IN THE SUPERIOR COURT OF THE STATE OF DELAWARE

IN AND FOR NEW CASTLE COUNTY

HLTH CORPORATION and EMDEON PRACTICE SERVICES, INC. Plaintiffs, v. AGRICULTURAL EXCESS AND SURPLUS INSURANCE 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.

MEMORANDUM OPINION

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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 Cavalieri LLC, Columbus, Ohio, Attorneys for Defendant Old Republic Insurance Company.

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COOCH, J.

I. INTRODUCTION

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[1]

[1] 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.

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 Synetic, Inc. ("Synetic"), 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, Synetic/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, Synetic 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 Synetic is referred to herein as the "Synetic Tower." The tower of insurance maintained by Emdeon is referred to herein as the "Emdeon Tower."

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 entitiy(ies) or person(s) of more than 50% of the outstanding securities representing the present right to vote for the election of directors 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.

Synetic's acquisition of MMC occurred on July 23, 1999.

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 insurance coverage is referred to as the "Federal Policy."

6. Federal did not participate in the MMC Tower.

7. The Synetic Tower provides a total of $100 million in coverage.

8. The Synetic 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 Synetic policies on July 23, 1999.

9. The Synetic policies also state:

> [If Synetic] (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.

Synetic was acquired by Emdeon on September 12, 2000.

10. The period during which claims may be reported 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:

* * * * *

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 superseding 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."

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 Synetic 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 Synetic 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 Synetic Tower.

20. The policy that Federal issued to Synetic 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 art 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 $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.

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[2]

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.

4. By stipulation and Order of the Court of Chancery, the matter was transferred to this Court on September 12, 2007.

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").[3]

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.

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[2] 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.

[3] 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.

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. Various defendants joined in Federal's Motion.[4]

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 Parital 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.[5] The Motion names Federal, Travelers, Clarendon, Lloyd's and New Hampshire.

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

[4] Clarendon, Travelers, Safeco, Lloyd's and Old Republic joined Federal's Motion. New Hampshire did not join Federal's Motion.

[5] 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.

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 3561126 00 (policy period September 12, 2000 to September 12, 2006). SO ORDERED by this Court on April 1, 2008.

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."[6] As the MMC, Synetic 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."[7] 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 Synetic tower and 14% to the Emdeon tower.[8] In support of their proposed allocation scheme, Defendants assert that Plaintiffs "acquired an entity [i.e. Synetic 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.[9]

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

[6] Defs. Mot. for Partial Summ. J., at 9.
[7] *Id.* at 10, 11.
[8] *Id.* at 13.
[9] *Id.* at 14.

"'Wrongful Act' in the Federal Policy."[10] 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."[11] 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."[12]

B. Exhaustion of Underlying Policy Limits

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."[13] 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."[14] Defendants contend that this type of provision is permissible and enforceable "in order to prevent settlements between an insured and an underlying insurer that

[10] Pls. Opp'n to Defs. Mot. for Partial Summ. J., at 10, 12.
[11] *Id.* at 17.
[12] *Id.* at 18, 21.
[13] Defs. Opp'n to Pls. Mot. for Partial Summ. J., at 14.
[14] *Id.* at 17.

attempt to shift risk to higher level insurers that received less premium to cover risk at a higher attachment point."[15]

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.[16] 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."[17] 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."[18]

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

[15] *Id.*
[16] Pls. Reply to Defs. Opp'n to Pls. Mot. for Partial Summ. J., at 9-10.
[17] *Id.* at 11.
[18] *Id.* at 12,13.

policy."[19] 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."[20] 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.'"[21] 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.'"[22] 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.

[19] Pls. Mot. for Partial Summ. J., at 17.
[20] *Id.* at 19.
[21] *Id.* at 23 (emphasis in original).
[22] *Id.* at 25.

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."[23] 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."[24] 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 Plainitffs.[25] 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."[26]

[23] Defs. Opp'n to Pls. Mot. for Partial Summ. J., at 8.
[24] Defs. Mot. for Partial Summ. J., at 11.
[25] Defs. Opp'n to Pls. Mot. for Partial Summ. J., at 9 (emphasis in original).
[26] *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."[27] No genuine issues of material fact exist as a matter of law where opposing parties have each sought summary judgment.[28] Superior Court Civil Rule 56(h) provides:

> 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[29]

The Synetic policies contain the following provision:

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[27] *Scottsdale Ins. Co. v. Lankford*, 2007 Del. Super. LEXIS 338, *11

[28] Super. Ct. Civ. R. 56(h).

[29] 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.

> [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.[30]

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 Synetic 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 Synetic tower contracts and the last was included in the Emdeon tower contracts):

> 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.[31]

> [If Synetic] (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

[30] See *supra* at 7.
[31] See *supra* at 6.

> actual or alleged Wrongful Act occurring after the effective time of the Transaction.[32]
>
> 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.[33]

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."[34]

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 Synetic tower and 14% to the Emdeon tower.[35] Defendants arrive at these percentages by allocating the alleged overt acts, according to the alleged dates of their occurrences as set forth in the indictment, to each tower's coverage period

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[32] See *supra* at 6.
[33] See *supra* at 7.
[34] Tr. of Oral Argument at 36 (May 5, 2008).
[35] See *supra* at 14.

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.

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.*,[36] the New Jersey Supreme Court found that a defendant

[36] *SL Industries, Inc. v. American Motorists Ins. Co.*, 607 A.2d 1266 (N.J. 1992).

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.[37] This case set out a rule, as further elucidated in *Hebela v. Healthcare Insurance Co.*,[38] 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.

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*

[37] *Id.* at 1280.
[38] *Hebela v. Healthcare Ins. Co.*, 851 A.2d 75 (N.J. Super. Ct. App. Div. 2004).

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.[39] As *Hebela* only stands as a practical clarification of the holding in *SL Industries*, it is not helpful.

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.[40] *L.C.S., Inc.*, similarly, only stands for a rule recognizing apportionment between covered and uncovered claims after the underlying claim has been resolved.

Finally, in *Morgan, Lewis & Bockius LLP v. Hanover Insurance Co.*,[41] 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

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[39] *Id.* at 83-84.

[40] *L.C.S., Inc. v. Lexington Ins. Co.*, 853 A.2d 974, 984-985 (N.J. Super. Ct. App. Div. 2004).

[41] *Morgan, Lewis & Bockius LLP v. Hanover Ins. Co.*, 929 F.Supp. 764 (D.N.J. 1996).

logic as set out in *SL Industries, Inc.* and *Hebela*, proceeded to apportion defense costs between covered and uncovered claims.[42] 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.

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."[43] 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.

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[42] *Id.* at 769-73.

[43] See *SL Indus., Inc.*., 607 A.2d at 1280.

Moreover, none of the above cases required allocation 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.[44] 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.[45] This letter demonstrates the Court's concern about redundant and wasteful litigation

[44] 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.

[45] *Id.*

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.

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.[46] 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.

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.[47] 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

[46] Pls. Opp'n to Defs Mot.s for Partial Summ. J., at 19, n.14.
[47] Defs. Mot. for Partial Summ. J., at 10.

three towers of insurance have some amount of contractually viable claims that have triggered them.

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.[48] The *Hebela* Court's approach coincides with that of this Court:

> [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.[49]

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

[48] *Hebela*, 851 A.2d at 85.
[49] *Id.*

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."[50] 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."[51] 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

[50] *Sun-Times Media Group, Inc. v. Royal & SunAlliance Ins. Co. of Canada*, 2007 WL 1811266, *11 (Del. Super. June 20, 2007).

[51] *Id.* at *8.

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.

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.*[52] 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:

> As the policy obligates [the insurer] to advance all defense costs as they are incurred, subject to a right of recoupment of payment for noncovered costs after the underlying litigation is completed, the court had no obligation at this juncture to rule on the allocation of defense expenses.[53]

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

[52] *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).

[53] *Id.*

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.[54]

Plaintiffs and Defendants have stipulated that Plaintiffs have reached settlement agreements with two of the underlying insurers.[55] 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

[54] See *supra* at 9.
[55] See *supra* at 9-10, 12.

will be liable only for covered losses in excess of [the primary policy limit plus the deductible on the excess insurance policy]." [56] 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."[57] Indeed, Delaware courts have followed this reasoning.[58]

New Jersey law is in accord with Delaware law on this issue. In *Westinghouse Electric Corporation v. American Home Assurance Company*,[59] 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

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[56] *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)

[57] *Id.*

[58] S*ee 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.")

[59] *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).

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.[60] The Court believes that the reasoning in *Westinghouse* and *Stargatt* applies equally here.

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.

[60] *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.").

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

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.

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Richard R. Cooch, J.

oc: Prothonotary