XL Specialty Ins. Co. v Loral Space & Communication, Inc.
2010 NY Slip Op 33851(U)
February 9, 2010
Sup Ct, NY County
Docket Number: 650529/2008
Judge: Richard B. Lowe III
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SUPREME COURT OF THE STATE OF NEW YORK — NEW YORK COUNTY

Index Number : 650529/2008
XL SPECIALTY INSURANCE
vs.
LORAL SPACE & COMMUNICATIONS
SEQUENCE NUMBER : 002
PARTIAL SUMMARY JUDGMENT

PART 56

E-FILE

INDEX NO. _____

MOTION DATE 10/8/09

MOTION SEQ. NO. _____

MOTION CAL. NO. _____

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

	PAPERS NUMBERED
Notice of Motion/ Order to Show Cause — Affidavits — Exhibits ...	
Answering Affidavits — Exhibits	
Replying Affidavits	

Cross-Motion: ☒ Yes ☐ No

Upon the foregoing papers, it is ordered that this motion

MOTION IS DECIDED IN ACCORDANCE WITH ACCOMPANYING MEMORANDUM DECISION

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

Dated: 2/9/10

RICHARD B. LOWE III
J.S.C.

Check one: ☐ FINAL DISPOSITION ☒ NON-FINAL DISPOSITION

Check if appropriate: ☐ DO NOT POST ☐ REFERENCE

SUPREME COURT OF THE STATE OF NEW YORK
COUNTY OF NEW YORK : IAS PART 56

----------x

XL SPECIALTY INSURANCE COMPANY,
ARCH INSURANCE COMPANY, and
SPECIALTY INSURANCE COMPANY

Plaintiffs,

Index No: 650529/2008

-against-

DECISION AND ORDER

LORAL SPACE & COMMUNICATION, INC.,

Defendant.

----------x

RICHARD B. LOWE III, J:

Plaintiffs XL Specialty Insurance Company ("XL Specialty"), Arch Insurance Company ("Arch Insurance"), and US Specialty Insurance Company ("US Specialty", and collectively "Plaintiffs") move, pursuant to CPLR § 3212, for partial summary judgment declaring that the Plaintiffs have no obligation to indemnify the defendant Loral Space & Communication, Inc. ("Loral") for any payments made to the counsel for the nominal plaintiffs in *In re Loral Space and Comm'ns Inc. Consol. Litig.* (CA No 2808-VCS [Del Ch filed May 10, 2007]). Loral cross-moves, pursuant to CPLR § 3212, for partial summary judgment declaring that payments made to the counsel for the nominal plaintiffs in the underlying dispute are covered under the insurance policy issued by Plaintiffs.

BACKGROUND

This insurance coverage dispute arises out of a corporate dispute, that proceeded as a consolidated class and derivative action (the "Delaware Action"), brought and tried in the Delaware Chancery Court (the "Delaware Court") by securities holders of Loral. The Delaware Court ordered Loral to pay significant attorneys' fees to stockholders class counsel in the

Delaware Action. The following undisputed summary of the facts is taken from the Delaware Court's post-trial decision (*In re Loral Space and Comm'ns Inc. Consol. Litig.*, 2008 Del Ch. LEXIS 136, 2008 WL 4293781 [Del Ch] ["*In re Loral*"], *aff'd Loral Space & Comm'ns, Inc. v Highland Crusader Offshore Partners, L.P.*, 977 A2d 867, 868 [Del 2009]).

Loral, a satellite communications company, emerged from bankruptcy in 2005. Its largest stockholder was MHR Fund Management LLC ("MHR"), which owned 35.9% of Loral's common stock. In October 2006, Loral entered into a Securities Purchase Agreement under which MHR acquired $300 million in convertible preferred stock (the "MHR transaction"). The preferred stock had a high dividend rate, a low conversion rate, and significant class voting rights. In addition, the stock gave MHR the potential to acquire 63% of Loral's total equity. When the MHR transaction was announced, Loral stockholders were outraged, and Loral announced that it would reconsider. But, the transaction closed without notable modification on February 27, 2007.

On March 20, 2007, Paul Weiss Rifkind Wharton & Garrison LLP ("Paul Weiss") filed an action in the Delaware Court on behalf of BlackRock Corporate High Yield Fund, Inc. and other investors holding approximately 25% of Loral common stock ("BlackRock complaint"). The BlackRock complaint alleged three derivative claims and one direct claim against MHR, Loral, and its directors. The BlackRock complaint challenged the propriety and fairness to Loral and its shareholders of the MHR transaction. On March 22, 2007, Abrams & Laster, LLP ("A&L"), on behalf of Highland Crusader Offshore Partners, L.P., the beneficial owner of approximately 8% of Loral common stock, commenced a second action in the Delaware Court on the same issue, alleging direct claims against MHR, Loral, and its directors, on behalf of all

Loral stockholders other than defendants and their affiliates. Following a scheduling conference, the two firms filed an amended and consolidated complaint and litigated the case jointly.

In September 2008, after trial and briefing, the Delaware Court issued an opinion examining the relationships among the individuals on Loral's Board of Directors and its Special Committee. The Delaware Court examined the Special Committee's process in evaluating the MHR transaction and financing alternatives. The Delaware Court explained:

> When, over the course of nearly a year, there appears to be no instance in which the Special Committee took any of the numerous opportunities available to it to explore the marketplace and determine whether it could obtain better terms than were available from the controlling stockholder, MHR, it is impossible for me to conclude that the Special Committee acted as an effective guarantor of fairness.

(*In re Loral*, 2008 Del Ch. LEXIS 136, at *95).

The Delaware Court went on to examine whether the MHR transaction satisfied Delaware's "entire fairness" standard, ultimately finding:

> Taken as a whole, the record leaves me persuaded that MHR received unfairly advantageous terms from Loral. The dividend rate was too high and the conversion rate too low. As important, the MHR Financing took MHR from a large blockholder who could not unilaterally prevent a control transaction to a preferred stockholder whose class voting rights gave it affirmative negative control over almost any major transaction.

(*id.* at * 114). As a remedy, the Delaware Court reformed the MHR transaction by "convert[ing] the Preferred Stock that MHR received into non-voting common stock on terms fair to Loral" (*id.* at * 116). The Delaware Court explained:

> Reforming the Securities Purchase Agreement in this fitting and proportionate way is necessary to address the serious overreaching engaged in by MHR. In this regard, I note that the nature of this remedy makes it unnecessary to undertake at this time a director-by-director liability assessment. The entire fairness test is one designed to address a transaction's sustainability, against any party other than the interested party, the test is, in itself, not adequate to determine liability for breach of duty. . . . Because the remedy is one that can be effected as between MHR and

> Loral, there is no need to make findings about the extent to which the individual directors would be subject to liability if I awarded Loral monetary damages.

(*id.* at * 120).

The Delaware Court concluded "that the MHR Financing was unfair and that a final judgment should be entered in favor of Loral and against MHR" (*id.* at * 150-151). The Delaware Court further ordered the parties to "collaborate on an implementing order" and "address the process for considering any fee application the Stockholder Plaintiffs might make, if agreement on that issue cannot be reached after good faith discussions" (*id.* at * 151).

By Stipulation and Order dated December 15, 2008, the parties to the Delaware Action agreed that Loral would pay the fees incurred by Paul Weiss as counsel for the BlackRock derivative plaintiffs in the amount of $8.7 million "on a *quantum meruit* basis" (May 28, 2009 Affidavit of James Sandes ["Sandes Aff"] Ex D, at 1 ["Paul Weiss Fee Stip and Order"]). Loral, however, could not reach agreement on the amount of attorneys' fees that A&L, Highland's counsel, should be paid. A&L was retained on a contingent fee arrangement, unlike Paul Weiss which was retained and paid on an hourly basis. The issue of A&L's fees was subject to further briefing to the Delaware Court.

A&L argued that the Delaware Action conferred substantial benefits on Loral entitling A&L to payment of its attorneys' fees under the Delaware Corporate Benefit Doctrine. A&L further argued that Loral should pay A&L's fees because Loral and all of its stockholders shared in the substantial benefits achieved through A&L's efforts. A&L proffered that the benefit to Loral was "$168.6 million from the cancellation of shares plus $36.4 million from control benefits" (Sandes Aff Ex E at 3), which yields aggregate quantifiable benefits of approximately $205 million.

Loral argued that there was no monetary benefit, any benefit conferred was not quantifiable in monetary terms, and, therefore, A&L's fees must be calculated on a theory of *quantum meruit*, or hourly rate-type basis.

The Delaware Court found that Loral did receive a substantial benefit as a result of the Delaware Action, but that it "cannot value the benefit in a precise way" (July 15, 2009 Affirmation of Eric Leon ["Leon Aff"], Ex K, at 72). Accordingly, the Delaware Court ordered Loral to pay A&L attorneys' fees and expenses in the amount of $10,627,587 (Sandes Aff, Ex J at 1 ["A&L Fee Order", and collectively with the $8.7 million Paul Weiss Fee Stip and Order, "Fee Award"]). By January 7, 2009 Loral had satisfied the final order entered in the Delaware Action, by paying the full amount of the Fee Award the nominal plaintiffs' attorneys. Loral now seeks to have Plaintiffs reimburse the funds paid out under the Fee Award. Plaintiffs notified Loral that they believe that the Fee Award is not covered by the Insurance Policy.

The Insurance Policy issued by the plaintiff insurers to Loral provides for a $40 million primary Limit of Liability (excess of a $5 million retention) of directors and officers insurance coverage for claims first made during the Policy Period of November 21, 2005 to November 21, 2006. Each of the Plaintiffs issued a share percentage of that primary $40 million Limit of Liability as follows: XL Specialty 50% or $20 million; and US Specialty and Arch Insurance, 25% or $10 million each. XL Specialty issued a full form policy, Policy No. ELU 90609-05 the (Sandes Aff, Ex K). Arch and US Specialty issued insurance binders, indicating that they follow the terms set forth in the XL Policy up to their quota share limits (*id.*, Exs L and M).

The Policy states that: "The Insurer shall pay on behalf of the **Company Loss** resulting solely from any **Securities Claim** first made against the **Company** . . . for a **Company**

Wrongful Act" (Leon Aff, Ex M, ¶ I[C], stamped DO 71 00 09 99 [emphasis in original]). The terms "Company", "Loss", "Securities Claim", and "Wrongful Act" are specifically defined. The term Loss is defined as:

> damages, judgment, settlement or other amounts and Defendant Expenses in excess of the Retention that the Insured is legally obligated to pay. Loss will not include:
>
> (1) punitive damages or exemplary damages or the multiplied portion of any damage award;
>
> (2) fines, penalties or taxes imposed by law; or
>
> (3) matters which are uninsurable under the law pursuant to which this Policy is construed.

(Leon Aff Ex M, Endorsement 5, ¶ 3[M] ["Policy Definition of Loss"], stamped DO 85 00 04 02). Securities Claim, in relevant part, is defined as "a Claim made . . . against any Insured":

> (1) for violation of any federal, state, local regulation, statute or rule regulating securities, including but not limited to the purchase or sale or, or offer to purchase or sell, securities which is:
>
> > (a) brought by any person or entity based upon, arising out of, direction or indirectly resulting from, in consequence of, or in any way involving the purchase or sale or, or offer to purchase or sell, securities of the Company; or
> >
> > (b) brought by a security holder of a Company with respect to such security holder's interest in securities of such Company; or
>
> (2) *brought derivatively on behalf of the Company* by a security holder of such Company.

(Leon Aff Ex M, Endorsement 11, at 1 ["Policy Definition of Securities Claim"] [emphasis added], stamped DO 85 176 06 02). Claim, in relevant part, is defined as: (1) a written demand for monetary or non-monetary relief; [or] (2) any civil proceeding in a court of law or equity, or arbitration . . . ." (Leon Aff, Ex M, ¶ II[C], stamped DO 71 00 09 99). Wrongful Act is defined

as: "any actual or alleged act, error or omission misstatement, misleading statement or breach of duty by the Company in connection with a Securities Claim" (*id.*, ¶ II[S] ["Policy Definition of Wrongful Act"], stamped DO 71 00 09 99).

While the claims in the Delaware Action were pending against Loral and its non-MHR directors and officers, the Plaintiffs advanced to Loral the cost of paying law firms chosen and retained by those insureds. The Plaintiffs paid Loral over $9 million in defense expenses in excess of the Policy's applicable $5 million retention. Loral has requested that the Plaintiffs acknowledge coverage under the Policy for the Fee Award.

On December 19, 2008, the Plaintiffs filed this declaratory judgment action seeking a declaration that the Fee Award was not a covered Loss under the Policy. On February 27, 2009, Loral filed its answer and counterclaim, taking the position that the Fee Award is a covered Loss within the language of the Policy. These cross-motions for summary judgment followed.

DISCUSSION

Concerning the standards for interpreting an insurance policy on a motion for summary judgment, the Court of Appeals explained:

> As with any contract, unambiguous provisions of an insurance contract must be given their plain and ordinary meaning. . . . [A] contract is unambiguous if the language it uses has a definite and precise meaning, unattended by danger of misconception in the purport of the [agreement] itself, and concerning which there is no reasonable basis for a difference of opinion. . . . Thus, if the agreement on its face is reasonably susceptible of only one meaning, a court is not free to alter the contract. . . . If the terms of a policy are ambiguous, however, any ambiguity must be construed in favor of the insured and against the insurer.

(*White v Continental Cas. Co.*, 9 NY3d 264, 267 [2007]; *see Vigilant Ins. Co. v Bear Stearns Cos., Inc.*, 10 NY3d 170, 177[ ]). "Indeed, where a policy's terms are ambiguous, the insurer can prevail only if it can demonstrate 'not only that its interpretation is reasonable but that it is

the only fair interpretation'" (*Antoine v City of New York*, 56 A.D.3d 583, 584-585 [2d Dept 2008], *quoting City of New York v Evanston Ins. Co.*, 39 AD3d 153, 156 [2d Dept 2007]). "[W]hen the terms and conditions of a policy are clear and unambiguous, the construction of the policy presents a question of law . . ., and the court may properly grant summary judgment"] (*Caliendo v Travelers Indem. Co.*, 225 AD2d 574 [2d Dept 1996][citations omitted]).

It is also a well-established principle of law that when an agreement defines a term, that definition should be used throughout the agreement unless the term is further modified in the agreement (*see State v R.J. Reynolds Tobacco Co.*, 304 AD2d 379 [1st Dept 2003] [applying a defined term to multiple sections of the agreement because the contexts of the sections that used the phrase were not sufficiently different to warrant different interpretations]; *Unimax Corp. v Lumbermens Mut. Casualty Co.*, 908 F Supp 148, 154 [SD NY 1995]).

Definition of Loss

According to Loral, the Fee Award is an amount that Loral was legally obligated to pay as a result of the Delaware Action. There is no dispute that the broad definition of the term Loss covers the Fee Award as it is "damages, judgment, settlement or other amounts . . . and Defense Expenses in excess of the Retention that the Insured is legally obligated to pay" (*see R.J. Reynolds*, 304 AD2d 379; *Unimax Corp.*, 908 F Supp at 154). Plaintiffs argue, however, that as a matter of law the term Loss should be offset from the benefit Loral gained as a result of the Delaware Decision. Plaintiffs argue that such a legal determination fits into the third exclusion from the definition of Loss, which excludes "matters which are uninsurable under the law pursuant to which this Policy is construed" (Policy Definition of Loss, ¶ 3[M][3]). According to Plaintiffs, the Fee Award is uninsurable as a matter of law according to certain First Department

precedent. These cases, Plaintiffs' argue, hold that losses incurred in litigation that would otherwise by insured must be offset by any benefit received from the underlying transaction.

There is nothing in the language of the Policy that allows the Plaintiffs to use a benefit to reduce or eliminate the amount of a covered Loss (*Hager v Allstate Ins. Co.*, 166 Misc 2d 905, 907 [Orange Cty, Sup Ct 1995] ["the only offsets that respondent would be entitled to are those which are included in the contract of insurance, and which are enforceable as a matter of law"]). Furthermore, "a court may not create policy terms by implication or rewrite an insurance contract. . . . Nor should a court reach to find an ambiguity where the policy language has a definite and precise meaning" (*Property and Cas. Co. v American Fleet Management, Inc.*, 2005 NY Slip Op 52244U; 10 Misc 3d 1075A; 814 NYS2d 890, at * 4 [NY Cty, Sup Ct 2005]). Therefore, the Court is bound to give effect to the clear and unambiguous definition of the term Loss which does not incorporate an offset.

On the other hand, it is undisputed that the Delaware Court found that the derivative action resulted in a benefit to Loral, regardless of the fact that Loral received no monetary award. The Delaware Court's determination was the result of its analysis of the Delaware Corporate Benefit Doctrine. The Delaware Corporate Benefit Doctrine provides that a nominal plaintiff may be entitled to reimbursement of its attorneys' fees even where there is no common fund, or common monetary benefit (*In re First Interstate Bancorp Consol. Shareholder Litig.*, 756 A2d 353, 357 [Del Ch 1999] ["the corporate benefit doctrine comes into play when a tangible monetary benefit has not been conferred, but some other valuable benefit is realized by the corporate enterprise or the stockholders as a group"]). From this Court's reading of the underlying litigation, however, the benefit resulting from the Delaware Action was actually

received by certain minority and public shareholders, at the controlling shareholder's expense. In terms of the benefit to the company itself, it appears to be a zero-sum transaction, where whatever unfair benefit MHR initially received was returned to the corporation in order to ensure the minority and public shareholders' respective voting rights. While the benefit to Loral may be found under the analysis Delaware Corporate Benefit Doctrine, the same analysis is not necessarily applicable under the rules for interpreting insurance contracts.

Loral did not receive any monetary benefit from the Delaware Action and any offset would be speculative at best. Additionally, the case law upon which Plaintiffs' rely -- including *Reliance Group Holdings, Inc. v Nat'l Union Fire Ins. Co.*, 188 AD2d 47, 57 [1st Dept 1993]) and *CNL Hotels & Resorts, Inc. v Houston Cas. Co.*, (505 F Supp 2d 1317, 1323 [MD Fla 2007]) -- is distinguishable and does not stand for the proposition that the Fee Award is not insurable as a matter of New York law.

In *Reliance*, the First Department found that for a payment to qualify as "damages, judgments [and] settlements" under the policy, "there must have been an ordered or actual payment of damages by the director or officer, either in satisfaction of a judgment, or by way of settlement of an action" (594 NYS2d at 23). The court declined, however, to find that the settlement at issue fell under this policy definition. The defendants had paid $21.1 million to settle an action against it concerning its actions during a takeover attempt of Walt Disney Productions, Inc., the company had received "greenmail" in exchange for abandoning the takeover and for dismissing a shareholder's derivative suit it had begun against Disney (*id.* at 22). The greenmail fund eventually totaled $94 million (*id.* at 23). The court held that the settlement was not a "loss" under the insurance policy because "Reliance sustained no 'loss' as

defined in the policy, but rather realized a profit of approximately $74 million in connection with its . . . takeover attempt" (*id.*).

The decision in *Reliance* (188 AD2d at 57), and similar cases such as *CNL* (505 F Supp 2d at 1323), stand for the proposition that "one may not insure against the risk of being ordered to return money or property that has been wrongfully acquired" (*Reliance*, 188 AD2d at 55 [quotation marks and citation omitted]; *Vigilant Ins. Co. v Credit Suisse First Boston Corp.*, 10 AD3d 528, 529 [1st Dept 2004] [disgorgement or restitution of "ill-gotten funds does not constitute 'damages' or a 'loss' as those terms are used in insurance policies" and such disgorgement "is not insurable under the law"]). Moreover, where defense costs are a component of uninsurable loss, a party may not be reimbursed for those costs as they "are only recoverable for covered claims" (*Vigilant*, 10 AD3d at 529).

In the instant matter, Loral's minority and public shareholders were found to be victims of a sweetheart financing deal between Loral and its controlling shareholder. There was no loss or gain to the corporation itself between the terms of the original transaction and the refashioned transaction. Not only was there no monetary gain to Loral resulting from the Delaware Action, but there is no allegation that Loral wrongfully acquired funds to which it was not entitled. As described below, the Policy expressly covers losses resulting from derivative claims, which by definition are actions brought on behalf of Loral. A successful result of a derivative claim would by definition, and by the terms of the Policy, benefit the Company. Therefore, simply because Loral received benefit does not automatically require an offset in terms of losses and defense costs sustained. For the foregoing reasons, there is no reasons to look beyond the plain and unambiguous words included in the broad definition of the term Loss, which undisputedly covers

the Fee Award, and the Fee Award does not fall into the third exception for uninsurable amounts.

Definition of Securities Claim and Company Wrongful Act

Plaintiffs state that "once the Delaware Court ruled, the allegations made in the Delaware Complaint became irrelevant" (Plaintiffs' May 28, 2009 Memo of Law at 18) and Plaintiffs' obligations to make any further payments became controlled by what the Delaware Court actually found. Contrary to Plaintiff's argument, the definition of Wrongful Act clearly relies on both findings and allegations made in connection with a Securities Claim against Loral. Here, both the allegations in the underlying action and the Delaware Court's findings explain that Loral entered into an unfair transaction in which Loral overpaid for MHR's capital infusion, thus a breach of duty to its minority and public shareholders. "[A]ny actual or alleged . . . breach of duty by the Company in connection with a Securities Claim" is covered by the definition of Wrongful Act (Leon Aff Ex M, ¶ II[S]).

Loral was brought into the class and derivative litigation as both a nominal and direct defendant. Loral did not bring affirmative claims because the dispute centered around its own financing transaction with its controlling shareholder. The Delaware Court explained that if Loral did not close on the MHR transaction, Loral would have been subject to potential litigation from MHR (*In re Loral*, 2008 Del Ch. LEXIS 136, at * 65-66). The Delaware Court found that the transaction violated Delaware's rule of entire fairness (*id.* at 150-151). The entire fairness doctrine protects minority and public shareholders and, as here, is at issue in class and derivative litigation brought by securities' holders. The underlying litigation involved the MHR transaction, which was an offer to sell securities, alleged violations of fairness rules regarding transactions with controlling shareholders, and breaches of duty to minority and public

shareholders. Furthermore, any class claims were brought by Loral securities holders with respect to their interest in securities of Loral. This clearly satisfies section 1 of the Definition of Wrongful Act. Additionally, the derivative claims were brought on behalf of Loral by a Loral security holder, satisfying section 2 of the Definition of Wrongful Act.

Again, there is no dispute that Loral received a benefit as a result of the class and derivative litigation, and that even though Loral received no monetary benefit, the Delaware Court ordered Loral to pay nominal plaintiff's attorneys' fees due to the application of the Delaware Corporate Benefit Doctrine. These appear to be the exact type of losses insured by section (2) of the Definition of Wrongful Act, which specifically insures losses resulting from litigation brought derivatively on behalf of Loral. By definition, a derivative action is a "suit by the beneficiary of a fiduciary to enforce a right belonging to the fiduciary; [such as] a suit asserted by a shareholder on the corporation's behalf against a third party" (BLACK'S LAW DICTIONARY 475 [8th ed 2004]). Plaintiffs insured against Loral's losses incurred as a result of a derivative action brought in Loral's name. Therefore, Plaintiffs' arguments concerning the resulting benefit of the derivative litigation is precluded by the terms of the Policy, where, as here, there is no allegation that Loral received "money or property that has been wrongfully acquired" (*Reliance*, 188 AD2d at 55).

Furthermore, the is no merit to Plaintiffs' argument concerning allocation of fees. The Fee Award and the Policy language are dispositive on this motion. The Fee Award resulted from nominal plaintiff's combined efforts in the consolidated class and derivative action, and resulted from, as the Delaware Court found, an improper transaction to which Loral was a party.

CONCLUSION

Accordingly, it is hereby:

ORDERED that plaintiffs' motion for partial summary judgment on its first cause of action is denied; and it is further

ORDERED that defendant's motion for partial summary judgment seeking a declaration that the amount paid to nominal plaintiffs' attorneys in the underlying litigation is covered by the insurance policy issued by the plaintiffs is granted.

This constitutes the decision and order of the Court.

Dated: February 09, ~~2009~~ 2010

ENTER:

RICHARD B. LOWE III

J.S.C.