IN THE UNITED STATES DISTRICT COURT
FOR THE EASTERN DISTRICT OF KENTUCKY
SOUTHERN DIVISION
AT LONDON

Ins2[redacted] INSURANCE CO., *et al.*,	:	
Plaintiffs,	:	
v.	:	Case No. [redacted]
ClienClient[redacted] *et al.*,	:	
Defendants/Third-Party Plaintiffs,	:	Judge [redacted]
v.	:	
THIRD PARTY DEFENDANTS	:	

INSURED DEFENDANTS' COMBINED RESPONSE TO THE SUMMARY JUDGMENT MOTIONS FILED BY THE INSURANCE COMPANIES

STATEMENT OF POINTS AND AUTHORITIES

The Insured Defendants, [redacted] ("[redacted] [redacted] ("[redacted] [redacted] ("Mr. [redacted] and [redacted] [redacted] ("Mr. [redacted] and [redacted] and [redacted] LLC ("[redacted] by counsel and for their Combined Response to the Summary Judgment Motions filed by the Insurance Companies,[1] state as follows:

INTRODUCTION

[redacted] and [redacted] are defending their respective insureds under reservation of rights. [redacted] has denied coverage altogether. [redacted] does not have a duty to defend, but instead has a duty to reimburse counsel chosen by the insureds and, in certain cases, to advance the defenses costs to insured's counsel. All five of the Insurance Companies have filed summary judgment motions. [redacted] and [redacted] ask the Court to find that their policies provide no coverage for any of the claims made by [redacted] (against [redacted] [redacted] Mr. [redacted] and Mr. [redacted] or Mr. [redacted] (against [redacted] and [redacted] in the "Foreclosure Actions" described below.

[redacted] on the other hand, has filed for summary judgment only on the [redacted] claim that [redacted] must provide defense through independent counsel. [redacted] asserts that a decision by this Court on the indemnity issues before a decision in the Foreclosure Cases is premature. The Insured Defendants are persuaded by the [redacted] authorities on this issue, but as will be seen below each of the Insurance Companies has a duty to defend their insureds (or in

[1] [redacted] Insurance Company ("[redacted]") and [redacted] Insurance Company ("[redacted] (Doc. #89-Motion on [redacted] case, and Doc. #91-Motion on [redacted] case), B. [redacted] Mutual Casualty Co. ("[redacted] (Doc. #90), C. [redacted] Indemnity Company ("[redacted] (Doc. #92), and D. [redacted] Indemnity Insurance Company ("[redacted] (Doc. #88) (all of whom are referred to hereinafter together sometimes as the "Insurance Companies").

Philadelphia's case, a duty to pay for defense by counsel chosen by its insureds) because the claims made in the Foreclosure Cases "potentially, possibly or might" come within the coverage of the policies. *O'Bannon v. Aetna Casualty and Surety Company*, Ky., 678 S.W.2d 390 (1984). In fact, as will be seen below, it is very likely that the ultimate decisions on indemnity will go in favor of the Insured Defendants.[2]

The Insurance Companies make their indemnity arguments based on the allegations in the Acme and Smith [redacted] complaints, for the most part ignoring the answers to those complaints and the extensive subsequent discovery in the cases.[3] This might be appropriate in the determination of the duty to defend in the first instance, but a focus solely on the language of the complaint is inappropriate now:

> "Whereas the duty to defend is measured by the allegations of the underlying complaint, the duty to indemnify is measured by the facts as they unfold at trial or are inherent in the settlement agreement." Because an insured's duty to indemnify is dependent on the outcome of a case, any declaration as to the duty to indemnify is premature unless there has been a resolution of the underlying claim.

Northland Cas. Co. v. HBE Corp., 160 F. Supp. 2d 1348, 1360 (M.D. Fla. 2001). Cited favorably in *Howell Props., LLC v. Kinzer Drilling Co., LLC (In re Clearwater Natural Res., L.P.)* 2011 U.S. Dist. LEXIS 65413, *13 (E.D. Ky. June 20, 2011).

Ins1 [redacted] Ins2 [redacted] and Ins3 [redacted] argue that their policies do not provide coverage for property damage caused by intentional acts.[4] They are incorrect as a matter of law on this and their insureds may be denied coverage only if it is proven at trial that each of Mr. Client [redacted] Mr.

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[2] It is even likely that there will be overlapping coverages here because, among other things, there are two CGL policies, two D&O policies, multiple policies issued to the Client [redacted] and the Client [redacted] and multiple umbrella policies.

Even though the parties have agreed that the evidence produced in discovery in the Foreclosure Cases can be used in this case – to the extent relevant. Agreed Order (Doc #: 79).

[4] See, Ins3 [redacted] Memorandum Doc #: 90-1 at p.1 of 35; and Ins2 [redacted] Memorandum Doc #: 89-1 at p. 1-2 of 36.

[redacted] and/or [redacted] acted with the intent to cause harm to [redacted] and Mr. [redacted]

In addition, [redacted] and [redacted] all argue that the claims fall outside of coverage because they arise out of a breach of contract (a breach of the non-disclosure agreements [the "NDAs"] [redacted] alleges that [redacted] Mr. [redacted] and [redacted] signed.[5] These assertions ignore the Defendants' claims that neither Mr. [redacted] nor [redacted] ever signed an NDA and their claims that the NDA signed by Mr. [redacted] on behalf of [redacted] was void ab initio.[6]

Similarly, [redacted] and [redacted] argue that because Mr. [redacted] alleges that [redacted] and [redacted] knew he owned the roll former and the inventory, their actions were "expected or intended from the standpoint of the insured" and consequently the [redacted] claims are not covered by their policies.[7] But these arguments ignore the claims of the Defendants that, while they knew that Mr. [redacted] was claiming to own the roll former, they did not believe his claims (whatever they were) to be superior to the claims of [redacted] In other words, the Insured Defendants claim that the injuries complained of were not "expected or intended from the standpoint" of [redacted] and [redacted] The question of whether Mr. [redacted] did have such a superior claim is a matter before the Court now in the [redacted] Roll Former Case.

These coverage defenses asserted by [redacted] and [redacted]

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[5] See, for example, [redacted] Memorandum in Support Doc #: 90-1 at p. 32 of 35; [redacted] Memorandum in Support Doc # 88-1 at p. 16 of 29 and [redacted] Memorandum in Support Doc #: 91-1 at p. 33 of 40.

[6] .See, Response of Defendants to Motion for Restraining Order filed in the [redacted] Case, attached as Exhibit 1 and Findings of Fact, Conclusions of Law and Order of the Jefferson Circuit Court denying the [redacted] motion for temporary restraining order, attached as Exhibit 2. The Circuit Court agreed, at least preliminarily, that the NDA signed by Mr. [redacted] on behalf of [redacted] was void.

[7] See, for example, [redacted] Memorandum in Support Doc #: 89-1 at p. 26 of 36.

make clear the wisdom of the Ins4 position. If, for example, this Court were to find that these Insurance Companies have no indemnity obligation because the Acme and Smith claims arise out of the breach of the NDAs and the Jefferson Circuit Court later determines that there were no NDAs, but that the Defendants are liable to Acme on some other (covered) claim a great injustice will have been done. The Insured Defendants will have lost insurance coverage for which they paid a premium and which they reasonably expected to provide coverage of claims they believe are without merit.

The coverage defenses raised by the Insurance Companies make clear that Ins3 Ins1 Ins2 and Ins4 are required to pay independent counsel chosen by the insured. Tthe Foreclosure Cases are "mixed actions" – actions involving both covered and uncovered claims – and the defense of the underlying cases can so clearly influence the outcome of the ultimate decision on coverage as to require independent counsel chosen by the Insured Defendants. Ins5 is required by the terms of its policy to pay independent counsel chosen by its insured in any event.

For the reasons outlined below, this court should deny the motions of these carriers and grant the motions of these Defendants with respect to the obligations of Ins5 and Ins4 to pay for independent counsel chosen by the Insured Defendants.[8]

PROCEDURAL HISTORY AND UNDERLYING FACTS

In general, the Insured Defendants agree with and incorporate herein the "Procedural History" and the "Facts" (through page 13) as set out in the Ins2 Memorandum (Doc #:

[8] This memorandum will also deal briefly with certain claims of these insurers that are unique. The claim by Ins5 for example, that it has no liability with respect to the Smith Inventory claim because it did not receive proper notice of the claim.

89-1 at pp. 3-13 of 36) with the following exceptions:

- The Insured Defendants do not agree that the Non-Disclosure Agreement was entered into pursuant to the 2012 negotiations between Acme and Client for the formation of a joint venture.
- The Insured Defendants believe that the Acme lease on the building in Montoursville had terminated long before Client repossessed the Acme assets.
- The Insured Defendants do not agree that Mr. Smith purchased the roll former in November of 2008.

AN OVERVIEW OF THE INSURANCE COVERAGES IN THIS CASE

The Commercial General Liability ("CGL") Policies.[9]

Ins1 has issued a CGL policy to each of Client and Client and that policy also provides coverage to affiliate, officers, directors and employees of those companies. Ins3 has issued a CGL policy to Client and that policy also provides coverage to affiliates, officers, directors and employees of Client

The parts of those policies relevant to this case provide coverage for sums that the insured becomes legally obligated to pay as damages because of: (a) "property damage" caused by an "occurrence" (defined as an accident); and (b) "advertising injury" caused by an "offense." "Property damage" means: (a) Physical injury to tangible property, including all resulting loss of

[9] These coverage and exemption summaries are taken from the Ins1 Policy Excerpts (Doc # 89-10) (which is attached hereto as Exhibit 3 with the relevant provisions highlighted) and the Ins3 Commercial General Liability Coverage Form (attached as Exhibit 4 with the relevant provisions highlighted).

use of that property; or (b) Loss of use of tangible property that is not physically injured."[10] "Advertising injury" includes "oral or written publication of material that slanders or libels a person or organization or disparages a person's or organization's goods, products or services." Each of the CLG policies provides that the carrier has both the right and the duty to defend any suit seeking these damages.

Each of the CGL policies contains the following exclusions relevant to this case: (a) "property damage" expected or intended from the standpoint of the insured; (b) "property damage" for which the insured is obligated to pay damages by reason of the assumption of liability in a contract or agreement; (c) "property damage" to property that has not been physically injured, arising out of a delay or failure by the insured or anyone acting on its behalf "to perform a contract or agreement in accordance with its terms;" (d) "advertising injury" arising out of oral or written publication of material, if done by or at the direction of the insured with knowledge of its falsity; (3) "advertising injury" for which the insured has assumed liability in a contract or agreement; and (4)"advertising injury" arising out of breach of contract. Exhibit 4 at page 5 of 16.

The Individual Policies.

Ins2 [redacted] has issued the homeowners and executive umbrella policies to Mr. and Mrs. Client [redacted] and to Mr. and Mrs. Client [redacted] The liability coverages and policy definitions in these policies do not greatly differ from those of the CGL policies and the coverage defenses offered up by Ins2 [redacted] are also generally the same. However, some of the unique defenses to the individual claims are addressed below.

[10] As will be shown below, this definition of "property damage" is materially different from the definition of property damage found in the Ins5 [redacted] D&O policy.

The Directors and Officers ("D&O") Policies.[11]

The Ins5 D&O policy provides that the company will pay any loss and defense costs resulting from any "wrongful act" of the insureds. "Wrongful act" is defined broadly to include any actual or alleged act, error, omission, misstatement, misleading statements, or neglect or breach of duty.[12] Unlike the other policies involved in this case, the Ins5 policy provides that "The Insured and not The Company shall have the right and duty to defend any claim." The policy provides Ins5 will advance defense costs if it determines that any claim may the covered, such determination not to be unreasonably withheld. The Ins5 D&O excludes coverage of losses "arising out of, directly or indirectly resulting from or in consequence of, or in any way involving:" (a) damage to or destruction of any tangible property including loss of use thereof, (b) the violation of statute or ordinance committed by or with the knowledge or consent of the insured; (c) any actual or alleged breach of contract or agreement, but this exclusion does not apply to "liability of the organization which would have attached even in the absence of such contract or agreement; or (d) any dishonest fraudulent act or omission or any

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[11] The coverage and exemption summaries below are taken from: (a) highlighted excerpts from the Ins5 D&O policy attached hereto as Exhibit 5 (which is extracted from Ins5 Doc #: 88-18) (b) and highlighted excerpts from the Ins4 D&O policy attached hereto as Exhibit 6 (which is extracted from Ins4 Doc #: 92-2).

[12] One can hardly imagine a broader definition of "wrongful acts," yet Ins5 claims that the Foreclosure Actions do not allege "wrongful acts." Ins5 Memorandum Doc #: 88 at p. 15 of 29. LEEP's combined second and third amended complaints comprise over 40 pages, 195 numbered paragraphs and 18 counts which include; breach of contract, tortious interference, breach of fiduciary duty, aiding and abetting a breach of fiduciary duty, fraud, as well as violations of RICO and the Kentucky Uniform Trade Secrets Act. Ins5 fails to show, or even attempt to show:

- how tortious interference is not an "act" or "error";
- how fraud is not a "misleading statement";
- how breach of fiduciary duty is not a "breach of duty"
- how, in general, aiding and abetting, violation of RICO and violation of the Kentucky Uniform Trade Secrets Act are not "wrongful acts".

This amazing coverage "defense" needs no further comment in this brief.

criminal or malicious act or omission, but "the insured shall be reimbursed for all amounts which would otherwise be covered under this Policy if such allegations are not subsequently proven."

In all matters relevant to this brief,[13] the Ins4 coverage afforded to Client is the same as the coverage afforded to Client except: (a) the Ins4 policy excludes losses for damage to or destruction of any tangible property including loss of use thereof, "whether or not such property is physically injured;" and (b) the Ins4 policy, like the CGL policies, provides that Ins4 as the right and duty to defend any claims.

ARGUMENT

I. A DECISION ON THE INDEMNITY ISSUES WILL BE PREMATURE

Each of the policies cover loss actually incurred and as of this point in time the insureds have not suffered a loss (other than fees paid to independent counsel). Quoting from the Ins4 Memorandum:

> Under Kentucky law, "[t]he duty to indemnify is narrower than the duty to defend because it only arises when there is an actual basis for the insured's liability to a third party." Travelers Prop. Cas. Co. of Am. v. Hillerich & Bradsby Co., 598 F.3d 257, 269 (6th Cir. 2010) (applying Kentucky law). See also Clearwater Nat. Resources, L.P. v. Clearwater Nat. Resources, LLC, Civil Action No. 7:10-cv-122-KKC, 2011 U.S. Dist. LEXIS 65413, *13 (E.D. Ky. June 20, 2011) (noting that the insurer's duty to indemnify depends on "theories of liability and facts established "in the underlying action" and "any declaration as to the duty to indemnify is premature unless there has been a resolution of the underlying claim").

(Doc #: 92-1 at p. 12 of 14.)

II. THE MAJOR COVERAGE DEFENSES EITHER ARE NOT VIABLE OR THEIR VIABILITY WILL BE DETERMINED BY THE FORECLOSURE LITIGATION.

A. The "No Occurrence" Defense:

[13] Except as discussed immediately below, the differences in the two policies are not relevant given that Ins4 has not moved for summary judgment on its indemnity obligations.

Ins2 [redacted] Ins1 [redacted] and Ins3 [redacted] all assert that there is no coverage for the property damage claimed by Acme [redacted] and Mr. Smith [redacted] because theY claim that the Insured Defendants acted intentionally and that property damage is covered only if caused by an "occurrence" (defined as an accident).[14] But this position is inconsistent with the language of the policies themselves, misinterprets Kentucky case law (placing far too much emphasis on *Kentucky Association of Counties All Lines Fund Trust v. McClendon*, 157 S.W.3d 626, 632 (Ky. 2005) and *Cincinnati Ins. Co. v. Motorists Mut. Ins. Cos*, 306 S.W.3d 69 (Ky. 2010)), and overlooks the broader trend among courts finding an occurrence where an insured's intentional acts were undertaken with the mistaken belief that the defendant had a right to take the action.

i. The Policy Language.

It is axiomatic that a contract must be construed as a whole, giving effect to all of its provisions and avoiding a construction that would render any of those provisions illusory or meaningless. *City of Louisa v. Newland*, 705 S.W.2d 916, 919 (Ky. 1986) (A written agreement generally will be construed "as a whole, giving effect to all parts and every word in it if possible.") If the term "occurrence" is interpreted to exclude the consequences of any intentional acts the interpretation renders the exclusion for "property damage" "expected or intended from the standpoint of the insured" is rendered meaningless or superfluous. If property damage is only covered if caused by an occurrence, and if an occurrence cannot include the consequences of an intentional act, there is no reason for an exclusion for acts "expected or intended."[15]

ii. Kentucky Law.

[14] "Accident" is not further defined in the policies.

[15] Of course, if the narrow definition of "occurrence" championed by these carriers is adopted, any coverage for property damage evaporates altogether – because there are no accidents which are not "caused" by an intentional act. The fact that the grocery store clerk intends to mop the floor does not mean that injuries to a patron who slips and falls are not accidental.

Reliance by the CGL carriers *Kentucky Association of Counties All Lines Fund Trust v. McClendon*, 157 S.W.3d 626, 632 (Ky. 2005) and *Cincinnati Ins. Co. v. Motorists Mut. Ins. Cos*, 306 S.W.3d 69 (Ky. 2010), is misplaced in this case.

Kentucky law is well settled that the term "occurrence" is to be construed broadly: "Courts and commentators alike are in agreement that the term 'occurrence' is to be broadly and liberally construed in favor of extending coverage to the insured." *James Graham Brown Foundation, Inc. v. St. Paul Fire & Marine Ins. Co.*, 814 S.W.2d 273, 278 (Ky. 1991). This rule of law has not been retracted by Kentucky Courts, it is still valid, and it is the interpretation which most adequately effectuates the purpose of commercial general liability policies. *James Graham Brown Foundation, Inc. v. St. Paul Fire & Marine Ins. Co.*, 814 S.W.2d 273, 278 (Ky. 1991).

The Kentucky Supreme Court decision in *Bituminous Cas. Corp. v. Kenway Contr., Inc*., 240 S.W.3d 633 (Ky. 2007) built on this foundation. There a contracting company was hired to demolish an attached carport on a residential building, and to tear up the concrete parking pad below it. The company's heavy equipment operator had not been clear on the scope of the work, and was found in the midst of demolishing the entire residential building when his supervisor arrived on the job site. There can be no question that the company's employee was acting intentionally, and was in control of the trackhoe at the time of demolition. Nonetheless, the Kentucky Supreme Court determined that the destruction of the plaintiffs' property, was not expected or intended from the standpoint of the company: "The damage to the Turners' property was unexpected and unintended by the insured. It was not the plan, design, or intent of the insured. Therefore, the fortuity requirement in the definition of accident is satisfied." *Id.* at 639. The court adopted the following definition of accident: "Accident includes intentional acts that cause unexpected or unintended results from the standpoint of the insured." *Bituminous Cas. Corp.*

v. Kenway Contr., Inc., 240 S.W.3d 633, 638 (Ky. 2007). The Court did not merely make this statement in passing, or hold it as dicta, the quotation above appears verbatim as a section heading in the opinion. It is this case, and not the older decision in *Kentucky Assn. of Counties*, *supra*, which best illustrates Kentucky law on this issue.

Ins2 [redacted] cites *Kentucky Assn. of Counties*, *supra*, for the proposition that: "The Kentucky Supreme Court has declared that there is no coverage under a liability policy for conversion as it is an intentional tort, and there are no "accidental" conversions of property." This statement is a misinterpretation of that case, and is far too broad. The Kentucky Supreme Court did not determine that case on the basis of conversion at all, and any references to conversion therein are mere dicta. The Court in that case said, "Regardless, we find that the underlying action did not sound in tort. Second, we believe that the underlying action is more analogous to an action for breach of contract than one for conversion." *Ky. Ass'n of Counties All Lines Fund Trust v. McClendon*, 157 S.W.3d 626, 632 (Ky. 2005). *Kentucky Assn. of Counties* has been questioned as it relates to conversion. The Court in *Kendrick v. Std. Fire Ins. Co.*, 2007 U.S. Dist. LEXIS 28461 (E.D. Ky. Mar. 31, 2007), said of *Ky. Ass'n of Counties*, that "there is no indication it was intended to nor does it address all considerations when pursuing a conversion claim." *Kendrick* at 43. Regarding the interplay between conversion and intent this Court agreed with earlier authority saying: "the intent of the party is immaterial… any wrongful exercise or dominion over chattels to the exclusion of the rights of the owner, or a withholding of them from his possession under a claim inconsistent with his rights, constitutes a conversion." *Kendrick v. Std. Fire Ins. Co.*, 2007 U.S. Dist. LEXIS 28461, *44 (E.D. Ky. Mar. 31, 2007) (internal citations omitted). Given the irrelevance of intent for finding liability for conversion, it is certainly possible that conversion can occur without intent to harm, and when it does it should be a covered claim.

The CGL carriers also rely on the decision in *Cincinnati Ins. Co. v. Motorists Mut. Ins. Co.*, 306 S.W.3d 69, 76-77 (Ky. 2010). This case was decided after *Bituminous Casualty*, and the *Cincinnati Ins. Co.* court described the earlier case as follows:

> Bituminous Cas. Corp., greatly relied upon by both the Court of Appeals and Motorists, did involve, like the case at hand, a CGL policy dispute over whether a contractor's actions constituted an "occurrence." **But the contractor's action in Bituminous Cas. Corp. is readily factually distinguishable from the case at hand because that case was not a faulty construction case.**

Cincinnati Ins. Co. at 76-77. (emphasis supplied).

Given the Court's efforts to distinguish the cases, it seems a stretch to find that the *Cincinnati Ins. Co.* decision had any substantial effect on the Court's earlier decision in *Bituminous Cas. Co.* Moreover, the issue before the Court in *Cincinnati Insurance Co.* was a narrow one, and the case should be limited to its facts. The Kentucky Supreme Court stated explicitly the issue before it in *Cincinnati Ins. Co.*: "We granted Cincinnati's motion for discretionary review in order to consider, apparently as a matter of first impression in Kentucky, whether faulty construction-related workmanship, standing alone, qualifies as an "occurrence" under a CGL policy." *Cincinnati Ins. Co.* at 72. Lest that statement leave any doubt, that Court summarized its holding as follows:

> In summary, We join the majority of other courts who have considered this question by holding that "a claim for faulty workmanship, in and of itself, is not an "occurrence" under a commercial general liability policy because a failure of workmanship does not involve the fortuity required to constitute an accident."

Cincinnati Ins. Co. v. Motorists Mut. Ins. Co., 306 S.W.3d 69, 79-80 (Ky. 2010).

It is clear that the holding in *Cincinnati Ins. Co.* was meant to be an adoption of the rule that faulty construction cannot be an accident. This holding is not inconsistent with the holding that

intentional actions undertaken with a mistaken belief that they were authorized can still be accidents. For example see the law of New Hampshire. In *Cincinnati Ins. Co*., the court cites the Supreme Court of New Hampshire in support of its holding:

> As Justice David Souter noted in an opinion he wrote while serving on the Supreme Court of New Hampshire, defective workmanship does not meet the definition of fortuity; and, thus, "[d]espite proper deference, then, to the reasonable expectations of the policyholder, we are unable to find in the quoted policy language a reasonable basis to expect coverage for defective workmanship."

Cincinnati Ins. Co. v. Motorists Mut. Ins. Co., 306 S.W.3d 69, 79 (Ky. 2010).

In the years since Justice Souter moved on to bigger things, New Hampshire has, as discussed below, become one of the leading proponents of the majority position that intentional actions undertaken with a mistaken belief that they were authorized can still be accidents. This is one of several states in which the law is clear that while faulty construction is not an occurrence, intentional actions undertaken with the belief that they were authorized are an occurrence.

iii. The Majority Rule.

A number of other state and federal courts including the Sixth Circuit Court of Appeals have examined whether an intentional act undertaken with a mistaken belief that it was authorized can be an accident. The Sixth Circuit in *Std. Constr. Co. v. Md. Cas. Co.*, 359 F.3d 846, (6th Cir. Tenn. 2004), interpreted a definition of “occurrence” which is substantially the same asthe definition at issue here. In that case, the Sixth Circuit upheld the district court’s determination that an intentional act of dumping construction debris was an accident because the insured believed, mistakenly, that it had the legal right to dump debris on the property. In that case, the Sixth Circuit said:

> The district court held that the dumping was an "occurrence" or "accident" within the meaning of the policy because, while the dumping was intentional, the fact that

> it was done without permission, thus making it wrongful, was not intended by the insured. We agree with this conclusion. As pointed out by the trial court, "if the resulting damages are unintended, the resulting damage is accidental even though the original acts were intentional."

Std. Constr. Co. at 850.

This interpretation of the term "occurrence" is favored by a majority of the courts which have confronted this question.[16] Some of these cases are discussed below:

In *Lumber Ins. Cos. v. Allen*, 820 F. Supp. 33, (D.N.H. 1993), the Court determined that under New Hampshire law, conversion could be an accident, and therefore an "occurrence." ("I conclude that the New Hampshire Supreme Court would determine that the insured's conduct was accidental in such cases if the insured's mistaken belief has a basis in fact.") *Lumber Ins. Cos. v. Allen*, 820 F. Supp. 33, 35 (D.N.H. 1993).

In *Vermont v. Glens Falls Ins. Co.*, 404 A.2d 101, 104 (1979), a sheriff was sued for conversion in a case where he levied upon property with the mistaken belief it was owned by someone else. Though the Sheriff was informed at the time of the repossession that the owner of the property he levied upon was not who the sheriff believed to be the owner, the court determined that the action was an "occurrence", and that the insurer was required to provide coverage. In *York Industrial Center, Inc. v. Michigan Mut. Liability Co.*, 271 N.C. 158, (N.C. 1967), the Court held that where a contractor mistakenly crossed a property line and caused damage to neighboring property, that the damage to the neighbors' property by the insureds constituted an "occurrence" *York Industrial Center, Inc. v. Michigan Mut. Liability Co.*, 271 N.C. 158, 161 (N.C. 1967) crossing the line without intent to harm the property of the neighbor was an

[16] "[T]his Court is persuaded that the best approach, and the one that should be adopted in Tennessee, **is that followed by a majority of the states that have had an opportunity to construe the language involved in this case.** *Std. Constr. Co. v. Md. Cas. Co.*, 359 F.3d 846, 850 (6th Cir. Tenn. 2004). (Emphasis supplied).

occurrence. See *J. D'Amico, Inc. v. Boston,* 186 N.E.2d 716, (1962), and *Patrick v. Head of Lakes Coop. Elec. Ass'n,* 295 N.W.2d 205, (Wis. App. 1980). (In each of these cases, trespass was considered accidental where premised on an entry onto land of plaintiffs by mistake). See also *Continental Casualty Co. v. Platsburg Beauty & Barber Supply, Inc.,* 48 A.D.2d 385, 386-87, 370 N.Y.S.2d 225, (1975).

The CGL carriers can avoid liability for the "conversion" of the Acme and Smith property only if it is proven at trial that the Insured Defendants expected and intended to harm to that property. The Insured Defendants are taking the position that Acme and Mr. Smith had no property rights under the UCC which were adversely affected by the repossession and sale of the assets located in the Montoursville facility.

Little more needs to be said on the intentional acts exclusion which has not already been said on the definition of occurrence, as the two ideas are related. The Sixth Circuit has held previously that "whether expressed as part of the definition of "occurrence" or stated as a separate exclusion, the point is the same." *Std. Constr. Co. v. Md. Cas. Co.*, 359 F.3d 846, 850 (6th Cir. Tenn. 2004).

Kentucky authority also exists interpreting this exclusion:

> BCC also argues that this court should hold that there is no coverage under the policy because it expressly excluded coverage for injuries and damages that were intended or expected. They assert that the Durhams expected the gases to be released from the oil wells. Further, they note the policy provision which states that the policy does not apply to '"bodily injury' or 'property damage' expected or intended from the standpoint of the insured. While it may be apparent that the insured individuals expected the oil wells to emit noxious gases during their operation, there is no indication that the insured individuals expected bodily injury or property damage to result.

Durham v. Bituminous Cas. Corp., 2003 Ky. App. Unpub. LEXIS 1084, 8-9 (Ky. Ct. App. Feb. 7, 2003).

> [I]n order to find that an intended or expected acts exclusion applies, it must be established that the insured intended the act *and* also intended or expected that injury would result. These are separate and distinct inquiries because many intentional acts produce unexpected results and comprehensive liability insurance would be somewhat pointless if protection were precluded if, for example, the intent to cause harm was not an essential (and required) showing.

Std. Constr. Co. v. Md. Cas. Co., 359 F.3d 846, 850 (6th Cir. Tenn. 2004).

B. The "Arises Out of Breach of Contract" Defense.

Ins1 Ins2 Ins3 and Ins5 all claim that their policies do not cover the losses alleged by Acme and Smith because those losses arise out of an alleged breach by the Insured Defendants of the NDAs. Ins1 and Ins2 claim that:

> LEEP's alleged defamation flows from the alleged breach of the NDA and oral contracts promising confidentiality. LEEP's action for eighteen counts of alleged wrongdoing are all based upon this alleged improper access to and misuse of confidential information which led to KHIC's purchase of the Fortress Note, subsequent possession of the former Acme assets in PA, and transfer of these assets to Stearns and Client for panel manufacturing. Without the initial breach of contract, none of these actions would have taken place, including the alleged defamation. Moreover, the Sixth Circuit has noted that for "the breach of contract exclusion to apply, the breach of contract need not have caused the injuries." Capitol, supra at 51. Rather, the Sixth Circuit explained that "the broad language of the exclusion requires only that the alleged injuries be incidentally related or connected to the breach of contract…." Id. at 52.

Ins1 Memo Doc #: 91-1 at p. 33 of 40.

> Similarly, Ins3 asserts
>
> Here, Acme alleges the Defendants entered into a NDA with Acme and were given highly confidential financial and proprietary information. (Exhibit 1 at ¶ 103.) Acme alleges the Defendants then breached the NDA by using this confidential information to purchase LEEP's secured debt, demand payment of over $7 million, and then seize LEEP's assets when payment was not made. Id. at ¶¶ 94 & 96. These

> allegations are based on the "assumption of liability in a contract," the NDA, and fall within the above-cited exclusion.

Doc #: 90-1 at p. 32 of 35. Ins3 also claims:

> Here, Acme alleges the Defendants breached a contract, the NDA, in accordance with its terms by using confidential information to purchase LEEP's secured debt, demand payment of over $7 million, and then seize LEEP's assets (property and inventory) when payment was not made. (Exhibit 1 at ¶¶ 94 & 96.) These allegations are specifically based on the Defendants' failure to abide by the terms of a contract, and they fall within this exclusion.

Id. at p. 33 of 35.

The major part of the Ins5 claim to have no coverage obligation here is based on the breach of contract exclusion:

> The gravamen of LEEP's claims is that, from early 2012 through December 26, 2012, the Defendants, including KHIC and Client allegedly obtained LEEP's confidential and proprietary information pursuant to the Non-Disclosure Agreement. Acme SAC, ¶¶ 41, 90, and 104. Acme alleges that the confidential and proprietary information included financial information regarding the Fortress Note and issues with its landlord in Montoursville, Pennsylvania. Id. at ¶¶ 91-93. It is further alleged that specific information was disclosed about what it would cost to get releases from Fortress and the landlord, and that the Defendants were specifically instructed not to contact either Fortress or the landlord. Id. Accordingly, the alleged breach of the Non-Disclosure Agreement forms the basis for all of the claims asserted by Acme
>
> Courts in other jurisdictions have held that the breach of a contractual obligation cannot be a wrongful act under a D&O policy.

Doc #: 88-1 at pp. 15 and 16 of 29.

There are fatal flaws in each of these arguments.

i. There Was No Contract.

In order for any breach of contract exclusion to apply, there must be a contract and Client and Mr. Client claim that they never signed an NDA. Mr. Jones has not produced any NDA signed by Client or Client and has testified that after a

diligent search of his records he cannot find any such NDA. See, Excepts from Mr. Jones's deposition at Exhibit 7. Moreover, the NDA signed by Mr. Client on behalf of Client was signed long before negotiations began about a possible joint venture between Acme and Client it had nothing to do with the 2012 negotiations and is not enforceable in any event. See, Response of Defendants to Motion for Restraining Order filed in the Acme Case, attached as Exhibit 1 and Findings of Fact, Conclusions of Law and Oder of the Jefferson Circuit Court denying the Acme motion for temporary restraining order, attached as Exhibit 2. The Circuit Court agreed, at least preliminarily, that the NDA signed by Mr. Client on behalf of Client was void.

The ability of the Insurance Companies to successfully make out this defense to their coverage obligations thus depends on the trial courts findings about the existence of the contracts.

ii. Not all of the Claims Arise Out of the Contracts Anyway.

There are breach of contract counts in the Acme Amended Complaint but not all of the counts mention breach of contract by the Insured Defendants.[17] None of the Smith Counts allege a breach of contract. One of the reasons the Acme complaint contains 28 counts is almost certainly so that Acme can preserve its case in the event the contract claims fall out of the case (on summary judgment or otherwise).

Ins5 and to a lesser extent Ins3 Ins1 and Ins2 go to great lengths to attempt to get all the claims under the breach of contract umbrella. In doing so, they ignore the

[17] The following Acme Counts do not mention a breach of contract by any Insured Defendant: Count IV – Tortious Interference with Contract Between Fortress and Acme Count V – Tortious Interference with Acme Contract; Count VI – Conversion of Acme's Property; Count VIII – Tortious Interference with Contract Between [redacted] Smith and Acme Count IX – Tortious Interference with Prospective Business Advantage; Count X – Breach of Fiduciary Duty; Count XIII – Tortious Interference with Contract Between [redacted] and Acme Count XVI – Violation of RICO, Section 1962(C); Count XVII – Violation of the Kentucky Uniform Trade Secrets Act KRS 365.880 to KRS 365.900; and Count XVIII – Aiding and Abetting Breach of Fiduciary6 Duty Against Acme

exception to the exclusion. The breach of contract exclusions in the Ins3 and Ins1 policies exclude "property damage" caused by a breach of contract by the insured or someone acting on its behalf. The Ins5 exclusion is different:[18]

> Exclusions . . . .
>
> The Company shall not be liable to make payment of loss or defense cost in connection with any claim made…arising out of, directly or indirectly resulting form or in consequence of, or in any way involving:
>
> L. Any actual or alleged breach of contract or agreement.
>
> This exclusion shall not apply to any of the following:
>
> 1. Liability of the organization which would have attached in the absence of such contract or agreement. . . .

The most important part of that exclusion is the exception. Ins5 goes to great pains to show this Court how to interpret the "arising out of" language in the breach of contract exclusion. The holdings in *Capitol Specialty Ins. v. Indus. Elecs., LLC*, 407 Fed. Appx. 47 (6th Cir. Ky. 2011), and *Liberty Corporate Capital Ltd. v. Sec. Safe Outlet, Inc.*, 937 F. Supp. 2d 891 (E.D. Ky. 2013) are not only misapplied to the facts of this case, as will be shown below, but are completely irrelevant to this case. This Court need not delve into an in-depth analysis of how Kentucky Courts are applying and interpreting the policy language; "arising out of." The policy itself speaks loud and clear about when this particular exclusion will apply, or more specifically, when this exclusion "shall not apply." That is when there is "Liability of the organization which would have attached in the absence of such contract or agreement."

The Court in *Liberty Corporate Capital Ltd.* even cites *Assurance Co. of Am. v. J.P. Structures*, 1997 U.S. App. LEXIS 34565 (6th Cir. Mich. Dec. 3, 1997) in order to distinguish the

[18] See, policy excerpts at exhibits 4, 5 and 8.

facts from that case. In *Assurance Co. of Am. v. J.P. Structures*, the Court found that the substance of the underlying claim was trademark infringement, not breach of contract. "It does not matter that U.S. Structures also may have suffered advertising injuries as a result of the breach of contract". *Id.* Both Court's decisions turned on whether it would have been possible for the defendants to commit the other torts claimed without the breach first occurring. The answer in *Liberty* was no, therefore the other claims arose out of the breach, and the answer in *Assurance* was yes, so the other claims did not arise out of a breach. The Court should also note that in all of the above cases, there was never any question as to whether a contract actually existed or was breached.

Assurance Co. also quotes a case that is exactly on point: *Ross v. Briggs and Morgan*, 520 N.W.2d 432 (Minn. Ct. App. 1994). In *Ross*, the insured terminated his employment with a business called Skin Diseases, P.A., took its client list of 8,000 patients without permission, incorporated his own practice as "Skin Physicians, P.A.," and sent letters to the 8,000 patients suggesting that his office was a new office of Skin Diseases. The underlying complaint alleged breach of contract, tortious interference with business relations, misappropriation of trade secrets, deceptive trade practices, unfair competition, and conversion. The insured's policy covered advertising injuries but excluded such injuries resulting from breach of contract. The court held that coverage was not excluded even though the injury was related to a breach of a non-compete agreement the insured had with his ex-employer:

> Given the manner in which [the insured] wrote the letter and the advertisements, [the ex-employer] could have sued [the insured] for the business torts even if no employment agreement had existed. As [the insured's] liability did not depend upon a contractual duty, [the ex-employer's] claims were not limited to breach of the contract.

Id. at 436.

This Court faces a decision almost identical to the one made in *Assurance Co. of Am. v. J.P. Structures*, and *Ross v. Briggs and Morgan* as the allegations in the underlying complaint are similar to the claims in those cases. The injuries, if any, flow from the acquisition of the Fortress security interest, subsequent repossession of the equipment and the eviction of Acme from their facilities. None of which flow from a Non-Disclosure Agreement that Client and Client were never a party to. Therefore, the claims of any wrongful acts did not "grow out of, or flow from" a breach of any non-disclosure agreement. "To hold otherwise would expand the breadth of the exclusionary clause to cover any claims brought in conjunction with a breach of contract claim, however tenuous the connection between them." *Auto Owners Ins. Co. v. La Oasis, Inc.*, 2005 U.S. Dist. LEXIS 43565 (N.D. Ind. May 26, 2005) *Auto Owners Ins. Co. v. La Oasis, Inc.*, heavily cites and relies on *Assurance Co. of Am. v. J.P. Structures*, for its holding.

iii. The Assumption of Liability in a Contract Exclusion is Inapplicable.

In its summary judgment motion, Ins3 claims an exclusion contained in its policy for "'[b]odily injury or 'property damage' for which the insured is obligated to pay damages by reason of the assumption of liability in a contract or agreement." (Doc #: 90-1 at p. 32 of 35).

Ins3 attempts to apply this exclusion to the facts of the Underlying Actions, saying:

> Here, Acme alleges the Defendants entered into a NDA with Acme and were given highly confidential financial and proprietary information. (Exhibit 1 at ¶ 103.) Acme alleges the Defendants then breached the NDA by using this confidential information to purchase Acme 's secured debt, demand payment of over $7 million, and then seize Acme 's assets when payment was not made. Id. at ¶¶ 94 & 96. These allegations are based on the "assumption of liability in a contract," the NDA, and fall within the above-cited exclusion.

Id.

Ins3 asserts that the exclusion means that any liability involving the existence of a contract is excluded from coverage. This interpretation would read out the word "assumed" which is the key to the entire exclusion: "The key to understanding this exclusion . . . is the concept of liability assumed." 2 Rowland H. Long, The Law of Liability Insurance § 10.05[2], 10-56, 10-57 (2002).

> The term "assumption" must be interpreted to add something to the phrase "assumption of liability in a contract or agreement." Reading the phrase to apply to all liabilities sounding in contract renders the term "assumption" superfluous. We conclude that the contractually-assumed liability exclusion applies where the insured has contractually assumed the liability of a third party, as in an indemnification or hold harmless agreement; it does not operate to exclude coverage for any and all liabilities to which the insured is exposed under the terms of the contracts it makes generally.

Am. Family Mut. Ins. Co. v. Am. Girl, Inc., 673 N.W.2d 65, 74 (Wis. 2004).

This discussion makes clear that the phrase "assumption of liability in a contract or agreement is far narrower than Ins3 asserts. As no claims for indemnity have been alleged, this exclusion is inapplicable to any allegations in the Underlying Complaints. Ins3 is not the first insurer to make this mistake, and in previous cases, courts and commentators have pointed out the correct interpretation:

> "Liability assumed by the insured under any contract" refers to liability incurred when one promises to indemnify or hold harmless another, and does not refer to the liability that results from breach of contract. Continental Insurance Co. v. Bussell, 498 P.2d 706, 710 (Alaska 1972);Dreis & Krump Manufacturing Co. v. Phoenix Insurance Co., 548 F.2d 681, 684 (7th Cir. 1977);J.L. Simmons Co., Inc. v. Fidelity and Casualty Co., 511 F.2d 87, 96 (7th Cir. 1975); Haugan v. Home Indemnity Co., 86 S.D. 406, 197 N.W.2d 18, 23 (S.D. 1972).

Olympic, Inc. v. Providence Wash. Ins. Co., 648 P.2d 1008, 1011 (Alaska 1982).

> Although, arguably, a person or entity assumes liability (that is, a duty of performance, the breach of which will give rise to liability) whenever one enters into a binding contract, in the CGL policy and other liability policies an "assumed" liability is generally understood and interpreted by the courts to mean the liability

> of a third party, which liability one "assumes" in the sense that one agrees to indemnify or hold the other person harmless.

21 Eric Mills Holmes, Holmes' Appelman on Insurance § 132.3, 36-7 (2d ed. 2000).

C. The Conversion is Property Damage Defense (Ins5 [redacted])

[redacted] also argues that all of the claims arise out of the conversion of Acme property, and that, according to the terms of the policy, conversion is property damage and consequently is excluded from coverage. The relevant exclusion is Exclusion B.

> B. Any actual or alleged: … damage to or destruction of any tangible property including loss of use thereof.

The "loss of use thereof" language in the exclusion is predicated on the damage to tangible property. Loss of use is a financial harm suffered due to property damage. For example; if someone destroys a machine that makes widgets, and as a consequence the owner of the machine misses out on sales of widgets that he otherwise would have had, the lost revenue is the "loss of use" suffered. A 2014 case out of Maryland also addresses this question and illustrates the difference between loss of use of property as the result of damage and loss of use of undamaged property.

> Plaintiff also contends that it suffered "property damage" within the terms of the Policy because it lost the use of the crates of sparkling wine. Again, Maryland courts have not directly addressed the precise issue presented in this case. 5Link to the text of the note However, this Court finds persuasive the distinction between "loss of use" and mere "loss of" a good:
>
> The correct analysis of loss of use coverage is set forth in *Collin v. American Empire Insurance Co.* [, 21 Cal. App. 4th 787, 26 Cal. Rptr. 2d 391, 408-09 (2d Dist. 1994),] The issue before the court was whether a claim for conversion of property constitutes a claim for loss of use of such property. The court held that it does not.
>
> > "Loss of use" of property is different from "loss" of property. To take a simple example, assume that an automobile is stolen from its owner. The value of the "loss of use" of the car is the rental value of

> a substitute vehicle; the value of the "loss" of the car is its replacement cost.
>
> 3 Insurance Claims and Disputes § 11:1 (6th ed.). In this case, Plaintiff has made no allegation of specific loss of use damages and no evidence has been proffered to support such a contention.

M Consulting & Exp., LLC v. Travelers Cas. Ins. Co. of Am., 2 F. Supp. 3d 730, 737-738 (D. Md. 2014)

The reference to "loss of use thereof" is referring to the harm suffered as a result of the property damage:

> Although no California court has specifically addressed whether "conversion" is property damage, virtually every other court to consider the question has held that it is not. (See *Nortex Oil & Gas. Corp. v. Harbor Insurance Co.* (Tex.Civ.App. 1970) 456 S.W.2d 489, 493 ["There is a material difference between 'property taken' and 'property damaged.' "]; *Travelers Ins. Companies v. P.C. Quote, Inc.*, supra, 570 N.E.2d 614, 618 ["There is a difference between damage to property and loss of property."]; *General Ins. Co. of America v. Palmetto Bank*, supra, 233 S.E.2d 699, 701 ["The only damage here alleged was, of course, the wrongful deprivation of property, not physical injury to the property."]; *B & L Furniture Co. v. Transamerica Ins. Co.* (1971) 257 Ore. 548 [480 P.2d 711, 713]; *Corvallis Sand & G. Co., Inc. v. Oregon Auto. Ins. Co.*, supra, 521 P.2d 1044, 1048; *Inland Const. Corp. v. Continental Cas. Co.* (Minn. 1977) 258 N.W.2d 881, 884 [A.L.R.4th 4043].)

Collin v. American Empire Ins. Co., 21 Cal. App. 4th 787 (Cal. App. 2d Dist. 1994). The vast majority of jurisdictions hold that pure economic loss, such as loss of profits, loss of good will, or loss of benefits, is not damage or injury to tangible property. 9 Couch on Ins. §126:36.

D. A Word About The Individual Policies

In addition to the coverage defenses raised with respect to its CGL policies, Ins2 [redacted] relies on the "arising out of business" exclusion in the individual umbrella policies. While each umbrella policy has an exclusion for acts arising out of "business pursuits," it specifically provides that this exclusion does not apply to acts or omissions "while acting within the scope of duties as

an officer…of a non-profit corporation." Since Client is a non-profit corporation, the "business pursuits" exclusion in the umbrella does not apply to the Acme claims against Mr. Client (who is an officer of Client

Another exception to the business pursuits exclusion is available to Mr. Client Coverage for personal injury or property damage is covered (in spite of the exclusion)" to the extent that insurance for such injury or damage . . . is provided by a policy listed in Schedule A." Schedule A of Mr. Client umbrella lists "Ins3 under the heading "Underlying Carrier Schedule." This can only be a reference to the Client comprehensive general liability policy with Ins3 – which does provide coverage to Mr. Client individually (at least for the defamation claim made by Acme So, because Mr. Client has coverage "provided by a policy listed in Schedule A," the exception to the business pursuits exclusion in his umbrella policy will mean that Mr. Client has coverage (not only under the Ins3 policy, but also under the Ins2 umbrella).

III. THE INSURANCE COMPANIES ARE REQUIRED TO PAY FOR INDEPENDENT COUNSEL CHOSEN BY THE INSURED.[19]

A. Kentucky Law

The courts have almost uniformly concluded that where an insurance company seeks to defend its insured under reservation of rights in a mixed action (an action with covered and uncovered claims) the inevitable conflicts of interest obligates the insurer to assume the cost of retaining independent counsel for the insured.[20] Here it is abundantly clear from the coverage defenses raised by the Insurance Companies that possible outcomes in the Foreclosure Cases can materially affect the coverage outcomes. If it is proven that Client and Mr.

[19] Ins5 is required to pay for counsel chosen by its insureds in any event. Eventually the defenses costs are going to be prorated among the carriers any way. The practical solution will be for the insurers to pro rate the costs of counsel chosen by the insureds.

[20] 50 A.L.R. 4th 932

[Client] did not sign NDAs, for example, much of the "breach of contract" coverage defense goes away. Similarly, if it is proven that Mr. [Client] and Mr. [Client] knew that Mr. [Smith] owned the repossessed inventory and roll former much of their insurance coverage goes away. This is not a matter of expecting counsel chosen by the Insurance Companies (or their Insurance Company contacts controlling the litigation) will act unethically. However, the subtle incentives will be there for insurance panel counsel (or the claims officer) to favor the insurer in every decision about what depositions to take, or how prepare the jury instructions, or any of the tens of thousands of decisions which get made as a case is readied for trial. The Insured Defendants have the right to be represented by lawyers with undivided, unquestionable loyalty.[21]

The resolution of this particular conflict issue appears to be a matter of first impression in Kentucky. However, Kentucky law is clear that when a conflict of interest exists between an insured and the insurer independent counsel must be appointed. See, *O'Bryan v. Leibson*, 446 S.W.2d 643 (1969). (Conflict of interest of insurer, in defending counterclaim against its insured when it was being sued by insured under uninsured motorist coverage, overruled responsibility to defend insured against counterclaim even though contract of insurance gave insurer right to defend.) See, also *Lee v. Medical Protective Co.*, 858 F. Supp. 2d 803, 806 (E.D. Ky. 2012) ("If a conflict of interest arises, such as receipt of an offer within the policy limits in a case where an excess verdict is possible, the attorney must so advise the insured and advise him or her further about the possibility of an excess verdict and of his right to retain his own attorney. In such cases, the insured typically does retain her own attorney, as the physician did in this case.")

[21] In Kentucky, insurance appointed counsel represents both the insured and the insurer. *Lee v. Medical Protective Co.*, 858 F. Supp. 2d 803, 806 (E.d. Ky. 2012) ("The true analysis of the relationship between the attorney hired by a liability insurer to represent the insured is that both are the attorney's clients."

B. The Majority Rule.

Once a conflict is identified, the insurance company must pay for independent counsel unless the insured waives the conflict.

> When the insurer creates a conflict-of-interest situation, the insured obtains the right to control the defense, and **the duty to provide defense services becomes a duty to reimburse independent counsel for the reasonable and necessary costs incurred in defending the insured**.

See generally Annot: Duty of insurer to pay for independent counsel when conflict of interest exists between insured and insurer, 50 ALR4th 932, and cases cited therein. See also 14 Couch on Insurance 2d (Rev ed) § 51:55 at 514-15, § 51:60 at 539, § 51:70 at 569-71; 7C Appleman, Insurance Law & Practice, § 4685.01 at 139-41; Windt, Insurance Claims & Disputes, §§ 4.20, 4.22. Courts have observed that without independent counsel, the "insurer may be subject to substantial temptation to shape its defense so as to place the risk of loss entirely on the insured." *San Diego Navy Fed. Credit Union v. Cumis Ins. Society, Inc.*, 162 Cal.App.3d 358, 364 (1984). See, also, *Manning v. Valor Ins.*, 1999 WL 183765 (N.D. Ill. 1999) ("[W]hen a conflict arises, the insured is entitled to retain independent counsel, paid for by the insurer") citing *Mobil Oil Corp. v. Maryland Cas. Co.* 681 N.E.2d 552, 561 (Ill.App.1997)); *Moeller v. American Guarantee & Liability Ins. Co.*, 707 So.2d 1062, 1069 (Miss. 1998) ("When defending under a reservation of rights . . . not only must the insured be given the opportunity to select his own counsel to defend the claim, the carrier must also pay the legal fees reasonably incurred in the defense."); *Public Service Mutual Insurance Company v. Goldfarb*, 53 N.Y.2d 392, 401 (1981) ("[I]nasmuch as the insurer's interest in defending the lawsuit is in conflict with the defendant's interest – the insurer being liable only upon some of the grounds for recovery asserted and not upon others – [the policyholder] is entitled to defense by an attorney of his own choosing, whose reasonable fee is to

be paid by the insurer"); *United States Fidelity & Guar. Co. v. Louis A. Roser*, 585 F.2d 932, 939-40 (8th Cir. 1978) ("[Insurer] was required to provide counsel free of the egregious conflict of interest present in this case, and that [insurer] must now reimburse appellant for the fair and reasonable value of the services rendered by appellant's independent counsel in defending the [underlying] action."); *Northland Ins. Co. v. Heck's Service Co. Inc.*, 620 F. Supp. 107 (E.D. Ark. 1985) ("in order to effectuate [insurers'] duty to defend [policyholder], [policyholder] must be allowed to select its own legal counsel."); *Fireman's Fund Ins. Co. v. Waste Management of Wisconsin, Inc.* 777 F.2d 366, 369 (7th Cir. 1985) ("where the insurer reserves rights the insurer does not also reserve the exclusive right to select counsel . . . [insurer] has the continuing duty to finance the independent counsel selected by [policyholder]"); *San Diego Naval Credit Union v. Cumis Insurance Society*, 208 Cal.Rptr. 494, 506 (1984); *Joseph v. Markovitz*, 27 Ariz.App. 122 (Div.1 1976) (when insurer was in a conflict of interest situation "public policy demands that [the policyholder] be able to choose his own attorney without relieving [the insurer] of its contractual obligation under the policy to pay for the defense."); *CHI of Alaska, Inc. v. Employers Reinsurance Corp.*, 844 P.2d 1113 (Alaska 1993) (holding the policyholder has a right to independent counsel, paid by the insurer, when an insurer has caused a conflict by reserving its rights); *Southern Maryland Agr. Ass'n, Inc. v. Bituminous Cas. Corp.*, 539 F. Supp. 1295 (D. Md. 1982) ([policyholder] has a right to select their own attorney to defend the [underlying lawsuit] and [the insurer] has an obligation to pay the reasonable costs and attorney's fees incurred by the [policyholder] in connection therein.); *Prahm v. Rupp Constr. Co.*, 277 N.W.2d 389 (Minn. 1979) (holding that when a conflict of interests exists between the policyholder and the insurer, the policyholder should retain its own counsel and the insurer should reimburse the policyholder.).

The majority of jurisdictions that have ruled on this issue have come down on the side of

the policyholder, protecting the policyholder's interests and entitling a policyholder to choose its independent counsel, to be reimbursed by the insurer, when the insurer has reserved its rights in such a way as to create a conflict.

C. Independent Counsel Is In the Best Interest Of All The Defendants, As Well As In The Best Interest Of The Insurance Companies.

The complexity of the Foreclosure Cases, the sheer number of insurance companies and lawyers, the number of defendants, and the relative impossibility of properly defending this or any action by a committee, all argues in favor of having one qualified firm overseeing the defense of this case. It has been, and will continue to be far more economical to pay independent counsel as opposed to each insurance company paying their respective counsels.

And Ins5 [redacted] is going to have to pay for counsel chosen by its insureds anyway.

IV. THE LACK OF PROPER NOTICE TO Ins5 [redacted]

[redacted] claims not to have received proper notice of the Smith [redacted] inventory case. Based on the D&O policy language, the claims from the inventory lawsuit must be covered in spite of the fact that the suit was filed after the policy period. Claims arising out of the same wrongful act or interrelated wrongful acts are addressed in §IV.E. (Exhibit 1 pp. 5) of the D&O Policy, which provides:

1. **Claims based on or arising out of the same wrongful act, interrelated wrongful acts, or a series of similar or related wrongful acts shall be**:

   a) Considered a single claim; and

   b) Considered first made only during the policy period, including the Extension Period, (if applicable), or during any prior or subsequent policy period in which the earliest claim arising out of such wrongful act(s) was first made Such claims whenever made, shall be assigned to only one policy (whether issued by this or any other insurer) and if that is this Policy, only one Limit· of Liability and one Retention shall apply.

All of the claims in the Inventory lawsuit arise out of the same acts that form the basis for the Acme and Smith Rollformer lawsuits. Based on the above unambiguous policy language, that means that the inventory suit will relate back to the notice given for the Acme suit and should therefore be covered. Ins5 cites a case, *C.A. Jones Management Group, LLC, et al. v. Scottsdale Indemnity Company*, case No. 5:13-CV-00173 (W.D. Ky. March 25, 2015), which actually makes Defendants' case for them. In *C.A. Jones Management Group, LLC,* the Court held that all of the different suits were deemed to be the same claim and coverage for all three underlying lawsuits was dependent on whether the first lawsuit was reported timely.[22] It is unclear why Ins5 would cite a case where the holding says the exact opposite of what Ins5 is asserting. Since the Acme and Smith Roll Former actions were reported within the policy period, and the Inventory lawsuit should be deemed to be the same claim based on the D&O policy language, there should be coverage for the Inventory lawsuit.

CONCLUSION

For these reasons the summary judgment motions of the Insurance Companies should be denied and the Court should set a briefing schedule on the CGL carriers' responsibility for paying counsel chosen by the Insured Defendants. The Court should grant the summary judgment motions of the Insured Defendants against the D&O carriers.

REQUEST FOR HEARING

The Insured Defendants request a hearing on these motions at the convenience of counsel and the parties.

[22] Doc # 88-1, p. 24

Respectfully Submitted,

/s/ D. Duane Cook

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CERTIFICATE OF SERVICE

I hereby certify that on June 15, 2015, a copy of the foregoing was filed with the Clerk of Court via the Court's ECF system, which will serve notification of such filing on all counsel of record.

/s/ D. Duane Cook

EXHIBITS

Exhibit 1 – Response of Defendants to Motion for Restraining Order

Exhibit 2 – Findings of Fact, Conclusions of Law and Order

Exhibit 3 – Doc. 89-10, Excerpts of Ins1 Businessowners Policy

Exhibit 4 – Pages from Ins3 Policy

Exhibit 5 – Excerpts from Ins5 Policy

Exhibit 6 – Excerpts from Ins4 Policy

Exhibit 7 – Excerpts from Jones Deposition

Exhibit 8 – Complete Excerpts from Ins1 [redacted] Policy