the Intervenors have met all of the requirements of Rule 24(a)(2).

The Intervenors have an interest in the property which is the subject of the action. A proposed intervenor must show that he has a “direct, substantial, and legally protectable” interest in the action. *Washington Electric Cooperative, Inc. v. Massachusetts Mun. Wholesale Electric Co.*, 922 F.2d 92, 97 (2d Cir.1990). Here, the Intervenors have a direct interest in property that is the subject of the instant action—namely, the insurance proceeds being sought by Plaintiff under Defendants' policies in connection with a judgment against the Trace officer and directors. The Second Circuit vacated the Judgment as against the Intervenors and remanded their case for retrial. The Intervenors allege that, as directors and officers of Trace, they are entitled to payment of their defense costs (both in connection with the first trial and the retrial) and indemnification from any judgment against them under Defendants' insurance policies^{FN16} in connection with a retrial. (See Notice of Mot. for Intervention, Ex. A, “Proposed Intervention Complaint,” ¶¶ 10, 16.).

FN16. The costs and judgment would appear fall under the general category of “Loss” as contained in the policies. See *supra* note 6.

The Court also finds that disposition of the instant action may adversely affect the Intervenors' ability to secure insurance proceeds under Defendants' policies. A finding that Plaintiff is entitled to all remaining pro-

Not Reported in F.Supp.2d, 2006 WL 1982789 (S.D.N.Y.)
(Cite as: 2006 WL 1982789 (S.D.N.Y.))

ceeds under Defendants' policies could prevent the Intervenor from receiving coverage of defense costs and future indemnification for any judgments against them. Similarly, a judgment in favor of Defendants that they do not have any further obligations under the policies would make it difficult for the Intervenor, as beneficiaries of these policies, to recover defense costs and any future indemnification.

The Court finds that the Intervenor's interests are not adequately protected by the current parties to the action. Defendants take the position that they have no further obligations under the policies and Plaintiff only seeks monetary judgment for the estate. Thus, none of the parties advocates for the Intervenor's claims of a right to payment of defense costs and indemnification in connection with the retrial.

*10 Finally, the Court finds that the application for intervention is timely. Courts examine the totality of circumstances in making a determination of timeliness. See *D'Amato v. Deutsche Bank*, 236 F.3d 78, 84 (2d Cir.2001). "Circumstances considered in this determination include: (1) how long the applicant had notice of the interest before [he] made the motion to intervene; (2) prejudice to the existing parties resulting from any delay; (3) prejudice to the applicant if the motion is denied; and (4) any unusual circumstances militating for or against a finding of timeliness." *Id.* (internal quotations omitted). The Court notes that the application for intervention was filed on January 23, 2006, nearly two years after the instant case was filed in this District on February 11, 2004. However, the Second Circuit decision reversing the judgment in the Underlying Action as to the Intervenor and remanding the case for a jury trial was not rendered until June 30, 2005. So, at least in connection with defense costs and any future indemnification associated with the retrial, the Intervenor was not aware until after this decision of their direct interest in seeking reimbursement for these costs under the policies. See, e.g., *Werbungs Und Commerz Union Austalt v. Collectors' Guild, Ltd.*, 782 F.Supp. 870, 874 (S.D.N.Y.1991) (finding that application for intervention filed almost two years after notice of interest in case was timely because application filed shortly after

interest became direct). In any event, the Court does not find that the delay between the filing of the instant action and the filing of the intervention application, when weighed with the other factors, warrants denial of intervention. See, e.g., *United States v. Pitney Bowes, Inc.*, 25 F.3d 66, ("[T]he time lapsed between notice of an interest in pending litigation and an application to intervene is only one of several factors a district court must weigh when deciding the issue of timeliness."). The Court notes in this connection that there is no prejudice to the existing parties as a result of this delay but that, as explained above, the Intervenor will be prejudiced if the application is denied.

In the alternative, the Court finds that permissive intervention is warranted under Rule 24(b)(2). Under this provision, a would-be party can be permitted to intervene "when an applicant's claim or defense and the main action have a question of law or fact in common." Fed.R.Civ.P. 24(b)(2) (West 2006). "In exercising its discretion the court shall consider whether the intervention will unduly delay or prejudice the adjudication of the rights of the original parties." *Id.* The Court finds that there are common questions of law and fact, that no such undue delay or prejudice will result from intervention and that, for substantially the reasons stated in its analysis of intervention as of right, permissive intervention is appropriate.

Preliminary Injunction Motion

*11 The Intervenor moves for a preliminary injunction "preserving the *status quo* by preventing the defendants from paying any monies under the Policies to [Plaintiff] ... and ... directing that the defendants continue to advance 'defense costs' [to the Intervenor] for retrial of the Prior Action." (Mem. in Supp. of Mot. for Intervention at 13.) In the Second Circuit, the standard for preliminary injunctive relief ordinarily requires the moving party to show that: (1) it is likely to suffer irreparable injury; and (2) either (a) a likelihood of success on the merits of its case; or (b) sufficiently serious questions going to the merits to make them a fair ground for litigation and a balance of hardships tipping decidedly in its favor. *Green Party of New York State v. New York State Bd. of Elections*, 389 F.3d 411, 418 (2d Cir.2004).

Not Reported in F.Supp.2d, 2006 WL 1982789 (S.D.N.Y.)
(Cite as: 2006 WL 1982789 (S.D.N.Y.))

“Irreparable harm is an injury that is not remote or speculative but actual or imminent, and for which a monetary award cannot be adequate compensation.” *Tom Doherty Assocs., Inc. v. Saban Entm't, Inc.*, 60 F.3d 27, 37 (2d Cir.1995) (internal quotations omitted).

The Court finds that a preliminary injunction is not warranted, as the Intervenor^{FN17}s have not made a showing of irreparable harm. The Intervenor^{FN17}s only allege monetary harm in that they may not receive all the insurance proceeds due to them. They do not even allege that they will be unable to mount their defense in the retrial without the insurance advances. Thus, the Intervenor^{FN17}s have failed to demonstrate the requisite irreparable harm.

FN17. Defendants indicate that they have not advanced any defense costs to the Intervenor^{FN17}s. To the extent then that the Intervenor^{FN17}s seek such costs, their request for injunctive relief would amount to a mandatory injunction rather than the requested prohibitory injunction seeking to keep the *status quo*. See *Tom Doherty Assocs., Inc.*, 60 F.3d 27 at 33-4. The former requires an even greater showing of harm “where extreme or very serious damage will result from a denial of preliminary relief.” *Id.* at 34 (internal quotations omitted). Because the Intervenor^{FN17}s have not made a showing of irreparable harm for a prohibitory injunction, they have not, *a fortiori*, made a showing of the harm required for a mandatory injunction.

CONCLUSION

For the foregoing reasons, Gulf's and Executive's motion to dismiss the complaint is granted to the extent it seeks to exclude coverage of the portion of the Judgment representing monies wrongfully obtained by Cogan and Nelson and is denied in all other respects, NUFIC's motion to dismiss is denied in its entirety, and Farace's and Smith's motion for intervention is granted but their application for a preliminary injunction is denied.

The parties shall appear in Courtroom 17C, United States Courthouse, 500 Pearl Street, New York, N.Y.

10007, for a pretrial conference on August 22, 2006 at 10:45 a.m. and shall file their Joint Preliminary Pretrial Statement (with a courtesy copy to chambers) by August 15, 2006.

SO ORDERED.

S.D.N.Y.,2006.
Pereira v. National Union Fire Ins. Co. of Pittsburgh, Pa.
Not Reported in F.Supp.2d, 2006 WL 1982789 (S.D.N.Y.)

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