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SUPERIOR COURT OF ARIZONA
MARICOPA COUNTY

CV 2011-019071 06/19/2012

HONORABLE J. RICHARD GAMA

CLERK OF THE COURT
D. Harding
Deputy

S P SYNTAX L L C, et al.

TODD R KERR

v.

NATIONAL UNION FIRE INSURANCE COMPANY OF PITTSBURGH P A, et al.

TIMOTHY M STRONG

MAUREEN BEYERS
ROBERT THOMAS SULLIVAN
KURT M ZITZER

MINUTE ENTRY

The Court has had under advisement the following motions:

- Defendant National Union Fire Insurance Company of Pittsburgh, Pa.'s Motion to Dismiss;
- Defendant Federal Insurance Company's Joinder in Motion to Dismiss Filed by Co-Defendant National Union Fire Insurance Company of Pittsburgh, Pa., and/or Motion for Judgment on the Pleadings Pursuant to Ariz. R. Civ. P. 12(c);
- Defendant Liberty Mutual Insurance Company's Joinder in National Union Fire Insurance Company's Motion to Dismiss; and
- Defendant XL Specialty Insurance Company's Motion for Judgment on the Pleadings Pursuant to Ariz. R. Civ. P. 12(c).

Having read and considered the briefing and having heard oral argument, the Court issues the following rulings.

I.

Syntax-Brillian Corporation ("SBC") was a publicly traded developer and distributor of televisions. SBC purchased "claims made" insurance coverage for its directors and officers ("D&Os").[1] Tower 1 (eff. Nov. 30, 2006 through Nov. 30, 2007) consisted of four separate $5 million policies. At issue here is Tower 2 (eff. Nov. 30, 2007 through Nov. 30, 2008), which consisted of $25 million in coverage from four insurers (collectively, "Defendants"): (1) a $5 million primary policy issued by National Union Fire Insurance Company of Pittsburgh, Pa. ("NU"); (2) a $5 million excess "follow form" policy[2] from Federal Insurance Company ("FIC"); (3) a $5 million excess follow form policy from Liberty Mutual Insurance Company ("LM"); (4) a $5 million Side A Only/Difference in Condition ("DIC") policy with "drop down" coverage from FIC; and (5) a $5 million Side A Only/DIC policy with drop down coverage from XL Specialty Insurance Company ("XL").

In 2007, equity investors in SBC filed the *Tsirekidze* action (the "TA") in Arizona federal district court against SBC and certain of the D&Os (the "Executives"), alleging that SBC & the Executives misrepresented SBC's financial condition to induce the plaintiffs' equity investment in SBC. The Executives tendered the TA for coverage to the Tower 1 insurers. In 2008, Plaintiffs SP Syntax LLC and SP3 Syntax LLC (collectively, "Silver Point" or "SP") filed the underlying action (the "UA") in California state court against the Executives in connection with a credit facility agreement ("CFA") for a $150 million term loan and a $100 million revolving loan. The Executives tendered the UA to Defendants and demanded Defendants fund a settlement with SP within the Tower 2 policy limits. Defendants refused to pay the coverage demand, contending generally that the UA alleges, arises out of, is based upon, is attributable to or is related to the facts, circumstances, or wrongful acts alleged in the TA. Subsequently, the Executives reached a settlement agreement with SP in which they paid SP $1.47 million from Tower 1, assigned their rights against Defendants to SP, and entered into a stipulated judgment for $26.47 million. In 2011, SP filed this breach of contract action against Defendants.

II.

In ruling on a Rule 12(b)(6) motion to dismiss, the Court will "assume the truth of the well-pled factual allegations and indulge all reasonable inferences therefrom." *Cullen v. Auto-Owners Ins. Co.*, 218 Ariz. 417, 419 (2008); *see Strategic Dev. & Constr., Inc. v. 7th & Roosevelt*

[1] The purpose behind "claims made" insurance is to limit the insurer's liability to a fixed period of time, which permits the insurer to charge lower premiums. *See, e.g., Zunenshine v. Exec. Risk Indem., Inc.*, 1998 WL 483475, at *5 (S.D.N.Y. 1998).

[2] The terms, conditions, and exclusions of a "follow form" policy are the same as those in the primary policy. *See Aztar Corp. v. U.S. Fire Ins. Co.*, 223 Ariz. 463, 466 n.1 (App. 2010); *Allamerica Fin. Corp. v. Certain Underwriters at Lloyds, London*, 871 N.E.2d 418, 421 (Mass. 2007).

Partners, LLC, 224 Ariz. 60, 63 (App. 2010) (contract or other document attached to complaint not "outside the pleading" within meaning of Rule 12(b)). The Court will grant the motion only if the plaintiff is not entitled to relief "under any facts susceptible of proof in the statement of the claim." *ELM Ret. Ctr., LP v. Callaway*, 226 Ariz. 287, 289 (App. 2010), *quoting Mohave Disposal, Inc. v. City of Kingman*, 186 Ariz. 343, 346 (1996).

A. *NU Policy; LM Follow Form Policy; FIC Follow Form Policy.*

NU argues that Endorsement 25 ("En.25")[3] (and Exclusion 4(d), "Ex.4(d)")[4] bars coverage for the UA as a matter of law.[5] *See Zahler v. Twin City Fire Ins. Co.*, 2006 WL 846352 (S.D.N.Y. 2006); *Zunenshine, supra.* NU contends the UA alleged and arose out of the same wrongful acts that were at issue in the TA, i.e., the same misrepresentations of SBC's financial condition made by the Executives vis-à-vis its financial arrangements with supplier Taiwan-Kolin ("Kolin") and account receivable payments by distributor South China House of Technology ("SCHOT").

As a threshold issue, SP contends that Arizona law requires a "causal connection" between wrongful acts for one wrongful act to "relate to" the other, when that term is not defined in the insurance policy. *See Ariz. Prop. & Cas. Ins. Guar. Fund v. Helme*, 153 Ariz. 129 (1987). The Court disagrees that *Helme* compels this conclusion. At issue in *Helme* was construction of the policy definition of "occurrence" as any "series of related incidents, acts or omissions resulting in injury…." *Id*. at 134. The *Helme* court held that there would be a single occurrence "if the acts are causally *related to each other* as well as to the final result." *Id*. at 136 (emphasis in original). At issue here is construction of "claims made" language and an exclusionary provision that is substantially broader, encompassing far more than "related acts" and defined by reference to a specified event (the TA). *See* n.3 *supra*. The Court declines to read the *Helme* requirement of causal connection into En.25. *See GRE Ins. Group v. Green*, 194 Ariz. 251, 253 (App. 1999) (distinguishing *Helme* on basis of significant difference in terms used in policies);

[3] En.25 excludes coverage for any Claim (defined to include any civil legal proceeding) "alleging, arising out of, based upon, attributable to or in any way related directly or indirectly, in part or in whole, to an Interrelated Wrongful Act…, regardless of whether or not such Claim involved the same or different Insureds, the same or different legal causes of action or the same or different claimants…." "Interrelated Wrongful Act" means "(i) any fact, circumstance, act or omission alleged in [the TA] and/or (ii) any Wrongful Act which is the same as, similar, or related to or a repetition of any Wrongful Act alleged in [the TA]."

[4] Ex.4(d) precludes coverage for claims "alleging, arising out of, based upon or attributable to…the same or related Wrongful Acts alleged or contained in any Claim which has been reported…under any policy of which this policy is a renewal." The TA was reported under the 06-07 Policy; the 07-08 Policy was a renewal of the 06-07 Policy.

[5] In this section, the Court addresses collectively the arguments made by NU, LM, and FIC (as to its Follow Form Policy) and SP's responses thereto. LM and FIC each argue further that their respective Follow Form Policies independently bar coverage. The court need not address these arguments because of the Court's resolution of this issue on the basis of En.25.

Emp'rs Mut. Cas. Co. v. DGG & CAR, Inc., 218 Ariz. 262, 268 n.4 (2008) (*Helme* involved different policy language and issue).

SP next contends that it alleged three different claims in the UA, not one, and that NU must show each claim falls under En.25.[6] NU contends that this argument cannot be reconciled with the Policy language and contradicts the Complaint in the UA. The Court agrees with NU on both bases. "[T]he concept of 'claim' within the meaning of insurance policies is textual rather than procedural." *Home Ins. Co. v. Spectrum Info. Techs., Inc.*, 930 F. Supp. 825, 847 (E.D.N.Y. 1996) (equating "claim" and "suit" inconsistent with plain language of policy). In the context of this action, the NU Policy defines "claim" to mean "a civil…proceeding for monetary…relief which is commenced by…service of a complaint or similar pleading…." (Section 2(b)(2).) The UA alleged one claim for negligent misrepresentation against the Executives based on alleged misrepresentations made in 2007 and 2008.[7] SP acknowledged as much in its Complaint in this action. *See* CV 2011-019071, Complaint at ¶¶ 19-20.

The first category of wrongful acts alleged in the UA references misrepresentations regarding SBC's financial condition made by the Executives to induce it to close the CFA in October 2007—in particular, representations regarding Kolin (price protection rebates and tooling deposits) and SCHOT (accounts receivable). *See* UA, Complaint at ¶¶ 48-65. Backhandedly acknowledging that these were the same misrepresentations alleged in the TA, SP draws a distinction between representations that were made publicly (the TA) and privately (the UA). The Court agrees with NU that this is a distinction without a difference. At the core, these allegations are the same as or a repetition of, or at the least are similar or related to, the wrongful acts alleged in the TA. *See Gateway Grp. Advantage, Inc. v. McCarthy*, 300 F. Supp. 2d 236, 243-45 (D. Mass. 2003).

The real issue is whether the second and third categories of wrongful acts arose from the same, similar, or related wrongful acts as those alleged in the TA. The second and third categories of wrongful acts alleged in the UA reference misrepresentations made by the Executives post-CFA that prevented it from acting sooner to mitigate damages under the CFA: (i) a December 2007 and January 2008 misrepresentation about an additional $40 million in account receivables owed to SBC by SCHOT, and (ii) a February 2008 misrepresentation at a board meeting regarding SBC's then-current financial condition. *See* UA, Complaint at ¶¶ 66-

[6] SP contends it alleged three claims: (1) misrepresentations that induced SP to enter into the CFA in 2007, causing damages because the loan was not paid back in full; (2) post-December 2007 misrepresentations that caused it to refrain from exercising its rights and remedies under the CFA until January 2008, by which time $36 million of cash collateral had dissipated; and (3) post-December 2007 misrepresentations that induced it to fund SBC's operations and professional fees, totaling millions of dollars.

[7] Under California law, a single material misrepresentation may establish the tort. *OCM Principal Opportunities Fund v. CIBC World Markets Corp.*, 157 Cal. App. 4th 835, 854 (2007).

74. SP pled these wrongful acts, however, as being part of a "wrongful course of conduct." UA, Complaint at 10, ln. 1-2. Wrongful acts are the same or at least related if they are tied together by a course of conduct aimed at a single particular goal. *Cont'l Cas. Co. v. Wendt,* 205 F.3d 1258, 1264 (11th Cir. 2000). These post-CFA misrepresentations on which SP alleges it relied in maintaining the CFA clearly at the least arose from the same core financial misstatements on which it alleges it relied in providing the CFA. *See Fimbers v. Fireman's Fund Ins. Co.,* 147 Ariz. 75, 76-77 (App. 1985) ("arising out of" implied originated from, grew out of, flowed from or had a connection with); *cf. ACE Am. Ins. Co. v. Ascend One Corp.,* 570 F. Supp. 2d 789, 801 (D. Md. 2008) (claims not interrelated when second action focused on circumstances and events that occurred subsequent to wrongful acts underlying first action and focused on different deceptive trade practices). SP does not allege new or different damages from these misrepresentations, only an interference with its ability to mitigate damages. UA, Complaint at ¶¶ 70, 74.[8]

SP relies on *Financial Management* in arguing that NU has not proven a sufficient factual nexus between the two lawsuits, brought by two unrelated parties who suffered distinct injuries. *Fin. Mgmt. Advisors, LLC, v. Am. Int'l Specialty Lines Ins. Co.,* 506 F.3d 922 (9th Cir. 2007); *see also Nat'l Union Fire Ins. Co. of Pittsburgh, Pa. v. Ambassador Group, Inc.,* 691 F. Supp. 618, 623 (E.D.N.Y. 1988). The Court agrees with NU that *Financial Management* is distinguishable on its policy language and facts. The policy at issue in *Financial Management* apparently did not define "related Wrongful Acts." 506 F.3d at 923-24. En.25 defines "Interrelated Wrongful Acts" with specific reference to the TA and bars coverage if the UA alleges, arises out of, or relates *in part or in whole* to an Interrelated Wrongful Act. Further, the acts averred in the two actions in *Financial Management* were less clearly connected than the core wrongful acts averred in the two actions here.

SP urges this Court to construe En.25 in a reasonable and common sense manner. "[T]he rule in Arizona is that we construe a clause subject to different interpretations by examining the language of the clause, public policy considerations, and the purpose of the transaction as a whole." *State Farm Mut. Auto. Ins. Co. v. Wilson,* 162 Ariz. 251, 257 (1989). Taking these into consideration, it does not defy reason and common sense to construe En.25 to bar coverage here, written as broadly as it is and with specific reference to the TA. Nor does such a construction render the promised coverage illusory. *Cf. Am. Med. Sec., Inc. v. Exec. Risk Specialty Ins. Co.,* 393 F. Supp. 2d 693, 703 (E.D. Wis. 2005). En.25 does not bar claims that do not arise out of or relate to the wrongful acts alleged in the TA. *Cf. id.* at 707 (lawsuits clearly "related" in any meaningful sense of the word); *Cont'l Cas. Co. v. Orr,* 2008 WL 2704236, at *6 (D. Neb. 2008) (defendants' proposed construction would render per-claim limit meaningless).

[8] The Court incorporates by this reference the Comparison of the Core, Overlapping Allegations in the *Tsirekidze* Action and the Underlying Action, attached as Exhibit B to NU's Motion to Dismiss.

Such construction is consistent with the purpose behind these "claims made" Policies, i.e., "to limit [the insurer's] liability to a fixed period of time." *Zunenshine*, 1998 WL 483475, at *5 (citation omitted). En.25 is an express limitation of risk beyond that already assumed under the Tower 1 policies for the then-well defined allegations as to SBC's false financial reporting.

SP argues that fact questions preclude the Court from deciding this issue as a matter of law on the pleadings.[9] *See Zunenshine*, 1998 WL 483475, at *1 (motion for summary judgment); *Gateway Grp.*, 300 F. Supp. 2d at 241 (same); *In re DBSI, Inc.*, 2011 WL 3022177, at **1-2 (Bankr. D. Del. 2011) (same). The Court disagrees. SP attached to its Complaint in this action all of the evidence needed to establish the applicability of En.25, including the Policies and the Complaints in the UA and TA. *See Zahler*, 2006 WL 846352, at *3; *see also Zunenshine*, 1998 WL 483475, at *4 (examination of policy's terms and comparison of two lawsuits at issue demonstrated insurer carried its burden of proving exclusion applied); *Acosta, Inc. v. Nat'l Union Fire Ins. Co.*, 39 So. 3d 565, 576 (Fla. App. 2010).

Based on the foregoing,

IT IS ORDERED granting Defendant National Union Fire Insurance Company of Pittsburgh, Pa.'s Motion to Dismiss; Defendant Federal Insurance Company's Joinder in Motion to Dismiss Filed by Co-Defendant National Union Fire Insurance Company of Pittsburgh, Pa., and/or Motion for Judgment on the Pleadings Pursuant to Ariz. R. Civ. P. 12(c) (as to its $5 million excess follow form policy); and Defendant Liberty Mutual Insurance Company's Joinder in National Union Fire Insurance Company's Motion to Dismiss.

B. *FIC and XL's Side A Policies.*

FIC's Side A Policy (the "Elite Policy") and XL's Side A Policy (the "XL Policy") stand alone and do not follow form to the NU Policy. SP alleges that the Elite and XL Policies (collectively, the "Side A Policies") by their terms drop down to perform as a primary insurance policy if the primary and excess D&O insurers in Tower 2 are not liable under the terms of those Policies. UA, Complaint at ¶¶ 39, 42. Thus, even if the Court were to find that En.25 applies to SP's claims, SP argues the Side A Policies still apply and provide coverage. FIC and XL (collectively, the "Side A Insurers") do not dispute that the Side A Policies might provide coverage in a case where a primary policy does not. However, the Side A Insurers argue this drop down feature is subject to the insuring clause and other terms and conditions of the Side A Policies. Although the Side A Policies do not reference the TA or En.25, the Side A Insurers contend that exclusions in those Policies operate to bar coverage in the same manner En.25 does.

[9] *But see* SP's Opp. to NU's Mot. to Dismiss at 10 (case law shows UA and TA not interrelated as a matter of law).

Interpretation of a contract is generally a matter of law for the Court. *E.g., ELM Ret. Ctr.,* 226 Ariz. at 291; *Powell v. Washburn,* 211 Ariz. 553, 555 (2006). In interpreting a contract, the Court must "determine the parties' intent and enforce that intent." *Grosvenor Holdings, L.C. v. Figueroa,* 222 Ariz. 588, 593 (App. 2009). In order to determine intent, the Court will first look to "the plain meaning of the words in the context of the contract as a whole." *Id.* The Court will also consider extrinsic evidence of intent, and if it finds that the contract language is "reasonably susceptible" of the interpretation advanced, such evidence is admissible to determine intent. *Taylor v. State Farm Mut. Auto. Ins. Co.*, 175 Ariz. 148, 154 (1993).

The meaning that appears plain and unambiguous on the first reading of a document may not appear nearly so plain once the judge considers the evidence. In such a case, the parol evidence rule is not violated because the evidence is not being offered to contradict or vary the meaning of the agreement. To the contrary, it is being offered to explain what the parties truly may have intended.

Id.; see also Velarde v. PACE Membership Warehouse, Inc., 105 F.3d 1313, 1317 (9th Cir. 1997) (*Taylor* limited use of parol evidence to contract interpretation and rejected its use to vary or contradict a final agreement). "Whether contract language is reasonably susceptible to more than one interpretation so that extrinsic evidence is admissible is a question of law for the court." *Taylor, id.* at 158-59; *see also In re Estate of Lamparella*, 210 Ariz. 246, 250 (App. 2005). However, when the Court concludes interpretation is needed and the extrinsic evidence establishes "controversy over what occurred and what inferences to draw from the events," the matter may be a question of fact for the jury. *Taylor, id.* at 159.

SP's counsel opined at oral argument that "the only practical difference between the National Union primary policy and the Federal Elite and the XL policies are that the Federal Elite and the XL policies do not refer to Tsirekidze." (Transcript Apr. 25, 2012 at 86-87.) Although the Court disagrees with the adjective "only," the Court does agree the lack of reference to the TA is an important difference in construing the Side A Policies' related acts and/or prior notice exclusions. *See Wilson, supra.* The issue whether the parties intended the Side A Policies to drop down under these facts precludes the Court from ruling as a matter of law, particularly on these motions for judgment on the pleadings. *See Johnson v. Earnhardt's Gilbert Dodge, Inc.*, 212 Ariz. 381, 386 (2006) (evidence admissible to determine intent of parties because conflicting language in transaction documents reasonably susceptible to interpretation that Earnhardt was a party to the contract). XL's counsel characterizes this issue as a red herring. (Transcript Apr. 25, 2012 at 90.) However, the Court finds the nature of the fish on the line in terms of the parties' intentions is more properly raised by way of Rule 56 motion than Rule 12(c). *See generally Emmett McLoughlin Realty, Inc. v. Pima Cnty.*, 203 Ariz. 557, 558 (App. 2002) (Rule 12(c) motion tests sufficiency of complaint and should be granted if complaint fails to state claim for relief); *Giles v. Hill Lewis Marce,* 195 Ariz. 358, 359 (App.

1999). Both SP and the Side A Insurers are free to argue this issue on motion for summary judgment following discovery, should either side be so inclined.

Based on the foregoing,

IT IS ORDERED denying Defendant Federal Insurance Company's Joinder in Motion to Dismiss Filed by Co-Defendant National Union Fire Insurance Company of Pittsburgh, Pa., and/or Motion for Judgment on the Pleadings Pursuant to Ariz. R. Civ. P. 12(c) (as to its $5 million Side A policy); and Defendant XL Specialty Insurance Company's Motion for Judgment on the Pleadings Pursuant to Ariz. R. Civ. P. 12(c).

ALERT: The Arizona Supreme Court Administrative Order 2011-140 directs the Clerk's Office not to accept paper filings from attorneys in civil cases. Civil cases must still be initiated on paper; however, subsequent documents must be eFiled through AZTurboCourt unless an exception defined in the Administrative Order applies.