

Federal Ins. Co. v Tyco Intl. Ltd.

2006 NY Slip Op 30686(U)

August 10, 2006

Supreme Court, New York County

Docket Number: 600507/03

Judge: Helen E. Freedman

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SUPREME COURT OF THE STATE OF NEW YORK — NEW YORK COUNTY

PRESENT: HELEN E. FREEDMAN
Justice

PART 39

Federal Insurance Company,

Plaintiff,

- v -

Tyco International Ltd., et al.

Defendant.

INDEX NO. 600507/03

MOTION DATE _____

MOTION SEQ. NO. ~~027~~ 7

MOTION CAL. NO. _____

The following papers, numbered 1 to _____ were read on this motion to/for _____

Notice of Motion/ Order to Show Cause — Affidavits — Exhibits ...

Answering Affidavits — Exhibits _____

Replying Affidavits _____

PAPERS NUMBERED

Cross-Motion: Yes No

Upon the foregoing papers, it is ordered that this motion is decided in accordance with accompanying memorandum decision.

UNFILED JUDGMENT
This judgment has not been entered by the County Clerk and notice of entry cannot be served based hereon. To obtain entry, counsel or the party's representative must appear in person at the Judgment Clerk's Desk (Room 41B).

Dated: August 10, 2006

[Signature]
Helen E. Freedman, J.S.C.

Check one: FINAL DISPOSITION NON-FINAL DISPOSITION

Check if appropriate: DO NOT POST

MOTION/CASE IS RESPECTFULLY REFERRED TO JUSTICE FOR THE FOLLOWING REASON(S):

SUPREME COURT OF THE STATE OF NEW YORK
COUNTY OF NEW YORK: PART 39

-----X

Federal Insurance Company,

Plaintiff,

-against-

Index No.600507/03

Tyco International Ltd., et al.

Defendants,

-----X

HELEN E. FREEDMAN, J:

Plaintiff Federal Insurance Company (“Federal”) commenced this declaratory judgment action to resolve whether it is obligated to defend and indemnify defendants Tyco International, Ltd. (“Tyco”) and former Tyco officers and directors in the civil lawsuits and criminal proceedings brought against those defendants.¹ Defendant L. Dennis Kozlowski now moves for an order directing that Federal pay him about \$ 17.8 million as a first installment for the costs and fees that he incurred to defend himself in the now-concluded criminal proceeding against him and defendant Mark H. Swartz, *People v. Kozlowski*, index no. 5259/02 (Sup. Ct. N.Y. Co.) (the “Criminal Action”)², and the related civil forfeiture action, *Morgenthau v. Kozlowski*, index no. 403698/02 (Sup. Ct. N.Y. Co.) Federal opposes and cross-moves for an order directing a partial summary judgment and declaring that the Policies that it issued to Tyco do not cover Kozlowski’s or Swartz’s defense costs in the Criminal Action.

¹For the sake of concision, I will assume the reader’s familiarity with the history of this action, which prior decisions set forth in detail. See *People v. Kozlowski*, 2004 N.Y. Slip Op. 50160(U)(Mar. 5, 2004) (“*Federal I*”), *aff’d as modified*, 18 A.D.3d 33 (1st Dept. 2005) (“*Federal II*”).

²Defined terms in *Federal I* and *Federal II* have the same meaning in this decision, unless otherwise indicated.

UNFILED JUDGMENT
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obtain entry, counsel or their representative must
appear in person at the Judgment Clerk's Desk (Room
410)

For the reasons set forth below, Kozlowski's motion is denied and Federal's cross-motion is granted.

Background: Criminal Action – Kozlowski and Swartz were indicted for conspiring to steal Tyco assets and defraud its investors, and for falsifying business records to conceal their crimes. After a mistrial followed by a six-month trial ending in June 2005, the jury found Kozlowski and Swartz each guilty on twelve counts of grand larceny in the first degree (in violation of New York Penal Law (“NYPL”) § 155.42), one count of conspiracy in the fourth degree (in violation of NYPL § 105.10[1]), one count of securities fraud (in violation of the Martin Act, N.Y. Gen. Bus. Law § 352-c[5]), and nine counts of falsifying business records in the first degree (in violation of NYPL § 175.10). The Court sentenced both Kozlowski and Swartz to prison terms of 8 and 1/3 years to twenty-five years. The Court also (1) ordered them to pay restitution to Tyco that totaling about \$ 134 million, for which the Court held them jointly and severally liable, (2) ordered Swartz to pay Tyco an additional \$1.2 million, and (3) imposed fines of \$70 million on Kozlowski and \$ 35 million on Swartz.

Kozlowski and Swartz were not convicted of a few of the charges. Of the thirty-one counts submitted to the jury, Kozlowski and Swartz were acquitted of “Count # 17”, which charged that they falsified business records in the first degree in connection with the “Tyco International (US) Inc. Florida Corporate Headquarters Relocation program.” Moreover, certain were never submitted to the jury (the “Dropped Charges.”) These included a charge of enterprise corruption, two grand larceny charges, and a falsifying of business records charge.

Coverage provisions - Moving for an order directing payment, Kozlowski claims that Federal must reimburse his defense expenses for the Criminal Action pursuant to “Insuring

Clause 1" of the Executive Liability and Indemnification section of the Policies (the "ELI Section"), which applies to "Loss for which the Insured Person is not indemnified by [Tyco] and which the Insured Person becomes legally obligated to pay on account of any Claim first made against him . . . during the Policy Period . . . for a Wrongful Act."³

The Policies contain two relevant coverage exclusions. Section 6(b) of the ELI Section (the "Fraudulent Acts Provision") provides:

[Federal] shall not be liable under Insuring Clause 1 for Loss on account of any Claim made against any Insured Person . . . based upon, arising from, or in consequence of any deliberately fraudulent act or omission or any willful violation of any statute or regulation by such Insured Person, if a judgment or other final adjudication adverse to the Insured Person establishes such a deliberately fraudulent act or omission or willful violation

Section 6(c) of the ELI Section (the "Personal Profit Provision") provides:

[Federal] shall not be liable under Insuring Clause 1 for Loss on account of any Claim made against any Insured Person . . . based upon, arising from, or in consequence of such Insured Person having gained in fact any personal profit, remuneration or advantage to which such Insured Person was not legally entitled.

Prior Rulings Before the verdicts in the Criminal Action were rendered, this Court and the First Department issued decision that addressed Kozlowski's rights to coverage under the Policy. In March 2004, this Court granted Kozlowski's summary judgment motion (the "Prior Motion") in part and declared (among other things) that the Policies obligated Federal to reimburse Kozlowski for those defense expenses. *Federal I*, 2004 N.Y. Slip Op. 50160(U) at *7-*8 & *9. This Court found that "[i]f any portion of a complaint [against an insured] might result in coverage, the insurer must defend or pay defenses expenses for all claims, both covered and non-covered. *Id.* at *8. The Personal Profit Provision did not excuse Federal from

³Capitalized terms in the quotations from the Policy are defined in it.

coverage⁴, because “[w]hile the Indictment alleges that Kozlowski obtained money illegally through the criminal enterprise, it also accuses him of crimes from he did not directly profit.” *Id.* at *7.

On appeal, the First Department limited Federal’s duty to pay Kozlowski’s defense costs to “only those costs relating to liabilities that fall under the coverage provided, i.e., defense costs for the covered claims.” *Federal II*, 18 A.D.3d at 38. The Appellate Division distinguished an insurer’s duty to defend from its duty to pay defense expenses under its policy: if the policy imposes a duty to defend, insurer must “afford a defense to the insured for covered as well as non-covered claims if the latter are intertwined with covered claims,” but if the policy only imposes a duty to pay defense expenses, the insurer could apportion them between covered and excluded claims. *Id.* at 41. Yet while an insurer can apportion defense expenses, its duty to reimburse the insured for expenses arises when the insured pays them. *Id.* at 41-42.

Accordingly, the Appellate Division found,

while Federal must pay defense costs as they are incurred in the [Criminal Action], its ultimate liability for such costs is only with respect to such liabilities as fall under the coverage provided. To the extent such liabilities are excluded from coverage by the [Personal Profit Provision], Federal is not required to pay for defense costs. Since this allocation cannot be made at this juncture . . . Federal must pay all defense costs as incurred, subject to recoupment when Kozlowski’s liabilities, if any, are determined.

Id. at 42.

⁴The courts did not address whether the Fraudulent Acts Provision affected coverage in *Federal I* and *Federal II*. The parties did not raise the issue in connection with the Prior Motion, since it was decided before the verdict in the Criminal Action.

After *Federal I* was issued, Federal commenced an interpleader action to resolve the competing claims to the Policy proceeds by Kozlowski and others. *Fed. Ins. Co. v. Kozlowski*, index no. 601416/04 (Sup. Ct. N.Y. Co.) (the “Interpleader Action”).

Discussion: Motion – Kozlowski’s application for an interim payment from the Policy proceeds is denied at this juncture because virtually all of Kozlowski’s defense expenses are excluded by his convictions in the Criminal Action. If Kozlowski had any pre-conviction right to be reimbursed for expenses as he incurred them, he never exercised it because he never sent Federal any invoices for his defense costs. See *Lehrer McGovern Bovis, Inc. v. Halsey Constr. Corp.*, 254 A.D.2d 335, 336 (2d Dept. 1998) (insured cannot seek payment of defense costs if it fails to provide insurer with copies of the bills it paid). In any event, Kozlowski’s motion papers do not include any competent evidence of the amount and reasonableness of the defense costs he has incurred, and all claims to the proceeds of the Policy must be pursued in the Interpleader Action. See Interpleader Action, dec. & order dated April 30, 2004.

Cross-motion – Federal’s cross-motion for a declaration that the Policies do not cover any of Kozlowski’s and Swartz’s defense costs in the Criminal Action is granted because virtually all of Kozlowski’s and Swartz’s defense expenses are now excluded from coverage by the Fraudulent Acts or Personal Profit Provisions, and Kozlowski and Swartz make no showing that any of their defense expenses can be allocated to covered losses.⁵ Before Kozlowski and Swartz were convicted, Federal had no duty to reimburse their defense costs because they never

⁵In fact, Kozlowski did not submit opposition to the Federal cross-motion, and Swartz does not address the issue of allocation, but merely requests that the Court stay its decision on the cross-motion while his criminal appeal is pending. That request is denied because Swartz’s conviction and sentence constitute a “judgment” within the meaning of the Fraudulent Acts Provision.

presented Federal with their bills, and after they were convicted on thirty of the thirty-one counts, the Fraudulent Acts Provision excluded the defense costs connected with those thirty offenses. In addition, the Personal Profit Provision excluded all costs connected with crimes from which Kozlowski and Swartz directly profited.

In theory, some of Kozlowski's and Swartz's defense costs would be payable if they could be apportioned to covered losses to which neither the Fraudulent Acts nor the Personal Profit Provisions apply. These include the cost of defending Kozlowski and Swartz against Count # 17 and the Dropped Charge for falsifying business records, for they which were not convicted and which do not accuse them of concealing crimes from which they directly profited.⁶ However, as a practical matter it seems all but impossible to allocate defense costs between the covered claims and the predominant excluded claims, since Kozlowski and Swartz were defended in a single criminal proceeding that ended with their conviction of all but one count. Moreover, Kozlowski's and Swartz's fail to submit billing records or any other evidentiary basis for apportioning costs specifically to covered expenses. In any event, the covered costs would be a minuscule portion of the total amount.

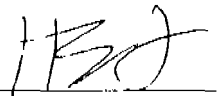
ORDERED that the motion by defendant L. Dennis Kozlowski for an order directing payment is denied and the cross-motion by plaintiff Federal Insurance Company for partial summary judgment is granted, and it is further

⁶ Also, defense expenses allocated to the Dropped Charge for enterprise corruption would be partially covered, since it was based on "pattern acts" that corresponded to the other counts in the indictment, including Count # 17. However, the two Dropped Charges of grand larceny fall with the Personal Profit Provision because they alleged that Kozlowski and Swartz stole for their own gain.

ORDERED AND ADJUDGED that Executive Protection Policy 8121-34-42-H that plaintiff Federal Insurance Company issued to defendant Tyco International, Ltd. providing coverage from March 15, 2001 to March 15, 2002, as extended by endorsement to March 15, 2003, does not provide coverage for the defense costs incurred by defendants Defendant L. Dennis Kozlowski and Mark H. Swartz in *People v. Kozlowski*, index no. 5259/02 (Sup. Ct. N.Y. Co.)

Dated: August 10, 2006

Enter:



Helen E. Freedman, J.S.C.

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