IN THE SUPERIOR COURT OF THE STATE OF DELAWARE
IN AND FOR NEW CASTLE COUNTY

AT&T Corp.,	)	
	)	
Plaintiff,	)	
v.	)	C.A. No. 04C-11-167
	)	
CLARENDON AMERICA INSURANCE, et al.	)	
	)	
Defendants.	)	

Date Submitted: March 6, 2006
Date Decided: September 18, 2006

OPINION

Upon the At Home Insurers' Joint Motion to Dismiss AT&T Corp.'s First Amended Complaint. **GRANTED**

Appearances:

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C. Scott Reese, Esquire of Cooch and Taylor, 824 Market Street, Suite 1000, Wilmington, Delaware, 19899, and Randall Block, Esquire (*Pro Hac Vice*) of Sedgwick, Detert, Moran & Arnold, One Embarcardo Center, 16th Floor, San Francisco, California, 94111, for the Defendant Zurich American Ins. Co.

Jurden, J.

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I. INTRODUCTION

This is a vast Directors and Officers (hereinafter "D&O") liability insurance coverage case. The Court has explained the background of this case in detail in an earlier opinion[1] and, thus, will not restate it here except as is necessary to adjudicate the motion to dismiss *sub judice*.

At issue are D&O liability policies issued (the "Policies") by five insurers (collectively the "At Home Insurers")[2] to At Home for the Policy Period July 8, 2001 through July 8, 2002. The primary insurer on this coverage tower is Genesis Insurance Company ("Genesis"). The four excess insurers are Clarendon America Insurance Company ("Clarendon"), North American Specialty Insurance Company ("North American"), Faraday Capital Limited, individually and as representative of certain underwriters at Lloyd's and other companies ("Lloyd's), and XL Specialty Insurance Company.[3] These Policies are triggered when an insured under those Policies – an At Home Director or Officer – suffers a "Loss" as defined by the Policies. Through its First Amended Complaint, AT&T Corporation ("AT&T"), standing in the shoes of ten AT&T employees who serve as At Home Directors

[1] *See AT&T Corp. v. Clarendon America Ins. Co*., 2006 WL 1382268 (Del. Super.).
[2] The "At Home Insurers" are Genesis Insurance Company, Clarendon America Insurance Company, North American Specialty Insurance Company, Faraday Capital Limited, individually and as representative of certain underwriters at Lloyd's London, and XL Specialty Insurance Company. *See* Opening Br. in Support of the At Home Insurers' Joint Mot. to Dismiss AT&T Corp.'s First Am. Compl., E-File 6627312, at 1.
[3] The excess policies, in the order in which they provide coverage above the Genesis Policy, are Clarendon Policy No. MAG 24 700288 10000, with limits of liability of $5 million in excess of the underlying coverage; North American Policy No. CKX0005084-00, with limits of liability of $5 million in excess of underlying coverage; Lloyd's Policy No. 509/QB405901, with limits of liability of $10 million in excess of underlying coverage; and XL Specialty Policy No. ELU 82554-01, with limits of liability of $20 million in excess of underlying coverage. *See* Aff. of Rick Swedloff in Support of the At Home Insurers' Motion to Dismiss AT&T's First Amended Complaint, E-File 6627312, Exs. B, C, D ("Swedloff Aff.").

and Officers, seeks coverage from the At Home Insurers for defense costs and indemnification related to *Williamson v. AT&T Corp., et al.,* No. CV 812506 (Cal. Super. Ct., Santa Clara Cty.) (the "*Williamson Fiduciary* Action*")* and *Leykin v. AT&T Corp., et al.,* No. 02CV1765 (S.D.N.Y.) ("*Leykin*" or "the *Leykin* Action) (sometimes hereinafter referred to collectively as "the Underlying Litigation.")[4] Of the six insurers who filed (or joined) the instant Motion to Dismiss, four wrote policies that follow form to the terms and conditions of the primary policy issued to At Home by Genesis, Policy No. YXB002358, for the period from July 8, 2001 to July 8, 2002.[5] As noted above, these policies provide coverage in excess of the Genesis primary policy and were sold in respective layers of coverage above the $10 million of Genesis primary coverage.[6] National Union Fire Insurance Company of Pittsburg ("National Union") has filed a joinder in support of the At Home Insurers Motion to Dismiss. It, too, seeks a forfeiture of coverage as to the At Home Directors, but for different policy years than the At Home Insurers.[7] The National Union policies sold to At Home that are the subject of national Union's Joinder are National Union Policy No. 859-11-89, with coverage from July 8, 1999

[4] AT&T also seeks coverage for costs associated with its defense of *James v. AT&T Corp.,* 334 F. Supp. 2d 410 (S.D.N.Y.2004) ("*James*"), which was dismissed as duplicative of *Leykin v. AT&T corp., et al.,* No. 02CV1765 (S.D.N.Y.) ("*Leykin*").

[5] *See* Aff. of Cara Tseng Duffield in Support of the At Home Insurers' Motion for Partial Summary Judgment on Plaintiff's Claims for Coverage for the Williamson Fiduciary and Leykin Actions Under the 2001 At Home Program, E-File 5937773, Ex. A ("Duffield Affidavit" or "Duffield Aff.").

[6] *See* Duffield Aff., ¶¶ 2-6.

[7] AT&T Corp.'s Answering Br. in Opp'n to the Joint Motion of the At Home Insurers to Dismiss AT&T's First Amended Complaint, E-File 6929374, at 4.

to July 8, 2000[8], and National Union Policy No. 468-76-83, with coverage from July 8, 2000 to July 8, 2001.[9] Both of these policies provide first layer coverage in their respective policy periods with the 1999-2000 policy providing coverage of $10 million and the 2000-2001 policy providing $15 million.

A. The Genesis Policy Language at Issue

The Genesis Insuring Agreements at § I.A.-B. provide, in relevant part:

> A. The insurer will pay, on behalf of the Directors and Officers, Loss arising from Claims first made during the Policy (or Discovery) Period against the Directors or Officers, individually or collectively, for a Wrongful Act, except for such Loss which the Company pays to or on behalf of the Directors and Officers;
>
> B. The Insurer will pay, on behalf of the Company, Loss which the Company is required to indemnify, or which the Company may legally indemnify, the Directors and Officers, arising from Claims first made during the Policy (or Discovery) Period against the Directors or Officers, individually or collectively, for a Wrongful Act….[10]

As reflected in the At Home Insurers' Opening Brief, their motion rests in part on the application of the definition of "Loss" incurred with respect to a "Wrongful Act":

[8] *See* Aff. of William P. Larsen in support of Defendant National Union's Motion for Partial Summary Judgment on the Pleadings, E-File 5938796), Ex. F ("Larsen Aff.").
[9] Larsen Aff., Ex. G.
[10] Duffield Aff., Ex. A., Genesis Policy, § I., p. 1 of 8.

F. "Loss" shall mean any amounts which the Directors or Officers are legally obligated to pay, such amounts which the company is required to indemnify the Directors or Officers, or such amounts which the Company may legally indemnify the Directors or Officers, for Claims made against the Directors or Officers, or any amounts which the Company is legally obligated to pay for Securities Claims made against the Company, in excess of the applicable Retention, including damages, Judgments orders, Settlements, and Defense Costs; provided, however, Loss shall not include criminal or civil fines or penalties imposed by law, multiplied portions of damages in excess of actual damages, taxes, or any matter which may be deemed uninsurable under the law pursuant to which this Policy shall be construed.[11]

L. "Wrongful Act" shall mean:

(1) under Insuring Agreements Section I.A. and B., any actual or alleged act, omission, misstatement, misleading statement, neglect, error or breach of duty by the Directors of Officers in their capacity as Directors or Officers of the Company or in their capacity as directors or officers of an Outside Entity, individually or collectively;

(2) under Insuring Agreement Section I.C., any actual or alleged act, omission, misstatement, misleading statement, neglect, error or breach of duty by the Company, or by persons for whose actual or alleged conduct the Company is legally responsible.[12]

B. The National Union Policy Language at Issue

The National Union Policy contains the following definitions of "Loss" and "Wrongful Act:"

[11] Duffield Aff., Ex. A, § II. F., p. 2 of 8.

[12] Duffield Aff., Ex. A, § II. L., pp. 2-3 of 8.

(j) "Loss" means damages, judgments (including any award of pre-judgment and post-judgment interest), settlements, Defense Costs and Year 2000 Crisis Loss; however, Loss shall not include civil or criminal fines or penalties imposed by law, punitive or exemplary damages, the multiplied portion of multiplied damages, taxes, any amount for which the Insured are not financially liable or which are without legal recourse to the Insureds, any judgment solely against, or settlement solely by, the Company and/or any Employee in a Year 2000 Third Party Claim, any cost or expense incurred by the Company in connection with the assessing, auditing, testing, correcting, converting, renovating, rewriting, designing, evaluating, inspecting, installing, maintaining, repairing or replacing any Computer System of the Company with respect to a potential Year 2000 Problem (as such terms are defined below in definition (r)).

In the event of a Claim alleging that the price or consideration paid or proposed to be paid for the acquisition or completing of the acquisition of all or substantially all of the stock issued by or assets owned by any entity is inadequate or excessive, Loss with respect to such Claim shall not include any amount of any judgment or settlement by which such price or consideration is increased or decreased, directly or indirectly; provided, however, that the foregoing shall not apply to any non-indemnifiable Loss resulting from any judgment (other than a stipulated judgment) against a Natural Person Insured.

Notwithstanding the foregoing, with respect to Securities Claims only and subject to the other terms, conditions and exclusion of the policy, Loss shall include punitive or exemplary damages imposed upon any Insured. It is further understood and agreed that the enforceability of the foregoing coverage shall be governed by such applicable law which most favors coverage for punitive or exemplary damages.

(q) "Wrongful Act" means:

(1) with respect to a Director or Officer, any actual or alleged Employment Practice Violation or other actual or alleged breach of duty, neglect, error, misstatement, misleading statement, omission or act by the Directors or Officers 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, or any matter claimed against a Director or Officer arising out of their serving as a director, officer, trustee or governor of an Outside Entity in such capacities, but only if such service is at the specific written request or direction of the Company, and

(2) with respect to an Employee, any actual or alleged breach of duty, neglect, error, misstatement, misleading statement, omission or act by the Employees in their respective capacities as such or any matter claimed against them solely by reason of their status as Employees of the Company but solely as respects a Securities Claim or a Year 2000 Claim, and

(3) with respect to the Company, any actual or alleged breach of duty, neglect, error, misstatement, misleading statement, omission or act by the Company, but solely as respects a Securities Claim or Year 2000 Claim.[13]

The At Home Insurers claim that the ten AT&T employees who serve as Directors and Officers of At Home have no "loss" to which D&O coverage applies. In opposition, AT&T argues that it would be inappropriate as a matter of law and policy for the Court to grant this motion because "[i]t would eviscerate the protections provided by At Home specifically for the benefit of its officers and

[13] Larsen Aff., Ex. F, § 2(j)(q).

directors."[14] For the reasons set forth below, the At Home Insurers' Motion to Dismiss is **GRANTED**.

II. STANDARD

When presented with a motion to dismiss under Superior Court Civil Rule 12(b)(6) the Court will consider all well-pleaded facts in the complaint and accept them as true.[15] "Dismissal under Superior Court Rule 12(b)(6) is appropriate only where it appears with reasonable certainty that [the plaintiff] would be unable to prevail on any set of facts inferable from the complaint." [16] In viewing the facts, the Court must draw "all reasonable inferences in favor of the non-movant."[17] The Court may consider documents that are "integral to a plaintiff's claim and incorporated in the complaint" in deciding a motion to dismiss.[18] Here, the Policies, the pleadings in the Underlying Litigation, the settlement of the *Williamson Fiduciary* Action, and the Assignments, are directly referenced in AT&T's Complaint[19] and are integral to AT&T's claims. Thus, this Court may

[14] Hr'g. Tr., D.I. 165, at 27, Nov. 17, 2005.
[15] *Crowhorn v. Nationwide Mut. Ins.,* 2001 WL 695542, at *2 (Del.Super.) (*citing Spence v. Funk*, 369 A.2d 967, 968 (Del. 1978)).
[16] *Lord v. Souder*, 748 A.2d 393, 398 (Del. 2000).
[17] *Rinaldi v. Iomega Corp.*, 1999 WL 1442014, at *2 (Del. Super.)(*quoting Ramunno v. Cawley*, 705 A.2d 1029, 1034 (Del. 1998)).
[18] *In re Santa Fe Pacific Corp. S'holder Litig.*, 669 A.2d at 69-70 (*citing Cortec Indus., Inc. v. Sum Holding, L.P.*, 949 F.2d 42, 47 (2d Cir. 1991). *See also Malpiede v. Townson*, 780 A.2d 1075, 1083 (Del. 2001) ("A claim may be dismissed if the allegations in the complaint or in the exhibits incorporated into the complaint effectively negate the claim as a matter of law.").
[19] AT&T's First Am. Compl., E-File 6484936, ¶¶ 24, 27, 29, 33-36, 38.

consider those documents without converting the motion to dismiss to a summary judgment motion.[20]

III. DISCUSSION

A. Introduction

The question presented is whether the ten AT&T employees who serve as Directors and Officers of At Home suffered a "loss" within the meaning of the relevant Policies. The At Home Insurers argue that AT&T has failed to state a claim because AT&T does not allege in its First Amended Complaint that the insureds, At Home and its Directors and Officers, have paid or will ever pay any amount to defend or settle the Underlying Litigation. In fact, as the At Home Insurers point out, AT&T concedes that it:

> …has paid all defense fees and costs and settlements, incurred in connection with the Leykin, James and Williamson Fiduciary Actions on behalf of the At Home Directors and Officers, and will pay any future defense fees and costs, settlements, or Judgments on behalf of the At Home Directors and Officers, in connection with Leykin.[21]

In opposition, AT&T explains that the At Home D&O Policies are liability policies, not indemnity policies, and asserts that the Insurer's arguments are based upon an artificially narrow interpretation of "loss" and "legal obligation to pay"

[20] *In re Santa Fe Pacific Corp. S'holder Litig.*, 669 A.2d at 70 (noting that it is appropriate and necessary to consider documents outside the pleadings in a breach of contact case because "complaints that quoted only selected and misleading portions of such documents could not be dismissed under Rule 12(b)(6) even though they would be doomed to failure") (citations omitted).

[21] First Am. Compl., at ¶ 41.

requirements, which courts have increasingly rejected.[22] According to AT&T, the Insurers' obligation under such policies is not triggered by whether At Home and its Directors and Officers have actually made payment, but whether they are obligated to pay or have a financial liability.[23]

In support of its opposition, AT&T argues that the At Home Directors and Officers were "abandoned" by the At Home Insurers when those Insurers refused to advance defense costs.[24] According to AT&T, these Directors and Officers then turned to AT&T for assistance in defending and paying settlements and judgments in the Underlying Litigation.[25] "In exchange for AT&T stepping up to the plate," the At Home Directors and Officers assigned their breach of contract claims against the At Home Insurers to AT&T.[26] AT&T claims such assignments were unnecessary, however, because "from the moment it started paying the defense costs of the Directors and Officers for which the At Home Insurers were primarily responsible, AT&T was equitably subrogated…to the Directors and Officers[']rights against the At Home Insurers."[27] Although the parties agree that California law applies to this dispute, they vehemently disagree as to what outcome California law compels in this case. The Court now turns to a discussion of the cases relied upon by the movants, the At Home Insurers.

[22] AT&T's Answering Br., at 20-24.
[23] *Id.* at 21-25.
[24] *Id.* at 24.
[25] Hr'g Tr., at 35.
[26] *Id.* at 36.
[27] *Id.* at 36-37.

B. Cases Relied Upon by The At Home Insurers

1. *Pan Pacific Retail Props., Inc. v. Gulf Ins. Co.*[28]

In *Pan Pacific*, Pan Pacific and Western, parties to a merger, sued their insurers, Gulf and Twin City respectively, alleging the insurers acted in bad faith by refusing to indemnify them against liability for claims, expenses and damages arising out of a class action suit brought as a result of the merger. Twin City, which issued a claims-made policy to Western and its Directors, Officers and Trustees, moved for summary judgment on the ground that Western suffered no "Loss" within the meaning of the relevant insurance policy, because Pan Pacific, and not Western, paid the settlement in the class action, and the attorney fees and costs incurred in defending that class action suit.

In opposition, Western argued that although Pan Pacific paid the settlement and agreed to indemnify Western and its Directors as part of the merger agreement, Pan Pacific did not intend to waive coverage under Western's Twin City policy or relieve Twin City of its insurance obligations. The Court in *Pan Pacific* ruled in favor of Twin City, holding that because Western did not pay any portion of the settlement, no covered "Loss" accrued with respect to Western. According to the Court in *Pan Pacific*, "[a]ny payment now by Twin City would constitute a windfall for the former Western and its directors and officers."[29] Because the *Pan*

[28] *Pan Pacific Retail Properties, Inc. v. Gulf Ins. Co*., 2004 WL 2958479 (S.D. Cal.).
[29] *Id.* at *10.

Pacific Court determined that Western suffered no "Loss" because it made no settlement payments, the Court did not address the issue of whether the indemnity agreement between Pan Pacific and Western relieved Twin City of an obligation to Western.[30]

AT&T argues that *Pan Pacific* is "not constructive here" because AT&T is not seeking a "windfall," rather, it is "enforcing, as an assignee and equitable subrogee, the D&O's rights." AT&T points out that the Court in *Pan* Pacific never addressed what Pan Pacific's rights would have been against Twin City, Western's insurer, as a subrogee or assignee of Western's coverage right.[31]

2. *PLM, Inc. v. Nat'l. Union Fire Ins. Co.*[32]

In *PLM,* PLM settled an action brought against it, five of its Directors and Officers, and certain PLM affiliates, in which Pillsbury alleged breach of contract and fraud. PLM sought reimbursement of a portion of the settlement payment from National Union, which had issued certain D&O policies to PLM's Directors and Officers. When National Union refused to reimburse PLM, PLM sued National Union, claiming it was entitled to coverage even though PLM was not an "Insured" and those who were insured – the Directors and Officers – paid nothing toward the settlement.

[30] *Id.*
[31] Hr'g Tr., at 62-64.
[32] *PLM, Inc. v. National Union Fire Ins. Co. of Pittsburgh PA.*, 1986 WL 74358 (N.D. Cal.), *aff'd,* 848 F.2d 1243 (9th Cir. 1988).

On the National Union's motion for summary judgment, the Court in PLM ruled that because the Directors and Officers (1) suffered no "loss," (2) did not become legally obligated to pay (even though they individually guaranteed some of the promised settlement payment), (3) paid no claim, and (4) incurred no obligations, the individuals were not entitled to coverage. Thus, the court granted National Union's motion on its counterclaim for a declaration that it had not breached the policies.

AT&T argues that the result in *PLM* is "ridiculous," and the case is a "classic catch 22," in that the Directors and Officers could not collect under Coverage A (company reimbursement), because the loss had been indemnified (by PLM), and the insured company (PLM), could not collect under coverage B (the Directors and Officers Policy), because it did not follow the California prerequisites for indemnification.[33] AT&T goes on to say that "the holding in *PLM* has no import in this case where the Directors and Officers were not indemnified by At Home,"[34] and, as a result of At Home's bankruptcy, the Directors and Officers "were entitled to turn to the At Home Insurers under Coverage A."[35]

[33] Hr'g Tr., at 61-62.
[34] *Id.* at 62.
[35] *Id.* Coverage A in the Genesis Policy provides: "The Insurer will pay, on behalf of the Directors and Officers, Loss arising from Claims first made during the Policy (or Discovery) Period against the Directors or Officers, individually or collectively, for a Wrongful Act, except for such Loss which the Company pays to or on behalf of the Directors and Officers." Duffield Aff., Ex. A., § I.A.

3. *Genesis Ins. Co. v. FTD.COM, Inc.*[36]

In *Genesis*, FTD, Inc. paid to settle shareholder litigation arising out of its acquisition of FTD.COM. FTD, Inc. then sought coverage for that settlement amount under the FTD.COM D&O insurance policy, because the settlement agreement provided that FTD, Inc. was obligated to pay "on behalf of all Defendants," including FTD.COM.[37] The Court in *Genesis*, applying Illinois law, held that the language "on behalf of" did not, by itself, create a legal obligation for FTD.COM to pay any part of the settlement:

> …the language "on behalf of" means what it says: FTD, Inc. paid the sums due on behalf of the other Shareholder Defendants, who were also released under the Settlement Agreement. The term does not, by itself, create a legal obligation for FTD.COM or any other party to pay any amounts due under the Settlement Agreement to the Shareholder Plaintiffs, FTD, Inc., or any other Shareholder Defendant.[38]

Having determined that FTD.COM was not legally obligated to pay the settlement, the Court in *Genesis*, construing Delaware law, held that FTD.COM suffered no "loss" within the meaning of the applicable policy.

[36] *Genesis Ins. Co. v. FTD.com, Inc.*, 2004 WL 1199984 (N.D. Ill.).
[37] *Id.* at *4 (N.D. Ill.).
[38] *Id.*

In so holding, the Court in *Genesis* noted that FTD.COM:

> …would not have been liable if FTD, Inc. had breached its obligations to pay the amounts it was obligated to pay "on behalf of" FTD.COM and the other Shareholder Litigation defendants. Thus, FTD.COM did not, and will not, have a legal obligation to pay under the terms of the Settlement Agreement and suffered no "Loss" by the settlement alone.[39]

AT&T argues that *Genesis* is inapposite because it does not involve "the assignment of rights by directors and officers under D&O insurance policies to a third party in consideration for a third-party's payment of defense costs, as well as any settlement or Judgment amounts."[40] AT&T points out that the court in *Genesis* denied Genesis' motion for judgment on the pleadings, holding that FTD.COM's execution of a promissory note to FTD, Inc.,[41] the entity that actually paid the settlement, established a "loss" because FTD.COM could be found legally obligated to pay pursuant to the promissory note for amounts its affiliate paid in the settlement.[42]

4. *American Continental Ins. Co. v. American Casualty Co*.[43]

In a case of first impression, American Continental Insurance Company ("ACIC"), sought reversal of the trial court's order dismissing its complaint for

[39] *Id.* at *5.
[40] AT&T's Answering Br., at 28.
[41] Viewed in the light most favorable to FTD.COM, the Court held that the promissory note "reflects a valid agreement between FTD.COM and FTD, Inc. to allocate the money paid under the Settlement Agreement, and such an allocation agreement could constitute a legal obligation to pay for a claim made for a wrongful act, *i.e.* a 'Loss' under the Policy." *Genesis Ins. Co.,* 2004 WL 1199984, at *5.
[42] *Id.* at *5-6.
[43] *American Continental Ins. Co. v. American Casualty Co.,* 103 Cal. Rptr. 2d 632 (Cal. Ct. App. 2001).

equitable contribution against the defendant, American Casualty. The California Court of Appeals affirmed the trial court, holding:

> where an insurer was never under any legal obligation to provide coverage under a policy of liability insurance, that insurer may not be required to contribute to the defense or indemnity costs which may have been incurred by a second insurer in defending and settling an action for medical malpractice allegedly arising, at least in part, from the negligent acts of a common insured who was not named as a defendant in said suit and against whom no claim of negligence was ever made.[44]

In *American Continental*, American Continental, which provided errors and omissions coverage to a hospital, sought to obtain equitable contribution from American Casualty, which insured a nurse who worked at the hospital. The nurse was not named as a defendant in the medical malpractice action spawning the coverage dispute. American Continental provided coverage for the hospital's settlement with the plaintiff and then sought contribution from the nurse's insurer, American Casualty, because the suit was against the hospital and its "employees."

The trial court rejected American Continental's request for equitable contribution, holding that it failed to demonstrate that American Casualty had a mutual obligation to pay the claims arising out of the malpractice action. The trial court determined such a mutual obligation did not exist because the nurse (who was not named as a defendant) had suffered no "loss," and had no obligation to pay.

[44] *Id.* at 634-35.

AT&T asserts that *American Continental* is distinguishable because the At Home Directors, unlike the nurse in *American Continental,* are named defendants in the *Williamson Fiduciary* and *Leykin* Actions, and, thus, have a "loss" and a legal obligation to pay.[45]

C. Cases Relied Upon by AT&T

AT&T argues that all the cases relied upon by movants are inapposite, and that the Court should rely, instead, on *Xebec Dev. Partners, Ltd. v. National Union Fire Ins. Co.*[46]

1. *Xebec Dev. Partners, Ltd. v. National Union Fire Ins. Co.*

In *Xebec*, the coverage dispute arose out of derivative and securities claims made against Xebec and two of its directors by Xebec Development Partners ("XDP"). Xebec and the two directors consented to Judgment in favor of XDP. In consideration for this, XDP entered into a covenant not to execute on its Judgment against Xebec and the directors, and Xebec assigned its rights to coverage from National Union, its D&O insurer, to XDP. When National Union refused to indemnify XDP for claims against its policy holders, XDP filed suit against National Union.

On appeal, National Union argued that because of XDP's covenant not to execute against Xebec and the two directors, these policy holders had no "loss" within the definition of the D&O policy, and therefore, XDP could not recover as

[45] AT&T's Answering Br., at 29.
[46] 15 Cal. Rptr. 2d 726 (Cal. Ct. App. 1993).

an assignee.[47] The California Court of Appeals disagreed, holding that the policyholders did have a "loss" reimbursable under the D&O policy, and National Union was obligated to XDP by virtue of the assignment.[48] According to AT&T, *Xebec* is particularly instructive here because:

> The Court rejected the formalistic notion that is at the root of the At Home Insurers' Motion to Dismiss – that the At Home Directors must first pay any defense costs and settlement or Judgment amounts in order to have a "loss."[49]

Specifically the Court in *Xebec* stated:

> But even were this Court to agree with National Union that the policy requires indemnity only for losses already paid, it would not be obliged to agree with National Union that the covenant not to execute would *ipso facto* release National Union from any obligation to pay indemnification under the policy. Assuming, for purposes of analysis, that the settlement accurately reflected, and that the arbitration award and judgment sufficiently implemented, a legally enforceable obligation upon [the policyholders] to pay an enormous sum to XDP, it would be an idle exercise to require [the policyholders] to fund an actual cash payment to XDP and then to pursue their own right of indemnity against National Union. Given these admittedly hypothetical assumptions, the result would be essentially the same in either case: National Union would pay the sum, XDP would receive the sum, and [the policyholders] would neither be wealthier nor poorer for the experience. In a sense [the policyholders] may be regarded as middlemen, and the assignment and covenant not to execute may be regarded as mechanisms by which the transaction can be simplified by permitting the middlemen to withdraw in order to allow XDP to proceed directly against National

[47] *Xebec Dev. Partners, Ltd*., 15 Cal. Rptr. 2d at 743.
[48] *Id.* at 743-44.
[49] AT&T's Answering Br., at 20.

> Union. There is no apparent just purpose to be served by insisting, in these circumstances, on a hypertechnically literal payment from [the policyholders] to XDP."[50]

Relying on *Xebec*, AT&T argues that because the At Home Insurers have failed to honor their contractual obligations, there is "no just purpose to be served by insisting…on a hypertechnically literal payment from the D&O's to their attorneys" in the *Leykin* or *Williamson Fiduciary* Actions or to the bondholder's trust in settlement of the *Williamson Fiduciary* Action.[51]

The At Home Insurers claim that *Xebec* is distinguishable because, *inter alia*, the settlement agreement in the *Williamson Fiduciary* Action expressly provides that only AT&T is promising to pay the settlement amount and the AT&T designees "never had, and never will have, any responsibility to pay any Judgment, settlement, or defense costs."[52]

2. Vitkus v. Beatrice Co.[53]

AT&T relies heavily on *Vitkus v. Beatrice Co.*, arguing that in *Vitkus*, National Union "found itself in the exact same position as AT&T does here…."[54] *Vitkus* involved a breach of contract action against Beatrice for its failure to provide insurance and indemnification protection to plaintiff, an employee of Beatrice who served at Beatrice's request as an outside director of a failed savings

[50] *Xebec Dev. Partners, Ltd*., 15 Cal. Rptr. 2d at 744 (emphasis added).
[51] Hr'g Tr., at 48.
[52] Reply Br. In Support of the At Home Insurers' Joint Mot. To Dismiss AT&T Corp.'s First Amended Compl., E-File 7124814, at 4.
[53] 127 F.3d 936 (10th Cir. 1997).
[54] Hr'g. Tr., at 68.

and loan association. Vitkus' employer, Beatrice, maintained a $10 million D&O policy with Lloyd's.[55] Vitkus left Beatrice and worked for Emhart Corporation. Emhart obtained an endorsement to its $25 million D&O policy with National Union to cover Vitkus' service on the board.

Vitkus requested that Beatrice pay his defense costs and indemnify him. Beatrice refused. Vitkus also requested that National Union pay his defense costs and indemnify him under the terms of the endorsement to Emhart's D&O policy. National Union, the FDIC, and all the defendants entered into a global settlement whereby National Union agreed to pay the FDIC $26.5 million in exchange for the release of all defendants. The settlement agreement provided that if the $26.5 million payment was not made by a certain payment date, none of the individual settling parties would be obligated to pay anything to the FDIC, and that the FDIC's sole remedy would be to terminate the agreement and continue the lawsuit. National Union paid the $26.5 million settlement by the payment date. The settlement, as approved by the court, did not allocate liability among the defendants. Each uninsured defendant agreed to pay National Union a small portion of the settlement. Those payments to National Union totaled approximately $300,000. After the settlement agreement was executed, National Union, Sherman & Howard, Jacobs, and Vitkus entered into an allocation

[55] "Under the merger agreement, Beatrice agreed to maintain D&O coverage, at terms no less advantageous than those in the Lloyd's policy, for a period of six years from the effective date of the merger. Lloyd's canceled its D&O policy shortly after the merger. Thereafter, Beatrice failed to purchase replacement D&O coverage, and thus became a self-insurer, with the scope of its obligations measured by the Lloyd's policy." *Vitkus*, 127 F.3d at 939.

agreement whereby $10 million of the settlement was allocated to Vitkus and $16.5 million was allocated to Sherman & Howard and Jacobs. After the parties had tentatively agreed to the allocation, Vitkus's counsel made a written request to Beatrice's counsel that Beatrice consent to the allocation and indemnify Vitkus for the $10 million. Beatrice's counsel refused to consent and indemnify Vitkus. Vitkus and National Union then filed suit against Beatrice to enforce Beatrice's obligation to indemnify Vitkus under the terms of the Lloyd's policy. The Lloyd's policy extended coverage to Beatrice's directors and officers for "all loss which such Directors and Officers shall become legally obligated to pay" for wrongful acts committed in executing their corporate responsibilities. An endorsement to this policy specifically extended coverage to Beatrice's officers and directors also serving as officers or directors of the savings and loan association.[56] "The policy defined 'loss' as 'any amount which the Directors and Officers are legally obligated to pay . . . for a claim or claims made against them for wrongful acts, and shall include, but not be limited to, damages, judgments, and settlements, and costs, charges and expenses…' "[57]

The question was whether Vitkus was "legally obligated" to pay any amount in settlement. Applying New York law, the court in *Vitkus* held that because National Union paid the $10 million on Vitkus's behalf under the Emhart excess policy to settle the FDIC's claims against Vitkus, it could stand in the shoes of

[56] *Vitkus*, 127 F.3d at 940.
[57] *Id.*

Vitkus and seek from the primary insurer the amount that Vitkus would have owed had he not received the protection of National Union. The FDIC could not enforce the terms of the settlement agreement against Vitkus. Rather, the settlement agreement provided that if National Union failed to pay the $26.5 million by the payment deadline, the FDIC's only remedy would be to cancel the agreement and pursue its legal claims in Court. According to the court in *Vitkus*,

> Since the agreement was non-binding, one might conclude that Vitkus (through National Union) paid the FDIC money that he was not "legally obligated to pay."
>
> That reading of the policy, urged upon us here by Beatrice, would eviscerate the protection of all insured with similar policies who execute even conventional, binding settlement agreements . . . .
>
> Beatrice argues that even if National Union is Vitkus's subrogee, it does not have an obligation to indemnify Vitkus. Beatrice contends that the settlement did not constitute a "loss" under its insurance, as defined by the Lloyd's policy, because Vitkus (1) never actually paid anything from his own funds and, once again, (2) that Vitkus never became "legally obligated to pay" any portion of the settlement amount as required by the policy. We disagree with Beatrice on both points.
>
> On Beatrice's first contention, it is irrelevant that National Union paid the $10 million on Vitkus's behalf in the first instance. *See Safeway Stores, Inc. v. National Union Fire Ins. Co.,* 64 F.3d 1282, 1290 (9th Cir. 1995) ("Insistence on a meaningless formality of having the directors and officers pay initially…should not be required to secure [insurance] coverage."). The Lloyd's policy only required that Vitkus incur an *obligation* to pay in order to be entitled to indemnification.

> We state again that at the time Vitkus agreed to the settlement, he incurred an obligation to pay.[58]

AT&T points out that in *Vitkus,* National Union cited *Xebec* in support of its argument that it would have been an "idle exercise and a meaningless formality" for Vitkus to have personally paid the settlement.[59]

The Insurers argue that *Vitkus* is inapposite, because it involved New York law, not California law. They also argue that, unlike National Union in *Vitkus*, "AT&T is not an innocent stranger to the events that caused the [*Williamson Fiduciary* settlement] payment."[60] The Insurers also argue that *Vitkus* is distinguishable because, unlike AT&T here, National Union in *Vitkus* had contractual subrogation rights.[61] Unlike National Union in *Vitkus*, an insurer subrogated to the claims of its insured, AT&T had no contractual obligation to indemnify the At Home Directors, nor did it face any exposure if it failed to do so.[62]

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[58] *Id.* at 943-944 (emphasis in original).

[59] Ins. Equit. Sub. Ans. Br., at 4. According to the Insurers:

> AT&T is (or was) a co-defendant with the At Home Directors in the Underlying Litigation and allegedly benefited from both its alleged misconduct and the alleged misconduct of the At Home Directors. In its brief (but not in its complaint), AT&T asserts that "it asked the At Home Directors to serve for At Home." According to the plaintiff in the *Williamson Fiduciary* Action, to whom AT&T paid $340 million to settle, AT&T was unjustly enriched from that service. Swedloff Aff. [Filing ID 6627313], Ex F. Under the circumstances, to accede to AT&T's attempt to raid the At Home Policies in order to fund, among other things, that settlement would hardly be equitable. Such a result would also have the inequitable consequence of diverting any available policy proceeds to AT&T and away from the non-AT&T affiliated At Home directors and officers. Answering Br. of the At Home Insurers on Equitable Subrogation Filed in Support of Their Joint Motion to Dismiss AT&T's First Amended Complaint, E-File 10728153, at 4-5.

[60] Ins. Equit. Sub. Ans. Br., at 4-5.

[61] Ins. Equit. Sub. Ans. Br., at 5.

[62] *Id.*

3. Other Cases Cited by AT&T

AT&T also relies on cases not involving California law to support its argument that the definition of "loss" in the applicable policies does not mean "amounts actually paid."

The At Home Insurers quickly dismiss AT&T's reliance on these cases, pointing out that all these cases, like *Xebec*, involve insureds who had a judgment entered against them or had agreed to settle an underlying case for a fixed sum and then assigned their rights to coverage in exchange for a promise from plaintiffs in the underlying action not to execute on the judgment or settlement. According to the At Home Insurers, the absence of such a covenant or agreement here is fatal to AT&T's claims.

D. The National Union Policies

AT&T argues that there is "no substantive difference" between the terms and conditions of the two D&O liability policies issued by National Union and the policies issued by the At Home Insurers. AT&T does, however, acknowledge a "slight difference" between the definition of "loss" in the National Union policies and the other polices.[63] The definition of "loss" in the 1999 and 2000 National Union policies is as follows:

[63] Hr'g. Tr., at 58. According to AT&T, "…National Union's definition of loss…is a little different in terms of its language. [It] [d]oesn't use the 'legally obligated to pay' language. It uses…'not financially liable' language. Frankly, I don't see any distinction in those words."

> "Loss" means damages, judgments (including any award of prejudgment and post-judgment interest), settlements, Defense Costs and Year 2000 Crisis Loss; however, Loss shall not include civil or criminal finds or penalties imposed by law, punitive or exemplary damages, the multiplied portion of multiplied damages, taxes, any amount for which the insureds are not financially liable or which are without legal recourse to the Insureds, any Judgment solely against, or settlement solely by, the Company and/or any Employee in a Year 2000 Third Party Claim, any cost or expense incurred by the Company in connection with the assessing, auditing, testing, correcting, converting, renovating, rewriting, designing, evaluating, inspecting, installing, maintaining, repairing or replacing any Computer System of the Company with respect to a potential Year 2000 Problem (as such terms are defined below in definition (r)).

National Union argues that the key language, clearly pre-empting coverage here is ". . . Loss shall not include . . . any amount for which the Insureds are not financially liable or which are without legal recourse to the Insureds . . . ."[64] AT&T claims this same argument was rejected by the Delaware Court of Chancery in *Cirka v. National Union Ins. Co.*[65]

In *Cirka*, the underlying litigation was filed by the Unsecured Creditors of the Debtor, Integrated Health Services, Inc. ("IHS") against IHS' former directors and officers. These directors and officers sought D&O coverage from National Union. One of the directors, the former CEO, Elkins, reached an agreement by which he limited his exposure to the amount of available D&O coverage provided by National Union.

[64] Aff. Larsen, Exs. F and G, § 2(j).
[65] 2004 WL 1813283 (Del. Ch.).

As a result of Elkins' agreement, National Union argued that the language in its "loss" definition: "not financially liable or which are without legal recourse to the Insureds," precluded recovery under the policy. The Court of Chancery disagreed, holding:

> National Union argues that since Elkins entered into an agreement by which the monetary damages for which he may be found liable is limited to coverage under the Policies, he cannot be said to be subject to a "Loss" as defined in the Policies. National Union relies on language excluding from "Loss" "any amount for which the Insureds are not financially liable or which are without legal recourse to the Insureds." This language is simply inapplicable here. *While Elkins may be exonerated from any liability from claims which exceed the amount paid under the Policies, he is not exonerated from all liability for those claims. That is, while National Union may be the sole source to which the Committee may look for recovery, Elkins is still very much a defendant in these claims and subject to judgment against him. In other words, Elkins was not exonerated from all liability; rather, he was exonerated from liability exceeding liability covered under the Policies.*[66]

AT&T urges the Court to apply this same analysis to National Union's "effort to escape its coverage liabilities" here." According to AT&T:

> While AT&T may have agreed to pay all amounts net of insurance, the directors and officers were, with respect to *Williamson* and *Leykin*, still very much defendants and subject to Judgment. There is simply no distinction between a legal "obligation to pay" and a standard which talks about being "financially liable."[67]

[66] *Cirka*, 2004 WL 1813283, at *2 n.4 (emphasis added).
[67] *See* AT&T's Answering Br., at 28; Hr'g Tr., at 59.

E. AT&T's Equitable Subrogation Claim

During oral argument, AT&T argued that it is "equitably subrogated" to the claims of the At Home Directors under the At Home Policies.[68] The insurers disagree, arguing that the well pled allegations in the First Amended Complaint do not establish a claim for equitable subrogation, and, even if they did, under an assignment or subrogation theory, AT&T can have no greater rights under the insurance contracts than those of the At Home Directors.[69]

Under California law, to be equitably subrogated, a party paying the debt of another must satisfy the following prerequisites: (1) Payment must have been made by the subrogee to protect its own interest. (2) The subrogee must not have acted as a volunteer. (3) The debt paid must be one for which the subrogee was not primarily liable. (4) The entire debt must have been paid. (5) Subrogation must not work any injustice to the rights of others.[70] The key issue with respect to AT&T's equitable subrogation claim is whether AT&T acted as a "volunteer" when it made the payments on behalf of the At Home Directors. Nowhere in its First Amended Complaint does AT&T allege that it had a legal or contractual obligation to indemnify the At Home Directors. AT&T asserts it is not a volunteer, because (1) it *asked* the At Home Directors to serve as directors or officers of At Home, (2) *agreed* to indemnify them net of any recoverable

[68] Hr'g. Tr., at 37. Because AT&T raised this issue for the first time at oral argument on the Insurers' motion to dismiss, the Court requested supplemental briefing. See E-File 10670136, 10672074, 10728153.
[69] Opening Supplemental Br. of the At Home Insurers on Equitable Subrogation Filed In Support of Their Joint Motion to Dismiss AT&T's First Am. Compl., E-File 10672074, at 2.
[70] *Caito v. United Cal. Bank*, 576 P.2d 466 (Cal. 1978).

insurance, (3) At Home could not indemnify them because of its bankruptcy, and (4) the At Home Insurers "refused to comply with their coverage obligations."[71]

The Insurers, on the other hand, argue that AT&T's failure (and inability) to plead that it was *obligated* to indemnify the At Home Directors, or that it made payments in discharge of an existing liability, is fatal to its equitable subrogation claim.[72] The Insurers correctly note that many of the equitable subrogation cases cited by AT&T involved claims by insurer subrogees who had contractual obligations to cover the debts of subrogor-insureds.[73] The At Home insurers argue that even if AT&T was obligated to indemnify the At Home Directors, under California law it could not have equitable subrogation rights against "other innocent co-indemniters."[74] The Insurers also point out that, contrary to AT&T's assertion, California law "conflict[s] directly" with the New York subrogation law on which the Tenth Circuit based its decision in *Vitkus*.[75]

[71] AT&T Op. Br. Equit. Sub., at 4.
[72] *See* At Home Ins. Op. Br. Equit. Sub., at 3-4. ("AT&T's failure to plead the elements of an 'equitable subrogation' claim and its contention that it had no obligation to indemnify the purported subrogors for a debt for which it was not primarily liable is dispositive.")
[73] *Id.*
[74] *Id*. at 4. *See Patent Scaffolding Co. v. William Simpson Constr. Co.,* 64 Cal. Rptr. 187, 193 (Cal. Ct. App. 1967); *See also Bramalea Cal., Inc. v. Reliable Interiors, Inc.*, 14 Cal. Rptr. 3d 302, 307 (Cal. Ct. App. 2004); *Cal. Food Serv. Corp. v. Great. Am. Ins. Co.*, 182 Cal. Rptr. 67, 72 (Cal. Ct. App. 1982).
[75] *Id*. at 5. AT&T stated at oral argument: "…California law is in full accord with the *Vitkus* decision." Hr'g. Tr., at 55.

F. The Court Concludes that AT&T Cannot Establish the At Home Directors Suffered a "Loss"

As noted earlier, dismissal under Superior Court Rule 12(b)(6) is appropriate only where it appears "with reasonable certainty" that a plaintiff "would be unable to prevail on any set of facts inferable from the complaint."[76] Accepting as true all the well-pleaded facts in AT&T's First Amended Complaint, and viewing them in the light most favorable to AT&T, the Court concludes that AT&T cannot prevail under any set of facts inferable from that complaint. Simply stated, the At Home Directors are not, and never have been, "legally obligated to pay" or "financially liable." Nowhere in the record is there a "document or reference…which specifically and clearly establishes an obligation personal to "the…At Home Directors" which obligated or required the directors to pay a portion of the *Williamson Fiduciary* settlement or the costs of defending the Underlying Litigation.[77] As in *AT&T Wireless*, the plaintiff has failed to plead any facts showing any payment by the Insureds or any legal obligation of the Insured to make a payment.[78] In fact, in this case, the Assignments[79] referenced in the First Amended Complaint establish that these At Home Directors have paid nothing and will never be obligated to pay anything. This case is controlled by California law,

[76] *Lord v. Souder*, 748 A.2d 393, 398 (Del. 2000).
[77] *See AT&T Wireless Svcs., Inc. v. Federal Insurance Co., et al.,* 2006 WL 267135 (Del. Super.) ("AT&T Wireless").
[78] *Id*. at *6.
[79] The Assignments state that AT&T (1) has paid for all of the Assignors' "defense costs and fees," (2) will indemnify the Assignors for "liability that results from any settlement or judgment, and (3) will "assume responsibilities for the fees and expenses" incurred by the Assignors in any continued litigation in conjunction with any claim filed against any Assignor…." *See* Swedloff Aff., Ex. I.

and *Pan Pacific*[80] and *PLM*[81] make clear that unless the At Home Directors made payments or incurred an obligation to pay, there is no "loss" under the Policies.

AT&T's reliance on *Smith v. Parks Manor*[82] is misplaced. The Court in *Smith* determined that the insureds entered into an agreement that obligated them to pay a certain amount – "a debt equivalent to a judgment debt."[83] The insureds in *Smith* were obligated to pay a certain amount. In sharp contrast, the *Williamson Fiduciary* settlement agreement specifically provides that:

> 2.1 On or before May 24, 2005, which is 15 business days from the date of the May 3 Settlement Agreement, AT&T shall pay on behalf of itself and the Individual Defendants the sum of $340,000,000 to Williamson by wire transfer to the escrow agent selected and paid for by Williamson and reasonably acceptable to AT&T….[84]

There is no undertaking or promise by the At Home Directors in this settlement agreement or elsewhere to make payment. Contrary to AT&T's assertion, *Vitkus* does not "gut" the Insurers' motion. In *Vitkus*, unlike here, the insured contractually agreed to make payment and therefore had a legal obligation to pay.

Xebec is also distinguishable. In *Xebec*, there was a settlement involving a promise to pay, and then that settlement was reduced to a joint and several judgment against the company and its officers and directors. Those defendants

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[80] *Pan Pacific Retail Properties, Inc. v. Gulf Ins. Co*., 2004 WL 2958479 (S.D. Cal.).
[81] *PLM, Inc. v. National Union Fire Ins. Co. of Pittsburgh PA.*, 1986 WL 74358 (N.D. Cal.), *aff'd,* 848 F.2d 1243 (9th Cir. 1988).
[82] 243 Cal. Rptr. 256 (Cal. Ct. App. 1987).
[83] *Id*. at 259.
[84] Swedloff Aff., Ex. G, § 2.1 (emphasis added).

then assigned their rights under their D&O insurance policy to the plaintiff in exchange for plaintiff's promise not to execute on the judgment. In the subsequent insurance coverage dispute, the court in *Xebec* rejected the insurer's argument that the individuals had suffered no loss in light of the covenant not to execute. The court held that given the liability of the individuals under the joint and several judgment, it would be an "idle exercise" to require them to pay the amount for which they were liable just to trigger the policy.[85] Here, however, as the Insurers correctly point out, there are no such promises to pay or judgments. The settlement agreement in the *Williamson Fiduciary* Action expressly provides that only AT&T is promising to pay the settlement amount. The plaintiffs in *Williamson* have no recourse against the At Home Directors if AT&T fails to make that payment. And the Assignments declare that AT&T will indemnify its ten designees for defense costs, fees, settlements, and judgments.

AKS[86] and Guillen[87] are also not instructive here. The courts in those cases held, like the court in *Xebec*, that where there is a judgment or written promise to pay, the insureds have a "loss." In this case, there is no judgment against the At Home Directors and they have not paid or promised to pay anything.

[85] *Xebec*, 15 Cal. Rptr. 2d at 744.
[86] *Aks v. Southgate Trust Co.*, 844 F. Supp. 650 (D. Kan. 1994).
[87] *Guillen v. Potomac Ins. Co.*, 785 N.E.2d 1 (Ill. 2003).

G. The Court Concludes that AT&T Cannot Prevail on its Equitable Subrogation Claim

Accepting the well pleaded allegations in AT&T's First Amended Complaint as true, and viewing them in the light most favorable to AT&T, the Court concludes that AT&T cannot prevail on its equitable subrogation claim because it clearly acted as a "volunteer" when it indemnified the At Home Directors.[88] As AT&T stated at oral argument:

> …AT&T was not obligated to indemnify those directors and officers, it was permissive indemnification.[89]

AT&T has failed to sufficiently plead in its First Amended Complaint that it did not act as a volunteer.[90] As in *AT&T Wireless*, the Court concludes that the At Home Directors are not "legally obligated" to pay any part of the *Williamson Fiduciary* settlement or any of the defense costs incurred in the Underlying Litigation.

[88] *See Smith v. Parks Manor*, 243 Cal. Rptr. 256, 259 (Cal. Ct. App. 1987).
[89] Hr'g. Tr., at 35.
[90] *Employers Ins. of Wausau v. Musick, Peeler, & Garrett*, 948 F. Supp. 942 (S.D. Cal.1995); *Caito v. United Cal. Bank*, 576 P.2d 466 (Cal. 1978); *Fireman's Fund Ins. Co. v. Md. Cas. Co.*, 26 Cal. Rptr.2d 762 (Cal. Ct. App. 1994); *Great Am. West, Inc. v. Safeco Ins. Co.*, 277 Cal. Rptr. 349 (Cal. Ct. App. 1991).

IV. CONCLUSION

It is clear from the First Amended Complaint and underlying documents that none of the At Home Directors have paid, will pay, or are obligated to pay any costs incurred in settling or defending the Underlying Litigation. Consequently, no insured has suffered a "loss." Because AT&T has failed to sufficiently allege that the insureds have incurred a "loss," the Insurers' Motion to Dismiss (joined by National Union) must be **GRANTED.**

IT IS SO ORDERED.

Jan R. Jurden, Judge