Freedom Specialty Ins. Co. v Platinum Mgt. (NY), LLC
2017 NY Slip Op 32728(U)
December 21, 2017
Supreme Court, New York County
Docket Number: 652505/2017
Judge: O. Peter Sherwood

SUPREME COURT OF THE STATE OF NEW YORK
COUNTY OF NEW YORK: COMMERCIAL DIVISION PART 49

----------X

FREEDOM SPECIALTY INSURANCE COMPANY, ATLANTIC SPECIALTY INSURANCE COMPANY, AND BERKLEY INSURANCE COMPANY,

Plaintiffs,

- against -

PLATINUM MANAGEMENT (NY), LLC, MARK NORTLICHT, DAVID LEVY, DANIEL SMALL, URI LANDESMAN, JOSEPH MANN, and JOSEPH SANFILIPPO,

Defendants.

----------X

DECISION AND ORDER

Index No.: 652505/2017
Motion Seq. No.: 004

O. PETER SHERWOOD, J.:

On this motion defendants and counterclaim-plaintiffs Platinum Management (NY) LLC, Mark Nordlicht, David Levy, Daniel Small, Uri Landesman, Joseph Mann and Joseph SanFilippo (collectively, the "Insureds"), seek (1) a preliminary injunction directing counterclaim-defendants Freedom Specialty Insurance Company ("Freedom"), Atlantic Specialty Insurance Company ("Atlantic"), and Berkley Specialty Insurance Company ("Berkley") (collectively, the "Excess Insurers") to advance their attorneys' fees and costs for defense of a criminal prosecution by the United States Attorney for the Eastern District of New York (the "EDNY Indictment"), a civil enforcement action by the United States Securities and Exchange Commission in the same court (the "SEC Complaint"), and a parallel civil action in Texas state court (the "Harris County Action"); and (2) an order staying any discovery pending resolution of the criminal prosecution and civil enforcement action in the Eastern District of New York ("EDNY").

I. BACKGROUND

The Insureds have insurance coverage under a $5 million directors and officers ("D&O") insurance policy (the "Primary Policy") for the policy period November 20, 2015 to November 20, 2016 and four associated excess policies (each $5 million) covering essentially the same period of time (the "Excess Policies") obtained by Platinum Management (NY) LLC ("Platinum"). The aggregate coverage limit ($25 million) compares with $5 million of coverage for the immediate prior policy period. The Insureds made claims pursuant to (the Primary Policy) and Excess

Policies in connection with their defense against the EDNY Indictment, the SEC Complaint, and, as applicable, the Harris County Action. The insurer of the Primary Policy, U.S. Specialty Insurance Company ("U.S. Specialty") or a "Primary Insurer"), acknowledged coverage and advanced defense fees and costs up to the now exhausted limit of the Primary Policy. Similarly, the first layer of excess coverage, provided by Berkshire Hathaway Specialty Insurance Company ("Berkshire") has been paid and is now exhausted. The Excess Insurers are responsible for the final three layers of excess coverage but have disclaimed coverage and filed this declaratory judgment action seeking to have the Excess Policies declared void for 1) breach of Warranty Statements falsely representing on their applications for coverage that they were unaware of any wrongful act of any insured that might result in a claim being made against any of them (Pl. Memo at 1-2) and 2) application of the "Prior or Pending Demand or Litigation Exclusion" ("PPL Exclusion") clauses which preclude coverage for claims arising out of any litigation which was pending as of November 15, 2015 (start of Policy Period) or substantially similar fact/event/proceeding upon which the EDNY Indictment is predicated (*see id.* at 6). The Excess Insurers identify two matters which are claimed to preclude coverage based on the PPL Exclusions: 1) a criminal case pending against former Platinum executive Murray Huberfield in the Southern District of New York ("SDNY") captioned *Untied States v Seabrook* 1:16–CR–00467 (SDNY); and 2) a civil fraud action brought by the Securities and Exchange Commission on December 19, 2016 captioned *SEC v Platinum Management (NY) LLC*, Case No. 16-CV-6848 (EDNY) ("SEC Complaint") (NYSCEF Doc. No. 143).

On this motion, the Insureds state that absent an immediate injunction directing the remaining Excess Insurers to honor their advancement obligations, they will be without coverage for their Defense Costs at a critical juncture in the criminal proceeding. They argue that their defense of the EDNY Indictment is already suffering, including from an inability to retain expert witnesses whose testimony is essential to refuting the Government's allegations concerning the sophisticated financial transactions at issue in that case.

Regarding the breach of Warranty Statements claim, the Excess Insurers state that the Insureds failed to disclose on their applications information alleged in the EDNY Indictment and SEC Complaint, specifically allegations that "Platinum Management was defrauding potential investors with material misrepresentations or omissions regarding the value of Platinum Management's assets and liquidity" (Am Compl. ¶ 62, NYSCEF Doc. No. 64). Regarding the PPI

Exclusions, the Excess Insurers claim the EDNY Indictment and the SEC Complaint fall under an earlier non-covered time period, and "share a common nexus of facts and circumstances" with those involved in a separate investigation of Murray Huberfield which is pending in the SDNY. In addition to opposing the Insured's motion, the Excess Insurers seek expedited discovery relevant to their coverage defenses (*see* Pl Memo at 9).

The Insureds argue that the Excess Insurers declaratory judgment action seeks to establish the truth of the allegations in the EDNY Indictment and the SEC Complaint, as a basis for avoiding coverage – even though they have denied the charges and allegations and no wrongdoing has been found in either case. The Insureds assert that if accepted, the Excess Insurers' arguments would make D&O coverage all but meaningless in any case alleging wrongdoing against a corporate officer.

The "Warranty Statements" state, in substance, that "no Insured has knowledge . . . of any wrongful act of any Insured," or of any "fact, circumstances or situation which (s)he has reason to suppose might result in a claim being made against any of the Insureds." Am. Compl. ¶ 42. The Excess Insurers allege that the Warranty Statements were breached because the Insureds did not disclose "information contained in the EDNY Indictment and SEC Proceeding" – *i.e.*, the allegations that the "Platinum Management was defrauding potential investors with material misrepresentations and omissions regarding the value of Platinum Management's assets and liquidity." Am. Compl. ¶ 62.

The Excess Insurers argue that Platinum Management received a subpoena in May 2015 from the U.S. Attorney for the SDNY relating to an investigation against Mr. Huberfeld but failed to disclose that fact on their applications in November 2015. The Insureds respond that no Insured was charged with wrongdoing in that case. Further, Huberfeld was accused of paying a bribe to a public official. The subpoena did not concern and is not interrelated with any alleged scheme to defraud investors which is the subject of the EDNY Indictment and SEC Complaint. Thus, the SDNY subpoena did not involve a "Wrongful Act" and did not result in a Claim against any Insured.

As to the PPL Exclusions defense, the Insureds maintain that the SDNY investigation involved a separate alleged bribery scheme by a non-Insured third party, which is unrelated to the alleged wrongdoing either in the EDNY Indictment or the SEC Complaint. The EDNY Indictment

(filed in December 14, 2016) and the SEC Complaint (filed in December 19, 2016) were both commenced within, the November 20, 2015 to November 20, 2016 Policy Period. They do not share a common nexus with the facts and circumstances of the SDNY investigation.

II. DISCUSSION

The law regarding interpretation of exclusionary clauses contained in D&O policies "is highly favorable to insureds" *Pioneer Towers Owners Ass'n v State Farm Fire & Cas. Co.*, 12 NY3d 302, 306 (2009). Any policy exclusions must "have a definite and precise meaning, unattended by danger of misconception . . . and concerning which there is no reasonable basis for a difference of opinion" *id.*

The duty of an insurer to defend is broader than its duty to indemnify (*see Federal Ins. Co. v Kozlowski*, 18 AD3d 33 (1st Dept 2005). "[U]nder a directors and officers liability policy calling for the reimbursement of defense expenses . . . insurers are required to make contemporaneous interim advances of defense expenses where coverage is disputed, subject to recoupment in the event it is ultimately determined no coverage was afforded. The duty to pay arises at the time the insured becomes 'legally obligated to pay.' The contemporaneous payment of defense costs is required because "[t]he only reasonable interpretation of the loss clause in the . . . [directors and officers] Policy is that the insurer's obligation to pay accrues when the insured incurs the obligation, not after it has paid a judgment" *(id.)* (internal citations and quotations excluded).

In this case, the Insureds have shown a likelihood of success on the merits. The Insureds have not been found to guilty of any of the charges contained in either the EDNY Indictment or the SEC Complaint. Until there has been a final adjudication of wrongdoing by the Insureds, the Excess Policies remain in effect and the Excess Insurers are required to pay the legal defense costs of their insureds (*see Dupree*, 96 AD3d at 546). Likewise, a failure to disclose the subpoena in the SDNY investigation has not been shown to constitute a breach of the Warranty Statements. The Huberfeld investigation involves alleged conduct (bribery) that is distinct from the conduct (fraud) alleged against the Insureds in the EDNY Indictment and SEC Complaint. The PPL Exclusion turns on a comparison of facts and circumstances as alleged in the complaints (*see Zuneshine v Executive Risk Indem.*, 1998 US Dist LEXIS 12699 8 10-1, No 97 Cir 5525[MBM] [SDNY Aug 17, 1998]). Here, Insurers made no attempt to compare the facts and circumstances as alleged in the SDNY investigation commenced during the prior policy period with those alleged

in the EDNY Indictment and SEC Complaint, both of which were commenced during the policy period. Thus, the Excess Insurers have not shown the PPL Exclusion to be applicable.

As to the other requirements for injunctive relief, the Insureds argue persuasively that they face irreparable harm without advancement of Defense Costs, and the balance of hardships tips decidedly in their favor. The First Department has held that a D&O insurer's failure to advance defense costs constitutes a "direct, immediate and irreparable injury," warranting the issuance of a preliminary injunction (*see Dupree v Scottsdale Ins. Co.*, 96 AD3d 546 (1st Dept 2012). Here, without preliminary injunctive relief, the Insureds will be irreparably harmed because they will be unable to mount adequate defenses, particularly in the EDNY criminal proceedings, where, according to Insureds, critical pre-trial motions were due in November, the government has already produced approximately 15 million pages of documents with discovery still ongoing and the Insureds are in need of funds to pay for the expert witnesses and consultants that are essential to their defense.

Regarding the balance of equities, the Insureds maintain that unless the Excess Insurers are ordered to advance the defense costs, the Insureds will face serious criminal and civil charges, and the potential loss of their freedom, without the funds necessary to mount an adequate defense. In contrast, the Excess Insurers will only face the economic risk of having to advance defense costs and can seek recoupment of such funds should the facts ultimately show that the Insureds were not entitled to coverage. The harm that the Insureds may suffer stemming from being unable to adequately defend themselves, including potentially losing their liberty, outweighs any possible economic loss that the Excess Insurers may experience. These arguments have substantial merit (*see Dupree*, 36 Misc3d 1210[A] [finding balance of equities favor insureds]).

As to the request to stay discovery, the Insureds insist that at this stage, the court need not and should not determine the validity of the Excess Insurers' coverage defenses before ordering advancement of defense costs. Rather, the Insureds must only demonstrate a likelihood of success on the merits of their claim for advancement of defense expenses with adjudication of the underlying insurance coverage disputes dependent on the outcome of the underlying criminal and SEC proceedings because an essential purpose of D&O insurance is to provide advancement of defense fees and costs to directors, officers, and employees in the event claims are made against them for alleged Wrongful Acts.

The demand for discovery in furtherance of the Excess Insurers' putative defenses against coverage shall be denied as premature. A declaratory judgment action cannot be used to conduct discovery regarding the very facts at issue in the EDNY Indictment and the SEC Complaint. Discovery aimed at establishing non-coverage must await outcome of the underlying criminal and civil proceedings.

Accordingly, it is hereby

ORDERED that the motion for preliminary injunction of defendant is GRANTED; and it is further

ORDERED that Freedom Specialty Insurance Company, Atlantic Specialty Insurance Company and Berkley Specialty Insurance Company are directed to pay the legal expenses in both the criminal and civil proceedings brought against the Insureds as they accrue and in accordance with the layers set forth in the policies and subject to recoupment up to the policy limits, until final adjudication that their alleged wrongdoings fall within policy exclusions; and it is further

ORDERED that discovery is stayed pending a final determination of the civil and criminal proceedings in the EDNY.

This constitutes the decision and order of the court.

DATED: December 21, 2017

ENTER,

O. PETER SHERWOOD J.S.C.