To Be Argued By:
BRIAN A. SUTHERLAND
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Court of Appeals

STATE OF NEW YORK

AMERICAN INTERNATIONAL SPECIALTY LINES INSURANCE COMPANY,

Petitioner-Respondent,

—against—

ALLIED CAPITAL CORPORATION and
CIENA CAPITAL LLC (f/k/a Business Loan Express LLC),

Respondents-Appellants.

BRIEF FOR RESPONDENTS-APPELLANTS

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CORPORATE DISCLOSURE STATEMENT

Pursuant to Court of Appeals Rule 500.1(f), Appellants respectfully state that appellant Allied Capital Corporation ("Allied") was merged with and into Ares Capital Corporation ("ARCC") in April 2010, with ARCC as the surviving corporation. ARCC is a publicly traded business development corporation that is managed by an indirect subsidiary of Ares Management Corporation, a global alternative asset manager that directly and/or indirectly manages a number of public and private funds and accounts.

The equity interests in appellant Ciena Capital LLC ("Ciena"), now known as Joyce Lane Capital LLC, were at all relevant times directly or indirectly owned by Allied or ARCC.

No entity other than ARCC has a direct financial interest in the outcome of this appeal.

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TABLE OF CONTENTS

Page

PRELIMINARY STATEMENT 1

QUESTION PRESENTED 7

JURISDICTION 7

STATEMENT OF THE CASE 8

A. History of New York Arbitration Law 8

1. Judicial Hostility to Arbitration in the Nineteenth Century 8

2. The Arbitration Act of 1920 and Establishment of State Policy Encouraging Arbitration 11

B. Arbitration Proceedings 14

1. The Insurance Policies, Arbitration Agreement, and Demand for Arbitration 14

2. The Parties' Motions for Summary Disposition 17

3. The Arbitrators' Partial Ruling on the Motions for Summary Disposition 18

4. The Arbitrators' Final Award 22

C. Judicial Proceedings 22

ARGUMENT 27

TABLE OF CONTENTS (Cont.)

I. The Parties' Written Agreement Authorized the Arbitrators to Issue Only One Final Decision and Award and Did Not Limit Their Authority to Reconsider Partial Rulings 29

A. The Partial Ruling on the Motions for Summary Disposition Was Not the Final Decision Contemplated in the Parties' Written Agreement Because It Did Not Decide All Disputes 32

B. The Parties' Written Agreement Did Not Limit the Arbitrators' Authority to Reconsider Their Partial Ruling on the Motions for Summary Disposition 36

1. If New York Recognizes "Partial Awards" That Arbitrators May Not Reconsider, the Parties Must Clearly Provide for Them in a Written Agreement 36

2. The Parties Did Not Enter into Any Agreement That the Arbitrators Could Issue a "Partial Award" 47

II. In Any Event, the Parties Submitted the Issue of Whether the Arbitrators Had Authority to Reconsider Their Partial Ruling to the Arbitrators 54

III. The Arbitrators Acted Well within the Scope of Their Authority in Ruling on the Reconsideration Issue 57

CONCLUSION 59

TABLE OF AUTHORITIES

Page(s)

Cases

Benihana, Inc. v. Benihana of Tokyo, LLC,
784 F.3d 887 (2d Cir. 2015) 55

Brigham v. Duany,
241 N.Y. 435 (1926).......... 43

Cable Connection, Inc. v. DIRECTV, Inc.,
44 Cal. 4th 1334 (2008).......... 39

Doke v. James,
4 N.Y. 568 (1851).......... 11

Dolman v. United States Tr. Co. of N.Y.,
2 N.Y.2d 110 (1956).......... 33

Flannery v. Sahagian,
134 N.Y. 85 (1892).......... 10, 11

Glass, Molders, Pottery, Plastics & Allied Workers Int'l Union Local 182B v. Excelsior Foundry Co.,
56 F.3d 844 (7th Cir. 1995).......... 10

Herbst v. Hagenaers,
137 N.Y. 290 (1893).......... 10

Hugo Boss Fashions v. Fed. Ins. Co.,
252 F.3d 608 (2d Cir. 2001) 21

In re B. Schwartz Silk Co.,
224 A.D. 705 (1st Dep't 1928).......... 51

In re Worldcom, Inc. Sec. Litig.,
354 F. Supp. 2d 455 (S.D.N.Y. 2005).......... 21

Jemzura v. Jemzura,
36 N.Y.2d 496 (1975).......... 43

Jones v. Welwood,
71 N.Y. 208 (1877) .... *passim*

Maplebear, Inc. v. Busick,
26 Cal. App. 5th 394 (Cal. Ct. App. 2018) 39

Matter of Am. Eagle Fire Ins. Co. v. New Jersey Ins. Co.,
240 N.Y. 398 (1925) 52

Matter of Bd. of Educ. of Dover Union Free Sch. Dist. v. Dover-Wingdale Teachers' Ass'n,
61 N.Y.2d 913 (1984) 31, 33, 43

Matter of Civil Serv. Bar Assoc., Local 237 v. City of New York,
64 N.Y.2d 188 (1984) 13

Matter of Feuer Transp., Inc. v. Local Union No. 445,
295 N.Y. 87 (1946) 8

Matter of Franco v. Dweck,
165 A.D.3d 551 (1st Dep't 2018) 51

Matter of Gantt v. Felipe y Carlos Hurtado & Cia., Ltda.,
297 N.Y. 433 (1948) 12

Matter of N.Y.C. Transit Auth. v. Transport Workers Local 100,
99 N.Y.2d 1 (2002) 8

Matter of N.Y. City Transit Auth. v. Transp. Workers' Union of Am., Local 100,
6 N.Y.3d 332 (2005) 57

Matter of Nat'l Cash Register Co. v. Wilson,
8 N.Y.2d 377 (1960) 31, 33

Matter of Nationwide Gen. Ins. Co. v. Investors Ins. Co. of Am.,
37 N.Y.2d 91 (1975) 14, 46, 55

Matter of S. M. Wolff Co. v. Tulkoff,
9 N.Y.2d 356 (1961) 11

Matter of Silverman v. Benmor Coats, Inc.,
61 N.Y.2d 299 (1984) .... *passim*

Matter of Smith Barney Shearson Inc. v. Sacharow,
91 N.Y.2d 39 (1997) 55, 57

Matter of Sprinzen v. Nomberg,
46 N.Y.2d 623 (1979) 43

Meacham v. Jamestown, Franklin & Clearfield R.R.,
211 N.Y. 346 (1914) 8

Michaels v. Mariforum Shipping, S.A.,
624 F.2d 411 (2d Cir. 1980) 34

Miller v. Schloss,
218 N.Y. 400 (1916) 42

Mobil Oil Indonesia Inc. v. Asamera Oil (Indonesia) Ltd.,
43 N.Y.2d 276 (1977) .... *passim*

Ott v. Schroeppel,
5 N.Y. 482 (1851) 38

President of the Del. & Hudson Canal Co. v. Pa. Coal Co.,
50 N.Y. 250 (1872) 9

Stolt-Nielsen S.A. v. AnimalFeeds Int'l Corp.,
559 U.S. 662 (2010) 39, 40

Sun Capital Partners, Inc. v. Twin City Fire Ins. Co.,
S.D. Fla. Case No. 9:12-cv-81397-KAM (Doc. 349: Jan. 16, 2018) 21

T.Co Metals, LLC v. Dempsey Pipe & Supply, Inc.,
592 F.3d 329 (2d Cir. 2010) 57

Trade & Transp., Inc. v. Natural Petroleum Charterers Inc.,
931 F.2d 191 (2d Cir. 1991) 48

TABLE OF AUTHORITIES (Cont.)

United Bhd. Carpenters & Joiners of Am. v. Tappan Zee Constructors, LLC,
804 F.3d 270 (2d Cir. 2015) 57

Wien & Malkin LLP v. Helmsley-Spear, Inc.,
6 N.Y.3d 471 (2006) 57

Wolff & Munier, Inc. v. Diesel Constr. Co.,
44 A.D.2d 530 (1st Dep't 1974), *aff'd*, 36 N.Y.2d 750 (1975) 52

Statutes

9 U.S.C. § 16(a)(1)(D) 39

1920 N.Y. Laws Ch. 275, § 2 .... 11, 12

1920 N.Y. Laws Ch. 275, § 3 12

1920 N.Y. Laws Ch. 275, § 8 11

1937 N.Y. Laws Ch. 341 12

1962 N.Y. Laws Ch. 308 12

Rules

CPLR 5602 7

CPLR 5611 7

CPLR 7501 .... 12, 29, 37, 42

CPLR 7507 .... 37, 42

CPLR 7511 22

CPLR 7511(b)(1) 28

CPLR 7511(b)(1)(iii) 7, 23, 37, 42

CPLR 7511(d) 51

Other Authorities

7A Couch on Insurance §§ 103:4, 103:5 (Westlaw 2018) 21

H. H. Nordlinger, *The Law and Practice of Arbitration in New York*, 13 Mo. L. Rev. 196 (1948) 9

John T. Morse, Jr., *The Law of Arbitration and Award* (Boston: Little, Brown & Co. 1872), https://bit.ly/2UDES7X 9

5 N.Y. Jur. 2d Arbitration and Award § 219 51

Temporary Commission on the Courts, *Second Preliminary Report of the Advisory Committee on Practice and Procedure* (Feb. 15, 1958) 13

PRELIMINARY STATEMENT

To regulate the process by which courts transform private dispute-resolution agreements into public judgments, the Legislature conferred jurisdiction on New York courts to enforce a written agreement to submit any controversy to arbitration and to enter judgment on an award. In general, whether a court may enter judgment enforcing an award turns on whether the written agreement authorized the award. Likewise, whether a court may vacate an award typically turns on whether the arbitrators exceeded their authority under the written agreement.

In this case, respondent American International Specialty Lines Insurance Company (the "insurer" or "AISLIC"), and appellant Allied Capital Corporation ("Allied"), a policyholder, entered into a written agreement providing that "all" policy disputes shall be submitted to a mediator or arbitration panel. (A. 146, 191) The written agreement further provided that, "[i]n the event of arbitration, the decision of the arbitrators shall be final and binding and provided to both parties, and the arbitrators' award shall not include attorneys' fees or other costs." (A. 146, 192) It thus provided for a single, unitary award at the conclusion of arbitration proceedings that would be final and binding.

In 2010, Allied incurred approximately $10 million in liability when it settled a *qui tam* action with the government. Allied sought coverage from its insurer, but the insurer denied coverage. The parties proceeded to arbitration and filed pre-hearing motions for summary disposition. The insurer argued that Allied did not suffer a covered "Loss" in connection with the settlement. The arbitrators initially accepted the insurer's argument and, at that time, erroneously ruled that Allied's settlement was not a covered "Loss." The arbitrators also ruled that Allied had sustained a covered "Loss" relating to defense costs, but found that the *amount* of this "Loss" was not suitable for summary disposition and would be determined at an evidentiary hearing. Allied moved for reconsideration of the ruling that the settlement was not a covered "Loss."

After a full and fair hearing on the motion for reconsideration, the arbitrators determined that they had authority to correct their error, issued a ruling that did so, and determined the remaining undecided defense costs issue in a final award. Supreme Court, New York County, confirmed the final award, but the Appellate Division, First Department reversed and vacated the award. It ruled that the arbitrators could not

correct the error in their ruling on coverage for “Loss” because they were *functus officio*—their authority had ended—with respect to the erroneous coverage ruling. The Appellate Division vacated the final award and confirmed the arbitrators’ initial and erroneous partial ruling.

The Appellate Division erred in holding that the arbitrators exceeded their authority based on the common-law doctrine of *functus officio* when they reconsidered their initial ruling on coverage under the insurance policies. Whether arbitrators have exceeded their authority is a question that depends on the content of the parties’ written agreement to arbitrate. Here, the parties did *not* enter into an agreement—in writing or otherwise—that limits the arbitrators’ authority to reconsider a partial ruling made during arbitration proceedings that does not resolve all disputes between the parties. The initial partial ruling on coverage did not resolve all disputes because it expressly left the amount of defense costs for further proceedings. Therefore, it was *not* their final decision and award under the written agreement and the arbitrators did not exceed their authority in reconsidering it.

Furthermore, the parties’ written agreement submits “all disputes” to the arbitrators, including procedural questions arising during the

proceedings, and the parties explicitly asked the arbitrators to determine *whether* they had authority to reconsider their initial partial ruling. The arbitrators plainly did not exceed their authority in resolving the dispute that the parties expressly submitted to them.

The Appellate Division inferred that Allied consented to issuance of a "partial final award"—a decision that resolves only *part* of the disputes between the parties and yet also constitutes a "final" and judicially-reviewable "award" that arbitrators may not reconsider. The Appellate Division did not analyze, however, whether the parties' *written agreement* precluded the arbitrators from reconsidering "partial" rulings or conferred jurisdiction on the courts to review and confirm such "partial" rulings, such that the arbitrators would lose their authority to reconsider them. Instead, the Appellate Division ruled that the arbitrators could not reconsider their partial ruling because Allied stated in an adversarial brief and at a hearing that the arbitrators could decide whether Allied was entitled to coverage for "Loss" first, and if so, decide the amount of "Loss" after an evidentiary hearing.

This ruling and reasoning is unprecedented. No court of this State has ever held that a party to an arbitration proceeding may unilaterally

empower an arbitrator to issue a judicially-reviewable "partial" award that is "final" and may not be reconsidered. Rather, under this Court's precedents, if New York recognizes the legal existence of judicially-reviewable "partial" awards at all, the parties must clearly provide for them together in their written agreement. Any different rule would enlist the courts in policing the availability of judicially-reviewable "partial final awards" based on a fact-intensive inquiry into the parties' conduct during arbitration proceedings.

The longstanding policy of this State is to promote and protect arbitration as an efficient way for parties to resolve disputes. But the Appellate Division's decision interferes with the power of arbitrators to administer proceedings in an efficient and just manner. It creates a brand new procedural vehicle that will ensnare the unwary and empower those who have the litigation resources to exploit it. It adds complexity to arbitration and judicial proceedings alike. And it will require New York's courts to devote ever more resources to adjudicating the question whether an arbitrator's "partial" ruling was "final" and judicially-reviewable or not, given all the consequences that follow from such a determination.

Moreover, the Appellate Division's decision reinstates a manifestly erroneous arbitration ruling that the arbitrators had corrected after a full hearing. Allied had incurred liability under the settlement agreement because the agreement required it to give up $10 million in value and to cause the government to be paid in cash. This was a covered "Loss." Ordinarily, a court will *not* vacate an arbitrator's award, even for manifest error. But here, ironically, the court vacated the arbitrators' *correct* award and replaced it with one that is manifestly erroneous, all based on a common-law doctrine that is nowhere to be found in the statutes governing confirmation and vacatur of awards or the parties' written agreement about the arbitrators' authority to bind them. For these reasons and those stated below, this Court should reverse.

QUESTION PRESENTED

Did the Appellate Division err in vacating the arbitrators' final award under CPLR 7511(b)(1)(iii) on the ground that the common-law doctrine of *functus officio* barred the arbitrators from reconsidering a partial ruling that did not decide all disputed issues and that expressly left disputed issues for further proceedings, where (1) the parties' written agreement provided for a single "final" decision and award and did not limit the arbitrators' authority to reconsider partial rulings, and (2) the parties submitted to the arbitrators "all disputes or differences which may arise under or in connection with this policy"?

JURISDICTION

This Court has jurisdiction under CPLR 5602 because the Appellate Division, First Department granted Allied's motion for leave to appeal to this Court. (A. 982) Allied argued below that the arbitrators did not exceed their authority by reconsidering their partial ruling on the motions for summary disposition. (A. 907-19; Allied First Dep't Br. at 34-43) The Appellate Division's order disposed of all issues in the proceedings within the meaning of CPLR 5611.

STATEMENT OF THE CASE

A. History of New York Arbitration Law

1. Judicial Hostility to Arbitration in the Nineteenth Century

In the nineteenth and early twentieth centuries, courts were openly hostile to arbitration. *See Matter of N.Y.C. Transit Auth. v. Transport Workers Local 100*, 99 N.Y.2d 1, 6 (2002) (noting prior "distrust and hostility toward arbitration"). Citing a long line of cases, Judge Cardozo declared that "resort to our courts [was] essential to the attainment of justice" and that "[i]f jurisdiction is to be ousted by contract, we must submit to the failure of justice that may result from these and like causes." *Meacham v. Jamestown, Franklin & Clearfield R.R.*, 211 N.Y. 346, 354 (1914) (Cardozo, J., concurring).

One manifestation of judicial hostility to arbitration was a refusal to enforce arbitration contracts. In our early history, courts did not enforce executory agreements to arbitrate, *i.e.*, agreements to arbitrate disputes that had not yet arisen. *See Matter of Feuer Transp., Inc. v. Local Union No. 445*, 295 N.Y. 87, 91 (1946). Commentators trace courts' refusal to enforce executory arbitration agreements to Lord Coke's statement in 1609 that an agreement to submit a dispute to arbitration

was freely revocable until the arbitrator issued an award. *See, e.g.*, H. H. Nordlinger, *The Law and Practice of Arbitration in New York*, 13 Mo. L. Rev. 196, 196-97 (1948).

By 1872, an accumulation of precedent led this Court to declare that "the rule that a general covenant to submit any differences that may arise in the performance of a contract, or under an executory agreement, is a nullity, is too well established to be now questioned …." *President of the Del. & Hudson Canal Co. v. Pa. Coal Co.*, 50 N.Y. 250, 258 (1872). Parties could agree to arbitrate disputes, but only after they had arisen. The vehicle for presenting such an existing dispute to arbitrators was called a "submission." *See, e.g.*, *Jones v. Welwood*, 71 N.Y. 208, 211 (1877) ("*Welwood*"). The "submission" was the "contract by which parties agree to refer matters … to be finally decided by the award of … arbitrators." John T. Morse, Jr., *The Law of Arbitration and Award* 36 (Boston: Little, Brown & Co. 1872), https://bit.ly/2UDES7X (cited and quoted with approval in *Welwood*).

Another manifestation of past judicial hostility to arbitration was the common-law doctrine of *functus officio*, which provided that after arbitrators have "fully exercised their judgment upon the facts submitted

to them and reached a conclusion which they have incorporated into their award, they are not at liberty at another and subsequent time to exercise a fresh judgment on the case and alter their award." *Flannery v. Sahagian*, 134 N.Y. 85, 87 (1892). As Justice Gische noted in dissent, a rule "[p]recluding arbitrators from reconsidering the merits of their own decisions arose, in part, from judicial skepticism that arbitrators could be free from outside influences …." (A. 1003-04 (citing cases)) Judge Posner put the point more bluntly: "The doctrine originated in the bad old days when judges were hostile to arbitration and ingenious in hamstringing it." *Glass, Molders, Pottery, Plastics & Allied Workers Int'l Union Local 182B v. Excelsior Foundry Co.*, 56 F.3d 844, 846 (7th Cir. 1995). The doctrine is hostile to arbitration because it deprives arbitrators of the ordinary and inherent powers of reconsideration that judges possess, and thus "reduces the utility of arbitration." *Id.* at 847.

This Court has not vacated or upheld the vacatur of an arbitration award on "*functus officio*" grounds since the 1800s. In those cases, the arbitrators issued or intended to issue an award that decided *all* issues submitted to them, thereby exhausting their contractual authority, and nevertheless issued another award. *See Herbst v. Hagenaers*, 137 N.Y.

290, 293-95 (1893); *Flannery*, 134 N.Y. at 88-89; *Doke v. James*, 4 N.Y. 568, 575-76 (1851). The Appellate Division's holding in this case that "*functus officio*" could apply to a *partial* ruling in which the arbitrators expressly reserved a disputed issue for further proceedings is unprecedented.

2. The Arbitration Act of 1920 and Establishment of State Policy Encouraging Arbitration

In the twentieth century, "dissatisfaction with this situation"—the unenforceability of arbitration agreements as to future disputes—led to the "enactment of our Arbitration Law." *Matter of S. M. Wolff Co. v. Tulkoff*, 9 N.Y.2d 356, 362 (1961). In 1920, the Legislature enacted a statute providing that "[a] provision in a *written contract* to settle by arbitration a controversy thereafter arising between the parties to the contract, or a *submission* hereafter entered into of an existing controversy to arbitration … shall be valid, enforcible and irrevocable, save upon such grounds may exist at law or in equity for revocation of any contract." 1920 N.Y. Laws Ch. 275, § 2 (emphasis added). The Legislature further provided that for purposes of applying pre-existing statutory provisions governing the "submission," the "arbitration agreement *shall be deemed a submission* to arbitration." *Id.* § 8

(emphasis added). In other words, the written arbitration agreement and the "submission" were functionally the same, and agreements to arbitrate both future and existing disputes would be equally enforceable.

In 1937, the Legislature recodified and amended New York's arbitration-related statutes as article 84 of the Civil Practice Act. 1937 N.Y. Laws Ch. 341. It maintained the distinction between a written agreement to arbitrate and a "submission" of an existing controversy to arbitration. *Id.* § 2 (amending Civil Practice Act § 1449). The Legislature provided that a "submission" to arbitrate an existing dispute was *void* unless the parties put the submission in writing. *See id.* § 3 (amending Civil Practice Act § 1449); *Matter of Gantt v. Felipe y Carlos Hurtado & Cia., Ltda.*, 297 N.Y. 433, 441 (1948).

In 1962, the Legislature codified New York's law governing arbitration awards as article 75 of the Civil Practice Law and Rules. 1962 N.Y. Laws Ch. 308. It abolished the outmoded distinction in terminology between an executory arbitration agreement and a "submission." *See id.* The drafters explained that the term "agreement" in what is now CPLR 7501 "is intended to embrace both submissions to arbitration of existing controversies and contracts to settle by arbitration controversies

thereafter arising." Temporary Commission on the Courts, *Second Preliminary Report of the Advisory Committee on Practice and Procedure*, 132 (Feb. 15, 1958).

At the same time, the Legislature loosened restrictions on arbitrators' power to revise an award, granting them statutory authority (now found in CPLR 7509 and 7511(c)) to modify a *final* award that decided all disputes between the parties. *See id.* at 143-44. As the drafters noted, allowing arbitrators to correct even final awards (to say nothing of interim rulings that decided only part of the disputed issues) was "in keeping with the expectation of the parties and relieves the court of the burden of making such a correction …." *Id.* at 144.

Meanwhile, the common law of *functus officio* fell into desuetude in this Court. This Court has issued countless decisions concerning arbitration in the past 120 years. But its only decision concerning *functus officio* since the 1800s holds that the trial court *erred* in vacating an award on *functus officio* grounds. *Matter of Civil Serv. Bar Assoc., Local 237 v. City of New York*, 64 N.Y.2d 188, 194-95 (1984). The fall of *functus officio* as a common-law basis for policing arbitration proceedings coincided with the rise of New York policy favoring arbitration and

discouraging active judicial supervision of arbitration proceedings. By 1975, this Court could confidently declare: "It is always useful to bear in mind that the announced policy of this State favors and encourages arbitration as a means of conserving the time and resources of the courts and the contracting parties." *Matter of Nationwide Gen. Ins. Co. v. Investors Ins. Co. of Am.*, 37 N.Y.2d 91, 95 (1975).

B. Arbitration Proceedings

1. The Insurance Policies, Arbitration Agreement, and Demand for Arbitration

The insurer issued two professional liability policies to insure Allied against "Loss" arising from a claim against Allied for failure to render professional services: a "2008 Policy" (A. 123-78) and a "2006 Policy" (A. 179-220). After short sellers of Allied's stock filed a *qui tam* action against Allied and a company that Allied owned, Ciena Capital LLC ("Ciena"), Allied timely notified its insurer of the action and sought coverage for "Loss" in the form of defense costs, which the insurer refused to provide. Allied, Ciena, and other defendants thereafter settled the case with the government. (A. 800-25)

Because Ciena was in bankruptcy proceedings, the parties acceded to the government's request to structure the settlement to ensure that

Allied had an obligation to cause the government to be paid. The settlement agreement required Allied to release secured claims in bankruptcy and take all steps necessary to ensure that Ciena paid approximately $10 million to the government and *qui tam* relators. (A. 804-11) Allied's obligations were "recourse, *in personam* obligations." (A. 811 [¶ 4(b)]) If Allied failed to discharge its settlement obligations, the settlement agreement would become void ab initio and Allied would be restored to its status as a defendant in the *qui tam* action. (A. 806-09, 814-15 [¶¶ 3, 3(g), 9]) In sum, Allied had a legal obligation to give up $10 million in value to effectuate a payment to the government. (A. 97) Allied ensured that the government was paid in full. It released a portion of its secured claims in bankruptcy and funded the settlement payment, which Ciena wired to the government in cash. (A. 474 [36:4-12])

The insurer nevertheless denied coverage for "Loss," *i.e.*, the settlement and defense costs. Thus, a dispute arose between the parties as to whether Allied was entitled to coverage for "Loss" under the two insurance policies. (A. 49 [¶¶ 2-3])

The 2006 Policy provided that the parties shall submit "all disputes or differences which may arise under or in connection with this policy,

whether arising before or after termination of this policy, including any determination of the amount of Loss" to a mediator or arbitrators. (A. 191-92; *see also* A. 146 [2008 Policy]) The crucial language in both policies empowering the arbitrators to issue an award stated: "In the event of arbitration, the decision of the arbitrators shall be final and binding and provided to both parties, and the arbitrators' award shall not include attorneys' fees or other costs." (A. 146, 192)

In accordance with the insurer's policies requiring Allied to submit all disputes to mediation or arbitration, Allied demanded arbitration. (A. 261-69) Its demand alleged that the policies obligated the insurer to compensate Allied for "Loss," which included Allied's defense costs and the amount of any settlement in the *qui tam* action. (A. 267-69) As specified in the written arbitration agreement (A. 146, 192), the parties each selected one disinterested and knowledgeable arbitrator, and the two arbitrators selected by the parties then selected an experienced arbitrator, Robert B. Davidson, to serve as the third arbitrator and chairman of the three-arbitrator panel (A. 17 [¶ 20]).

2. The Parties' Motions for Summary Disposition

At the outset of arbitration proceedings, in 2013, the arbitrators issued an order stating that they would "render a reasoned Award." (A. 525 [¶ 20]) They also authorized each side to "make a dispositive motion." (A. 525 [¶ 14]) In March 2015, the insurer sought to remove one of the arbitrators under JAMS rules. (A. 789) In response, the arbitrators decided that JAMS rules did *not* apply to the *ad hoc* arbitration proceeding (A. 798 ("the JAMS Comprehensive Rules do not govern the arbitration")), and later denied the insurer's request.

In July 2015, each side filed a motion requesting summary disposition in its favor. Allied's motion sought a determination that its side was covered for "Loss" incurred in the *qui tam* action, including coverage for both the $10 million settlement and more than $1.4 million in defense costs. (A. 746-47) The insurer argued that the policies did not provide coverage and that there were numerous factual uncertainties regarding the claimed defense costs. (A. 80-81)

Each side also opposed the other's motion. In its opposition, Allied argued that the claim for defense costs was proper. (A. 630) It added that the "quantum" or amount of defense costs "need not be decided on this

motion, but could be subject to a separate evidentiary process in the event coverage is found." (A. 630) Similarly, at the hearing that followed on the cross-motions, counsel for Allied recognized that the amount of defense costs was a factual question that would appropriately be a subject for later hearings "if there is coverage found." (A. 399 [140:6-141:22]) Chairman Davidson asked: "So a *partial summary disposition* is in the cards?" (A. 399 [141:2-3 (emphasis added)]) Mr. Fields, counsel for Allied, replied: "I think that makes the most sense." (A. 399 [141:4-5])

3. The Arbitrators' Partial Ruling on the Motions for Summary Disposition

The arbitrators issued a partial summary disposition, which they labeled as a "Partial Final Award" on their own initiative. (A. 48) The majority at that point ruled that the approximately $10 million settlement was not a covered "Loss" (A. 72 [¶ 64]) and that, while defense costs *would* be covered, their *amount* was not suitable for summary disposition (A. 81-82). The arbitrators also noted that coverage under the 2008 Policy was subject to a "'Retention' of $1,000,000 for Loss." (A. 82 [¶ 98]) "How that impacts Allied's claim for defense costs," the arbitrators continued, "will also be dealt with in further proceedings." (A. 82 [¶ 98])

Allied requested reconsideration of the arbitrators' determination that the $10.1 million settlement was not a covered "Loss." (A. 444-56) The insurer opposed the request on the ground that JAMS rules did not permit Allied's motion for reconsideration. (A. 457-60). In making this argument, the insurer simply ignored the arbitrators' prior ruling that JAMS rules did *not* apply (A. 798) and did not seek reconsideration of that ruling. Allied replied to the opposition, arguing that JAMS rules did not preclude reconsideration. (A. 515) Allied also argued that the common-law doctrine of *functus officio supported* reconsideration because arbitrators lose their powers only after fully discharging their duties. (A. 516-17)

The insurer submitted another letter to the arbitrators, calling Allied's reference to *functus officio* a "red herring" and reiterating its claim that JAMS rules barred the request. (A. 461-62) Later, the insurer agreed to "participate in the hearing [on Allied's request for reconsideration] fully and in good faith," while stating that it "reserve[d] all of its legal rights with respect to contesting the propriety of [this] procedure." (A. 464) The only objection that the insurer raised in advance of the hearing was that JAMS rules precluded reconsideration. (A. 464)

The arbitrators heard extensive argument on the question "whether or not the panel has the authority to revisit the partial final award in this case" and the "merits of the application." (A. 466 [3:7-4:4]) The insurer argued at the hearing that "we have to procedurally determine whether reconsideration is allowed." (A. 486 [84:16-18]) And then it argued the "reconsideration" and *functus officio* issues at length (A. 486-89 [84:13-97:5]), as well as the merits (A. 479-86 [57:11-84:12]). At the conclusion of the hearing, Chairman Davidson warned the insurer:

> I will not hesitate if I think I made a mistake, to revisit it and make it right. I won't stand on ceremony and think, well, I've already decided something and, therefore, I have to confirm my own error …

(A. 496-97 [125:21-126:2])

The arbitrators thereafter issued a "Partial Final Award (Corrected)." (A. 86) The new majority recognized and explained its authority to reconsider the earlier interlocutory decision. (A. 88-96) As relevant here, it explained that the common-law *functus officio* doctrine did not bar reconsideration where "the parties did not bifurcate the proceedings, but … did make reciprocal motions for summary disposition

on the issue of coverage" and the initial decision on those motions "did not resolve all issues submitted to the arbitrators …." (A. 94, 95)

Going to the merits, the arbitrators revisited their ruling that the settlement amount was not a covered "Loss." (A. 96-98) Their initial ruling had been based on the fact that Allied loaned funds to Ciena to pay the settlement. (A. 66-72 [¶ 58 & n.14]) In the corrected ruling, the arbitrators recognized that Allied nonetheless had incurred liability in the settlement agreement because Allied agreed to cause payments that would directly reduce the value of its interest in Ciena. (A. 97) As the arbitrators recognized in their corrected ruling, Allied's incurrence of liability for the underlying settlement created a "Loss," no matter how the settlement was later funded.[1] (A. 96-97)

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[1] The error corrected by the arbitrators was fundamental: "It is a general principle under insurance law, that the [insurer's] obligation to pay under a liability policy arises as soon as the insured incurs the liability for the loss …." *In re Worldcom, Inc. Sec. Litig.*, 354 F. Supp. 2d 455, 464 (S.D.N.Y. 2005). A policyholder has "liability" when it has a legal obligation to make or cause a payment. *See* 7A Couch on Insurance §§ 103:4, 103:5 (Westlaw 2018). Thus, a policyholder may incur "liability" (an obligation to pay) in a settlement agreement and is entitled to coverage under a liability policy even if it does not make the payment directly. *See Hugo Boss Fashions v. Fed. Ins. Co.*, 252 F.3d 608, 623 n.15 (2d Cir. 2001) (applying New York law); *Sun Capital Partners, Inc. v. Twin City Fire Ins. Co.*, S.D. Fla. Case No. 9:12-cv-81397-KAM (Doc. 349:

4. The Arbitrators' Final Award

The arbitrators next conducted evidentiary proceedings on the amount of defense costs and issued a unanimous "Final Award." (A. 106) The arbitrators calculated the amount due to Allied, after setoffs, at $7,509,144.91, plus simple interest at nine percent per annum from November 29, 2010, to the date of full payment of the final award or confirmation of the award—at present, about $6 million. (A. 116-18)

C. Judicial Proceedings

After the arbitrators issued their corrected ruling but before they issued their final award, the insurer initiated judicial proceedings by filing a "Petition to Vacate Corrected Partial Final Arbitration Award and Reinstate and Confirm Initial Partial Final Award." (A. 979) After the arbitrators issued the final award, the insurer withdrew that petition and filed an amended petition under CPLR 7511, seeking to vacate the final award as well. (A. 12-41, 979-80)

The trial court denied the insurer's petition to vacate and confirmed the final award. (A. 7-8) The court held that the parties' written

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Jan. 16, 2018) (applying New York law). The arbitrators' corrected ruling applied these principles.

arbitration agreement did not require the application of JAMS rules and, even if it did, an arbitrators' error in failing to comply with procedural rules is not a ground for vacating an award. (A. 7) The court further held that "[t]he Panel was also not prohibited from reconsidering the partial final award, having determined that the award was not final, and to the extent that [the insurer] argues that the Panel erred in so concluding, it is not a sufficient ground on which to vacate the award." (A. 7)

The Appellate Division reversed in a divided decision, confirmed the initial partial final award, vacated the corrected partial final award, and vacated the final award. The Appellate Division held that "when the panel reconsidered the [partial final award as originally issued], it exceeded its authority based on the common law doctrine of functus officio," rendering the final award subject to vacatur under CPLR 7511(b)(1)(iii). (A. 991)

The Appellate Division stated several relevant principles in its decision. First, it stated that the "doctrine of functus officio provides that absent an agreement to the contrary, after an arbitrator renders a final award, the arbitrator may not entertain an application to change the award …." (A. 991) Second, a "final award" is one that decides all issues

submitted, including "'not only the issue of liability of a party on the claim, but also the issue of damages.'" (A. 992 (quoting *Michaels v. Mariforum Shipping, S.A.*, 624 F.2d 411, 414 (2d Cir. 1980))) Third, "'the submission by the parties determines the scope of the arbitrators' authority.'" (A. 992 (quoting *Trade & Transp., Inc. v. Natural Petroleum Charterers Inc.*, 931 F.2d 191, 195 (2d Cir. 1991)))

The Appellate Division then held that "[d]uring the arbitration proceeding, [the parties] agreed that the panel was to make an immediate, final determination as to the issue of [the insurer's] liability under the policies …." (A. 993) But the court did *not* base its conclusion on the parties' "submission," *i.e.*, the written arbitration agreement. *See supra*, at 11-13. To the contrary, the court effectively acknowledged that the written agreement did *not* authorize a "partial" award when it stated that "Allied fails to provide any support for its theory that parties to an arbitration may only seek bifurcation in their initial submission to the arbitrator or not at all." (A. 995)

Instead of basing its decision on the parties' written agreement, or even any oral agreement, the Appellate Division relied on:

(1) A statement in Allied's adversarial arbitration brief that "the quantum of attorneys' fees need not be decided on this motion, but could be subject to a separate evidentiary process in the event coverage is found."

(2) A statement by Allied at the hearing on the cross-motions for summary disposition that the amount awarded as defense costs "would be the topic for a separate proceeding ... like an inquest to prove up what was done and how much was done."

(3) The fact that the insurer's counsel "did not disagree" with Allied's statement that defense costs could be decided in a later proceeding, *i.e.*, that counsel remained *silent* on the issue instead of objecting.

(4) The title "partial final award" on the arbitrators' ruling.

(A. 994 (italics omitted))

The Appellate Division reasoned that "the fact that Allied requested, and [the insurer] agreed to, an *immediate* determination on the liability issue, leaving the calculation of damages for a later time, indicates that the parties were seeking a *final* determination on the issue of [the insurer's] liability under the policies." (A. 995 (emphasis added)) The court also reasoned that nothing in the record established that the "parties or the panel believed that the [partial final award] would be

anything less than a final determination" of liability issues. (A. 996) And it held that it was not "bound" by the arbitrators' determination that their ruling was not final and the parties did not "bifurcate" the proceedings. (A. 995)

Justice Gische dissented. (A. 998) She reasoned that the doctrine of *functus officio* prohibits arbitrators from revisiting a matter "only after a final award is made." (A. 1002) The proposition that "functus officio requires finality," Justice Gische observed, "is consistent with well established legal precedent that a court has no authority to review a nonfinal arbitration order." (A. 1004 (citing *Mobil Oil Indonesia Inc. v. Asamera Oil (Indonesia) Ltd.*, 43 N.Y.2d 276 (1977))) Justice Gische would have held that the arbitrators' ruling on the cross-motions for summary disposition was *not* final because the arbitrators decided that the insurer was liable for Allied's defense costs but reserved the amount of damages for a later proceeding. (A. 1005, 1007-08)

Justice Gische also reasoned that the parties had not agreed to "bifurcate the proceedings" so as to create a "final" ruling on liability. (A. 1008) "Allied's representations," she concluded, "were no more than an acknowledgement that disputes about the amount of defense costs

may not be disposable by a summary adjudication." (A. 1009) The "bifurcation" that occurred was a consequence of the *arbitrators'* decision not to decide defense costs by summary disposition, not a product of any agreement by the parties to "bifurcate" issues. (A 1009) And the arbitrators' review and determination that the parties did *not* agree to "bifurcate" was entitled to the same deference ordinarily accorded to an arbitrator's findings. (A. 1001, 1009)

As Justice Gische explained in dissent, "[t]he majority opinion in this case is the first reported New York decision ever to recognize a bifurcation exception to functus officio." (A. 1006) Allied filed a motion in the Appellate Division for leave to appeal to this Court on the ground that the application of *functus officio* to an interlocutory and partial ruling on liability presented novel issues of statewide importance, and the Appellate Division granted the motion.

ARGUMENT

"The *only* basis upon which an award can be vacated at the behest of a party who participated in the arbitration or was served with notice of intention to arbitrate is that the rights of that party were prejudiced by corruption, fraud or misconduct in procuring the award, partiality of

an arbitrator, that the arbitrator exceeded his power or failed to make a final and definite award, or a procedural failure that was not waived." *Matter of Silverman v. Benmor Coats, Inc.*, 61 N.Y.2d 299, 307 (1984) (emphasis added); *see* CPLR 7511(b)(1). Here, the Appellate Division held that the arbitration panel "exceeded its authority based on the common law doctrine of functus officio." (A. 991) This was error for two basic reasons.

First, the parties' written agreement authorized the arbitrators to issue only a single "final" decision and award at the end of the proceedings. The arbitrators' ruling on the motions for summary disposition was not their final decision and award because it did not resolve "all disputes" between the parties. Nothing in the written agreement precluded the arbitrators from reconsidering any ruling that was not their final decision and award, let alone with the clarity that this Court has demanded for such an atypical limitation on arbitrators' authority over an ongoing arbitration. *Functus officio* would not apply on its own terms in this situation, and could not override the parties' written agreement.

Second, the parties authorized the arbitrators to resolve all disputes and explicitly asked them to decide *whether* they had authority to reconsider their ruling on the motions for summary disposition. Having bargained for the *arbitrators* to decide all disputes, including the question whether *functus officio* would impose any extra-contractual constraint on their authority, the insurer cannot now claim that the arbitrators exceeded their authority in deciding the question.

I. The Parties' Written Agreement Authorized the Arbitrators to Issue Only One Final Decision and Award and Did Not Limit Their Authority to Reconsider Partial Rulings

To determine whether arbitrators had authority to reconsider their ruling on the motions for summary disposition, this Court should look to the parties' written arbitration agreement, which defines the scope of their authority. *See* CPLR 7501 ("A *written agreement* to submit any controversy … to arbitration is enforceable." (emphasis added)). If a valid written agreement to arbitrate exists, "any limitation upon the power of the arbitrator must be set forth as part of the arbitration clause itself …." *Matter of Silverman*, 61 N.Y.2d at 307. "Moreover, absent provision in the arbitration clause itself, an arbitrator is not bound by principles of substantive law or by rules of evidence." *Id.* at 308.

Here, the written agreement states that after the parties submit "all disputes" for arbitration, the arbitrators shall provide a "final and binding" "decision" to the parties. (A. 146, 191-92) This language establishes a *contractual* limit on the arbitrators' authority because their "decision" (singular) would be neither "final" nor "binding" if the arbitrators could issue another decision after the final one that decided "all disputes" submitted to them. In other words, the parties here entered into the usual bargain, consistent with the classic common-law application of *functus officio*: the arbitrators' power would end when the arbitration proceedings ended. (*See* A. 996 ("*functus officio*" means "'without further authority or legal competence because the duties and functions of the original commission have been fully accomplished'" (quoting Black's Law Dictionary 787 (10th ed. 2014)))

The parties did *not* bargain for the additional limitation on the arbitrators' power that the Appellate Division perceived based on its unprecedented version of *functus officio*. Nothing in the parties' written arbitration agreement precludes the arbitrators from reconsidering a partial ruling that was *not* the arbitrators' final and binding decision and award on all disputes submitted to them. This fact is dispositive because

a court may *not* vacate an award based on a supposed "limitation on the arbitrator's powers" that is not "contained, explicitly or by reference, in the arbitration clause itself …." *Matter of Silverman*, 61 N.Y.2d at 302.

Even if the clause here were ambiguous as to whether it bars the arbitrators from reconsidering any decision that is *not* their final and binding resolution of all disputes (and it is not), the Court should construe it in favor of upholding the arbitrators' interpretation of their mandate. *See Matter of Bd. of Educ. of Dover Union Free Sch. Dist. v. Dover-Wingdale Teachers' Ass'n*, 61 N.Y.2d 913, 915 (1984); *Matter of Nat'l Cash Register Co. v. Wilson*, 8 N.Y.2d 377, 383 (1960). As this Court held, "[t]o infer a limitation from an ambiguous and general clause in the substantive provisions of the agreement would, in effect, require judicial interpretation of the contract and judicial interference with an arbitration award …." *Matter of Bd. of Educ. of Dover Union Free Sch. Dist.*, 61 N.Y.2d at 915. These principles mandate reversal here.[2]

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[2] Moreover, the insurer is responsible for any ambiguity in the arbitration clause. The clause is part of standard-form insurance policies that the insurer drafted, as demonstrated by the footer information stating, "American International Group, Inc. All rights reserved" and providing a version date. (A. 146, 192) If the insurer argues that the written arbitration clause is ambiguous, it will be challenging a clause that it

A. The Partial Ruling on the Motions for Summary Disposition Was Not the Final Decision Contemplated in the Parties' Written Agreement Because It Did Not Decide All Disputes

The parties agreed to submit "*all* disputes or differences which may arise under or in connection with this policy, whether arising before or after termination of this policy, including any determination of the amount of Loss," to arbitration. (A. 191 (emphasis added); *see also* A. 146 ("all disputes or differences which may arise with regard to the construction or interpretation of the provisions of this policy")) Several disputes arose under the two policies at issue. One dispute was whether Allied's settlement with the government was a "Loss." Another dispute was whether Allied's defense costs were a "Loss." And a third dispute pertained to the *amount* of "Loss" that Allied sustained. (A. 267-69; *see supra*, at 14-16)

The arbitrators' ruling on the cross-motions for summary disposition did not resolve *all* of these disputes, and therefore plainly was not the arbitrators' final decision and award. The parties' agreement stated that "[i]n the event of arbitration, *the* decision of the arbitrators

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unilaterally drafted and imposed on Allied as part of the insurance policies.

shall be final and binding and provided to both parties, and *the* arbitrators' award shall not include attorneys' fees or other costs." (A. 146, 192 (emphasis added)) As this Court stated in *Welwood*:

> These provisions fairly import a single award or decision embracing all the matters submitted. They speak of *the* decision, and *the* final decision.

Welwood, 71 N.Y. at 214 (emphasis in original).

If the parties had contemplated that the arbitrators would issue multiple "final and binding" decisions (plural) and multiple awards (plural), they would not have referred to "the" final and binding decision and "the" award upon that decision. Even if this language were ambiguous (it is not), any such ambiguity should be construed in favor of upholding the arbitrators' interpretation, as reflected in their final award that decided all disputes. *See Dover Union Free Sch. Dist.*, 61 N.Y.2d at 915; *Matter of Nat'l Cash Register Co.*, 8 N.Y.2d at 383.

The parties, moreover, should be presumed to have contracted with knowledge of the legal meaning of the word "award" and the contract should "be construed in the light of such law." *Dolman v. United States Tr. Co. of N.Y.*, 2 N.Y.2d 110, 116 (1956). And as this Court stated in *Welwood*, "[t]he general rule is, that the award must be co-extensive with

the submission, and that it must be a final determination of the matter submitted." 71 N.Y. at 212; *see also Michaels*, 624 F.2d at 414. As noted (*supra*, at 9), the term "submission" as used in *Welwood* refers to the parties' *contract* to present a dispute to an arbitrator.

This Court reiterated the general rule that the award "must be coextensive with the submission" in *Mobil Oil Indonesia Inc. v. Asamera Oil (Indonesia) Ltd.*, 43 N.Y.2d 276, 281 (1977). The Court held that "before the court may intervene or even entertain a suit seeking court intervention, there must be an 'award' *within the meaning of the statute*." *Id.* (emphasis added). The "awards of arbitrators," the Court stated, "are the final determinations made *at the conclusion of the arbitration proceedings*." *Id.* (emphasis added).

The arbitrators' ruling on the motions for summary disposition did not resolve *all* the disputes between the parties, and therefore was *not* "coextensive with the "submission," *i.e.*, the written agreement to arbitrate. The arbitrators ruled that Allied had sustained a "Loss" but also held that the *amount* of "Loss" was not suitable for summary disposition and would "be dealt with in further proceedings." (A. 82 [¶ 98]) Because they left this dispute unresolved and expressly

contemplated *further* proceedings, their ruling was not a final determination made *at the conclusion* of proceedings. *Mobil Oil Indonesia*, 43 N.Y.2d at 281. Accordingly, the partial ruling was not an "award" as a matter of law.

The Appellate Division acknowledged in its opinion that an "award" must determine all claims submitted. (A. 992) The court also acknowledged that the amount of defense costs was a dispute that had arisen between the parties and that the arbitrators' ruling on the cross-motions for summary disposition did *not* resolve that dispute. (A. 988-89) But it found an exception to the rule that an award must resolve all disputes in the case law of the Second Circuit, which provides that "'if the parties agree that the [arbitration] panel is to make a final decision as to *part* of the dispute, the arbitrators have the authority and responsibility to do so ….'" (A. 992 (emphasis added, quoting *Trade & Transport*, 931 F.2d at 195)) Thus, the Appellate Division held that the parties may contract for a judicially-reviewable "partial award," *i.e.*, a species of award that finally decides part of the disputed issues and reserves other issues for further determination in a *subsequent* award. As explained below, however, even assuming New York law recognizes such judicially-

reviewable "partial awards," the parties did not agree in writing or otherwise that the arbitrators could issue one here.

B. The Parties' Written Agreement Did Not Limit the Arbitrators' Authority to Reconsider Their Partial Ruling on the Motions for Summary Disposition

The principle that courts may not vacate an award on the ground that the arbitrators exceeded their authority unless the limit on their authority appears clearly and unambiguously in the parties' written agreement applies with particular force in this case. Whether this Court recognizes the validity of a judicially-reviewable "partial award" is doubtful. But even if New York recognizes that private parties may create jurisdiction to review "partial awards" that are valid, confirmable, and beyond the power of arbitrators to reconsider, the parties must clearly provide for them in their written agreement. They did not do so here; therefore, the arbitrators had authority to reconsider their partial ruling on the motions for summary disposition.

1. If New York Recognizes "Partial Awards" That Arbitrators May Not Reconsider, the Parties Must Clearly Provide for Them in a Written Agreement

Nothing in article 75 of the CPLR or any other New York statute or rule authorizes arbitrators to issue or courts to review a "partial final

award" to be followed by a "final award" in connection with the same controversy or claim. The Legislature has chosen *not* to use the phrase "partial award" or any comparable term in enacting our arbitration laws. Instead, the Legislature provided that arbitrators shall issue an "award" (singular) and courts may enter judgment on an "award" (singular). CPLR 7501, 7507. One of the few grounds for vacating an award is that it was *not* "a final and definite award upon the subject matter submitted." CPLR 7511(b)(1)(iii). This ground for vacatur is inconsistent with the concept of "partial" awards, which, by definition, decide only "part" of the disputed issues. In fact, the concept of *seriatim* "partial" awards is inconsistent with the common-law doctrine of *functus officio* itself, which contemplates only *one* award made at the end of the arbitration proceedings.

This Court's last statement concerning "partial awards" dates back to the 1800s and casts significant doubt on the proposition that arbitrators may issue seriatim awards, *i.e.*, a "partial award" to be followed by another award in connection with the same controversy. In *Welwood*, the Court stated:

> I infer that the learned arbitrators supposed that they had a right to make an award in the nature of an interlocutory judgment; and then proceed *and make further awards afterwards*. In this, I think, with great respect, they were mistaken.

71 N.Y. at 216 (emphasis added).

The Court next rejected the contention that the parties had made a "supplemental submission" authorizing the arbitrators to issue "further awards" because "no such paper was produced." *Id.* Moreover, the Court reasoned, even if the parties had expressly authorized the arbitrators to issue a "partial award," such an award would be invalid because it would leave undecided questions that were part of the same controversy. *See id.* The Court concluded: "It is only when the matters omitted are not necessarily dependent on, and connected with the other points, that a partial award will be sustained." *Id.* at 217; *see also Ott v. Schroeppel*, 5 N.Y. 482, 490 (1851) (sustaining awards where "there [was] no room to doubt that the parties not only submitted two distinct matters, but provided for separate awards upon them").

This Court's modern-era case law affirms that the law does not permit an arbitrator to issue an award in the nature of an interlocutory judgment. In *Mobil Oil Indonesia*, the Court squarely held that an

interlocutory ruling was not and could not be an award. 43 N.Y.2d at 281. And while the ruling at issue in that case was procedural, the Court did not limit the scope of its ruling to "procedural" matters. Rather, it stated that "for the court to entertain review of intermediary arbitration decisions involving procedure *or any other interlocutory matter*, would disjoint and unduly delay the proceedings, thereby thwarting the very purpose of conservation [of time and resources of the courts and the contracting parties]." *Id.* at 282 (emphasis added). Thus, the default rule in this State is that courts may not confirm or vacate an arbitrator's ruling until he or she makes a final determination of all matters submitted at the conclusion of proceedings.[3]

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[3] Similarly, in California, a "partial final award" is *not* an "award" under that State's law. *See Maplebear, Inc. v. Busick*, 26 Cal. App. 5th 394, 399 (Cal. Ct. App. 2018) ("the arbitrator's partial final award is not an 'award' under section 1283.4 , and therefore cannot be the subject of a petition to vacate …"); *see also Cable Connection, Inc. v. DIRECTV, Inc.*, 44 Cal. 4th 1334, 1367 (2008) (Baxter, J., concurring) ("it is questionable whether parties to an arbitration agreement may contract to obtain premature judicial merit review of arbitral decisions that are labeled as 'awards,' but which in substance merely resolve one or more legal or factual issues pertaining to only a portion of the controversy submitted to the arbitrators for their determination"). Unlike New York law, the Federal Arbitration Act contemplates the existence of a "partial award." 9 U.S.C. § 16(a)(1)(D). Even so, the federal courts remain "divided" on the questions of whether and when a court may review a "partial award." *Stolt-Nielsen S.A. v. AnimalFeeds Int'l Corp.*, 559 U.S. 662, 692 (2010)

Even if New York law does not foreclose the possibility of a judicially-reviewable "partial final award" that the arbitrators could not reconsider, the Court should hold that it does so in this case because the parties did not authorize the arbitrators to issue one in a written agreement. At the very least, New York law disfavors the issuance of a confirmable "partial" award to be followed by a subsequent confirmable award in connection with the same controversy. *See Mobil Oil Indonesia*, 43 N.Y.2d at 281-82. Thus, *Welwood* states that "[i]n cases of doubt, the presumption is in favor of an intention that all matters should be decided." 71 N.Y. at 213. When "everything is submitted," *Welwood* states, "it requires clear language to justify a partial award." *Id.* at 214.

In their opposition to Allied's motion for leave in the Appellate Division, the insurer emphasized *Welwood*'s statement that the "question" was whether the arbitrators' award deciding fewer than all matters submitted "was justified—first, by the terms of the submissions;

(Ginsburg, J., dissenting). In *Stolt-Nielsen*, the parties' written agreement provided that the arbitrators could enter a "partial award" and then stay proceedings so that the parties could seek judicial review. *See id.* at 692 & n.7. Nothing even close to such an agreement exists in this case.

or second, by the consent or action of the parties at the hearing." 71 N.Y. at 212; *see* A. 1082 (Opposition to Motion for Leave for Appeal, at 24). Accordingly, Allied expects the insurer to argue again that *Welwood* provides that arbitrators may issue a "partial" award based on the "consent or action of the parties at the hearing." If the insurer makes that argument, this Court should reject it for numerous reasons.

To begin, *Welwood* itself *answered* the "question" it posed by holding that courts should look at the "language of the submission" (71 N.Y. at 213), which is the written agreement to arbitrate in this case. The law "*requires* clear language" to justify a judicially-reviewable partial award. *Id.* at 214 (emphasis added). And *Welwood* looked exclusively in the "*contracts* [for] any color for a construction justifying a partial award." *Id.* (emphasis added). When one party claimed that the parties had agreed on a "partial award" in a "supplemental submission," the Court rejected that claim in part because "no such *paper* was produced." *Id.* at 216 (emphasis added). Finally, the treatise on which *Welwood* relied states that a "written submission cannot be varied by parol evidence." Morse, The Law of Arbitration and Award 63.

Thus, *Welwood* is not authority for the proposition that one party alone or even both parties together may give arbitrators authority to issue confirmable partial awards by oral statements or by conduct. Even if *Welwood* could be so construed (it cannot), the Legislature and this Court have since made clear that courts have jurisdiction to enforce a "written agreement" and enter judgment upon an "award" that is a final determination of all issues submitted in the written arbitration agreement at the conclusion of proceedings. CPLR 7501, 7507, 7511(b)(1)(iii); *Mobil Oil Indonesia*, 43 N.Y.2d at 281-82. Oral statements and conduct are not a "written agreement" and therefore courts lack jurisdiction to enforce them under the CPLR.

Moreover, as a matter of traditional contract principles, a contract cannot be implied where the parties have entered into a written agreement covering the subject. *See Miller v. Schloss*, 218 N.Y. 400, 406-07 (1916) ("A contract cannot be implied *in fact* where … there is an express contract covering the subject-matter involved"). Thus, because the parties entered into a written agreement to arbitrate providing that the arbitrators would issue a single decision and award, a court may not

find that the parties *also impliedly* agreed that the arbitrators could issue seriatim partial awards.

A rule that parties could impliedly consent to give the arbitrators new authority *without* a written agreement would undermine the efficiency of arbitration. Whether a party has impliedly entered into contract via conduct requires examination of the surrounding "facts and circumstances." *Jemzura v. Jemzura*, 36 N.Y.2d 496, 503-04 (1975); *Brigham v. Duany*, 241 N.Y. 435, 438 (1926). That inquiry would seriously disrupt and impede the efficiency of proceedings to confirm or vacate an arbitration award and draw courts into the very sort of second-guessing and fact-finding that this Court's precedents forbid. *See Matter of Silverman*, 61 N.Y.2d at 302-03; *Dover Union Free Sch. Dist.*, 61 N.Y.2d at 915; *see also Matter of Sprinzen v. Nomberg*, 46 N.Y.2d 623, 631 (1979) ("courts must be able to examine an arbitration agreement or an award on its face, without engaging in extended factfinding or legal analysis, and conclude that public policy precludes its enforcement"). And in light of the stakes, this Court could expect numerous parties seeking to avoid an adverse arbitration ruling to argue that the final award was improper

because it conflicted in some way with an earlier ruling that the parties had supposedly and impliedly agreed would *also* be final.

One might say that in the wake of the lower court's decision, counsel would take care to state affirmatively on the record and in their papers that although their clients want an "immediate" ruling on liability, they are *not* consenting to "finality" or seriatim "partial awards" in connection with that ruling. But requiring such affirmative statements would mean that arbitrators' partial rulings during arbitration are *presumptively final*, which is the opposite of what this Court's law provides. *See, e.g.*, *Mobil Oil Indonesia*, 43 N.Y.2d at 281-82. In any event, requiring counsel to state their objections to "finality" repeatedly so as to avoid a decision like this one in which consent to "finality" was inferred against their wishes would be inefficient. The better rule is to require clear language in a written agreement before concluding that the parties have authorized a partial award that does *not* decide all disputes and yet cannot be reconsidered.

It is also no answer to say that arbitrators can avoid these problems by labeling their awards as "interim" awards instead of "partial final awards." In a future case, the parties would just argue that they "asked

the arbitrators to make a final partial award as to a particular issue and the arbitrators have done so ….” (A. 993 (quotation marks omitted)) If the existence of an award depends on (1) the parties' contractual intent to create finality and (2) the existence of a ruling deciding all issues that the parties wanted decided in that ruling, then arbitrators might not defeat finality by labeling their ruling as "interim." And future litigants could point to the Appellate Division's decision and argue that a party's acquiescence in an immediate ruling on liability is enough to create finality, in the absence of any contemporaneous objection thereto.

The Appellate Division's decision also engenders great uncertainty about when judicial proceedings after a partial award will be appropriate. As the majority and the dissent appeared to agree, an award rendered off-limits to arbitrators by *functus officio* necessarily would be a final award subject to a petition to confirm or vacate. (A. 991-92, 1004-05) If the "finality" of a "partial award" depends on what can be inferred from parties' positions in arbitration, as opposed to express contractual agreements or the issuance of an award that terminates the arbitration completely, the need to file a petition in particular scenarios will be unclear, increasing litigation costs and inefficiency.

For example, in a regime in which the existence of "partial award" turns on counsel's conduct at the hearing and not the parties' written agreement, cautious parties may flood the courts with "protective" petitions to confirm, so as to guard against an argument that the time to file a petition to confirm has expired. Such a petition would then be met with the argument that the petition should be dismissed because the parties did *not* authorize a "partial award." Indeed, in this case, there was a dispute when the insurer sought to vacate the partial final award, with the policyholders responding that its petition was premature. (A. 990) That sort of unnecessary resort to the courts on *interlocutory* rulings is especially unfortunate in the context of what ideally should be an efficient dispute resolution mechanism. *See Matter of Nationwide Gen. Ins. Co.*, 37 N.Y.2d at 95 (recognizing that "the Legislature has assigned the courts a minimal role in supervising arbitration practice and procedures" in part "to prevent parties to [arbitration] agreements from using the courts as a vehicle to protract litigation" (quotation marks omitted)).

In short, clear default rules as to whether and when rulings on only part of the disputed issues are "final" for *functus officio* purposes are

vitally important. To carry out the intent of the Legislature in enacting article 75 of the CPLR and to avoid embroiling the lower courts in fact-intensive disputes in connection with summary proceedings to confirm or vacate an award, this Court should reaffirm that the submission—the parties' written agreement to arbitrate—dictates the scope of a permissible arbitration award. And it should hold that if New York law recognizes "partial" awards at all, then the parties must clearly provide for them in a written agreement.

2. The Parties Did Not Enter into Any Agreement That the Arbitrators Could Issue a "Partial Award"

The only written agreement to arbitrate is the one contained in the insurance policies. It does not authorize the arbitrators to issue a "partial award." Rather, as explained, it authorizes them to make a "decision" (singular) and "award" (singular). (A. 146, 192) Because the written agreement lacks "clear language" that could justify a partial award, it does not authorize one as a matter of law. *Welwood*, 71 N.Y. at 214.

The Appellate Division concluded that the parties here agreed on a "partial award" during the arbitration proceedings. (A. 992-96) But to paraphrase *Welwood*, "no such paper" exists. 71 N.Y. at 216. Nothing in

the record shows that the parties entered into a *contract*, consisting of offer and acceptance and memorialized in writing, to modify their submission so as to permit a "partial" award. As a result, this case is different from the sole case on which the Appellate Division relied, in which "the parties modified their original submission to the arbitrators." *Trade & Transport*, 931 F.2d at 195.

Nothing in the record shows that the parties mutually agreed that the arbitrators could issue a "partial award" that would be final and judicially-reviewable and that the arbitrators could not reconsider. Allied stated in its opposition to the insurer's motion for summary disposition that the amount of defense costs could be the subject of a separate hearing (A. 630, 994), but its adversarial opposition brief was not a contract with the insurer. It was an opposition brief. The insurer did not "accept" Allied's opposition statement (which was not an "offer") because it contended that the policies did not provide coverage for defense costs in the first place. The Appellate Division's decision does not point to any document or statement evidencing the insurer's agreement. Instead, it refers only to silence, stating that the insurer "did not disagree" (A. 994), which is not "clear language" justifying a partial award. And even if the

parties had entered into an agreement to "bifurcate" (they did not), they never requested a "partial award." The same reasoning applies all the more strongly to Allied's oral statement at the hearing. (A. 399 [140:6-141:22], 994)

Not only is there *no* evidence that the parties agreed that the arbitrators could issue a "partial award," the arbitrators appeared to rule out the prospect of a "partial award" at the hearing. Chairman Davidson asked: "So a *partial summary disposition* is in the cards?" (A. 399 [141:2-3 (emphasis added)]) Counsel for Allied concurred, stating "I think *that* makes the most sense." (A. 399 [141:4-5 (emphasis added)]) In other words, a "partial summary disposition" made sense, not a "partial award," which was never mentioned. Thus, even if Allied could unilaterally modify the written submission or otherwise create finality by making an oral statement at a hearing (it could not), its willingness to receive a "partial summary disposition" was not an agreement with the insurer or anyone else that the arbitrators could issue a "partial award."

To the extent that the Appellate Division held that a request for an "immediate determination" on liability *is* an agreement to the issuance of a "partial award" (A. 995), that proposition finds no support in New

York law. As Justice Gische observed (A. 1006), the majority's decision was the first of its kind. And as explained above, it conflicts with precedent requiring clear language in a written agreement to authorize a partial award. *See supra*, at 40-43.

The Appellate Division's decision is also unsound as a matter of policy. Under the court's decision, a litigant who agrees to multi-phase proceedings (*e.g.*, an "immediate" decision on liability followed by a subsequent proceeding on damages, if necessary) *also* agrees that the ruling at the conclusion of each phase will be "final" such that the arbitrator will be *functus officio* with respect to that ruling. If multi-phase proceedings presumptively become final at the end of each phase, disputes will follow about which issues each phase encompassed, and policing the boundary between issues decided in one phase and issues presented in another may become a full-time judicial occupation.

Similarly, the mere possibility that a court will overturn an arbitrator's award based on *de novo* review creates a very powerful incentive to characterize a final award as having departed from an interim "award" in some unacceptable way that violates the doctrine of *functus officio*. This will draw courts into messy and wasteful

adjudication of whether the final award sufficiently respects what would be tantamount to the "law of the case" established by the earlier "partial" award. Creative lawyers can and already are involving courts in disputes over whether a final award conforms to the "partial" award that preceded it. *See Matter of Franco v. Dweck*, 165 A.D.3d 551, 553 (1st Dep't 2018) (adjudicating argument that final award violated "functus officio" because it was inconsistent with "partial final award").

Moreover, courts cannot vacate a partial ruling without affecting the arbitrators' intended final award that incorporates the partial ruling. In this case, for example, the Appellate Division vacated the final award on the ground that the arbitrators were *functus officio* with respect to their ruling on "Loss" and thereby *also* vacated the ruling on defense costs. Thus, there is no existing award that addresses the amount of defense costs—an outcome that neither the arbitrators nor the parties intended.[4] The parties contracted for a single decision and award (A. 146,

[4] Even if the Appellate Division's vacatur were proper (it was not), its order left the parties stranded without a ruling on all disputes between them. Because the alleged defect was procedural, as opposed to bias or corruption, the court should have remanded the entire matter to the original panel of arbitrators for a new hearing. *See* CPLR 7511(d); 5 N.Y. Jur. 2d Arbitration and Award § 219; *In re B. Schwartz Silk Co.*, 224 A.D. 705, 705 (1st Dep't 1928). On remand, the arbitrators would have

192), not a series of awards, each one subject to judicial review, with unpredictable consequences.

The possibility that litigants will make hay out of any partial ruling may discourage arbitrators from *granting* summary disposition even when it is warranted. Fearing that an interim decision on an issue may constrain its future discretion, arbitrators may perceive a need to deny summary disposition to allow future decisionmaking flexibility. This case illustrates the point: if this Court's decision stands, that will mean that the granting of summary disposition made the arbitrators unable to correct a serious and unjust error worth more than $10 million, even though they had fully heard from the parties on the issue of whether they

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authority to enter the *same* final award that they already provided at the conclusion of arbitration proceedings here. *See Wolff & Munier, Inc. v. Diesel Constr. Co.*, 44 A.D.2d 530, 530 (1st Dep't 1974) (remand after vacatur authorized arbitrators "to reconsider the matter" at issue), *aff'd*, 36 N.Y.2d 750 (1975). But there is no good reason to follow such a convoluted remand process so as to obtain the same award that the arbitrators already issued. At a minimum, if the parties wish to make multiple trips through the court system in connection with a single controversy (and assuming the courts allow them to do so), then they should make that mutual intention unmistakably clear in their written arbitration agreement. *See Matter of Am. Eagle Fire Ins. Co. v. New Jersey Ins. Co.*, 240 N.Y. 398, 409 (1925) ("If the law or the parties contemplate the possibility of an endless chain of frustrated arbitrations … [that] meaning should be unmistakably expressed.").

should change the initial partial ruling (A. 465-97) and no one had requested an *irrevocable* "partial summary disposition" or "partial award."

Likewise, the reasoning of the Appellate Division's decision may interfere with arbitrators' ability to issue all manner of other interim rulings. Could *functus officio* deprive an arbitrator of authority to reconsider an order *denying* summary disposition, and thus compel the parties to proceed with an unnecessary evidentiary hearing? Or at such a hearing could *functus officio* keep the arbitrator from revisiting other decisions (such as whether JAMS rules apply) because the parties have stated that the arbitrator could make such decisions immediately? For all these reasons, the Appellate Division's decision engenders great uncertainty about the legal status of interlocutory rulings, and with great uncertainty comes greater inefficiency and cost, undermining the very purpose of arbitration.

In sum, the arbitrators' ruling on the cross-motions for summary disposition did not decide "all disputes" arising under the policy and the parties did not enter into any agreement, written or otherwise, to authorize the arbitrators to issue a "partial award." And a rule that

acquiescence in multi-phase proceedings automatically authorizes "partial awards" in the absence of an objection thereto is contrary to the CPLR, this Court's precedent, and sound public policy. Accordingly, this Court should hold that the parties did not authorize the arbitrators to issue a "partial award" and that their ruling on the cross-motions for summary disposition was not an "award" under New York law.

II. In Any Event, the Parties Submitted the Issue of Whether the Arbitrators Had Authority to Reconsider Their Partial Ruling to the Arbitrators

Even if there were reason to doubt whether the parties had authorized the arbitrators to reconsider their rulings at partial summary disposition, the parties' arbitration agreement would still compel reversal in this case, because it invested the arbitrators themselves with power to decide that question. The parties agreed in writing to submit "*all* disputes or differences which may arise under or in connection with this policy, whether arising before or after termination of this policy, including any determination of the amount of Loss," to arbitration. (A. 191 (emphasis added))

There is no dispute in this case that the parties agreed to arbitrate Allied's claims. That being the case, the arbitrators had authority to

decide all remaining questions of contract interpretation, including those relating to their authority to decide procedural reconsideration questions. As this Court has stated, "[o]nce it appears that there is, or is not a reasonable relationship between the subject matter of the dispute and the general subject matter of the underlying contract, the court's inquiry is ended." *Matter of Nationwide*, 37 N.Y.2d at 96. Particularly in light of the breadth of the arbitration clause at issue here, the issue of *whether* the parties had authorized the arbitrators to reconsider any partial summary disposition ruling was itself a dispute the parties had authorized the arbitrators to decide. *See Matter of Smith Barney Shearson Inc. v. Sacharow*, 91 N.Y.2d 39, 43-44 (1997) (broad arbitration clause submits *all* disputes to arbitrators); *see also Benihana, Inc. v. Benihana of Tokyo, LLC*, 784 F.3d 887, 899 (2d Cir. 2015) (citing *Matter of Smith Barney*).

There is more. Even if a written submission of "all disputes" between the parties somehow did not encompass the question of whether the arbitrators could reconsider a ruling made on *part* of the disputed issues during arbitration (as opposed to at the conclusion of proceedings), the parties later submitted that precise issue to the arbitrators. Allied

sought reconsideration. (A. 444-56) The insurers in response argued that the arbitrators' authority to reconsider depended on the JAMS arbitration rules. (A. 457-60, 461-63, 464) This was a concession that the arbitrators could decide whether they had authority to reconsider a partial ruling because, as Allied explained in a letter to the arbitrators, JAMS Rule 11 gives the *arbitrators* authority to determine the scope of their own authority. (A. 517) In response to Allied's letter, the insurer reiterated their request for *the arbitrators* to issue a ruling *under JAMS rules*. (A. 463)

While JAMS rules did not in fact apply (A. 996-97, 1002), the insurer's unambiguous position was that they did. Even when purporting to reserve its right to contest the "propriety" of the hearing on the motion for reconsideration, the insurer reaffirmed that "[its] position is that the JAMS Rules apply to the instant arbitration …." (A. 464) Indeed, at that point, the insurer had dismissed the applicability of the common-law doctrine of *functus officio* out of hand as a "red herring." (A. 461)

Thus, both parties submitted that the arbitrators had authority to determine the reconsideration question before them (albeit for different reasons). And the arbitrators had authority to resolve "all disputes"

submitted to them, including this one. *See Matter of Smith Barney*, 91 N.Y.2d at 43-47; *see also United Bhd. Carpenters & Joiners of Am. v. Tappan Zee Constructors, LLC*, 804 F.3d 270, 277 (2d Cir. 2015); *T.Co Metals, LLC v. Dempsey Pipe & Supply, Inc.*, 592 F.3d 329, 344-45 (2d Cir. 2010).

III. The Arbitrators Acted Well within the Scope of Their Authority in Ruling on the Reconsideration Issue

The remaining analysis is straightforward. New York law compels the conclusion that the arbitrators did not exceed their authority by ruling that they could reconsider their ruling on the cross-motions for summary disposition and then reconsidering that ruling.

Vacatur of the final award would be justified only if it was "violative of a strong public policy" or "totally irrational," or "exceed[ed] a specifically enumerated limitation on [the arbitrators'] power." *Matter of Silverman*, 61 N.Y.2d at 308; *see also Wien & Malkin LLP v. Helmsley-Spear, Inc.*, 6 N.Y.3d 471, 479-80 (2006); *Matter of N.Y. City Transit Auth. v. Transp. Workers' Union of Am., Local 100*, 6 N.Y.3d 332, 336 (2005). For all the reasons stated above, however, public policy, rationality, and the parties' written agreement fully support the arbitrators' conclusion that they could reconsider their partial ruling on the cross-motions for

summary disposition and ensure that the insurance policies here are properly enforced. Even if the arbitrators' conclusion were erroneous, however, that would not be a ground for vacatur. The trial court had it just right: "The Panel was also not prohibited from reconsidering the partial final award, having determined that the award was not final, and to the extent that petitioner argues that the Panel erred in so concluding, it is not a sufficient ground on which to vacate the award." (A. 7)

In this case, the arbitrators corrected a fundamental error in a partial ruling after a full and fair hearing. Their final award embodied this just result. Rather than protect and respect the arbitrators' final award, however, the Appellate Division transformed the common-law doctrine of *functus officio* into a vehicle for *vacating* the only final award that decided all disputes between the parties. That decision, if allowed to stand, will complicate and undermine the integrity of final awards in arbitration, a result that is directly contrary to the policy of this State.

To encourage parties to arbitrate their disputes in accordance with New York law, this Court should hold that arbitrators may reconsider a partial ruling that does not decide all disputes between the parties unless the parties have clearly provided otherwise in their written agreement.

Application of that simple rule, which follows from article 75 of the CPLR and this Court's precedents, compels reversal here.

CONCLUSION

For the reasons stated above, this Court should reverse the judgment of the Appellate Division, First Department.

Dated: April 26, 2019

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Word Count Certification

I, Brian Sutherland, hereby certify pursuant to Rule 500.13(c)(1) that the total word count for all printed text in the body of the brief is 11,964 words.

ADDENDUM

UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF FLORIDA

CASE NO. 12-81397-CIV-MARRA

SUN CAPITAL PARTNERS, INC.

Plaintiff,

v.

TWIN CITY FIRE INSURANCE COMPANY

Defendant.
_______________________________________/

ORDER ON CROSS MOTIONS FOR PARTIAL SUMMARY JUDGMENT

This Cause is before the Court upon Plaintiff Sun Capital Partners, Inc.'s ("Sun") Motion for Partial Summary Judgment (DE 252) and Defendant Twin City Fire Insurance Company's ("Twin") Motion for Partial Summary Judgment on Indemnity for Sun's Claimed Settlement Payment (DE 280). The motions are fully briefed. The Court held oral argument on January 4, 2018. The Court has carefully considered the arguments of counsel and the entire record and is otherwise fully advised in the premises. For the reasons stated below, Sun's Motion is granted in part and denied in part at this time, and Twin's Motion is denied at this time.

I. BACKGROUND

Twin issued an excess insurance policy to Sun with a $10,000,000 aggregate limit of liability for the policy period from December 31, 2007 to December 31, 2008 ("Policy").[1] Houston Casualty Company ("HCC") issued a primary policy with an aggregate limit of $10,000,000 to Sun for the same policy period.

[1] Unless otherwise stated, the term "Policy" refers to the Twin Policy and any incorporated terms of the underlying primary policy issued by Houston Casualty Company.

In September of 2008, a committee of unsecured creditors of Mervyn's (the "Committee") filed a lawsuit (the "Underlying Lawsuit") against Sun and other defendants, claiming, among other things, that certain transactions were consummated while Mervyn's was insolvent or rendered Mervyn's insolvent, resulting in fraudulent conveyances and breaches of fiduciary duty. (DE 250, Pl.'s SOF ¶ 33; DE 295, Def.'s SOF ¶ 33.) Ultimately, Sun and the other defendants entered into a settlement with the Committee ("Settlement Agreement"). (DE 299-6, at 3.)

HCC agreed to pay a portion of the settlement damages and a portion of the defense costs that Sun allegedly incurred as a result of the Underlying Lawsuit, up to the amount available under HCC's $10,000,000 policy limit. Sun has brought this breach-of-contract action against Twin as a result of Twin's refusal to pay under Twin's excess Policy.

II. LEGAL STANDARD

The Court may grant summary judgment "if the movant shows that there is no genuine dispute as to any material fact and the movant is entitled to judgment as a matter of law." Fed. R. Civ. P. 56(a). The burden of establishing the absence of a genuine issue of material fact lies with the moving party. *Celotex Corp. v. Catrett*, 477 U.S. 317, 323 (1986).

The movant "bears the initial responsibility of informing the district court of the basis for its motion, and identifying those portions of [the record,] which it believes demonstrate the absence of a genuine issue of material fact." *Id.* To discharge this burden, the movant must point out to the Court that there is an absence of evidence to support the nonmoving party's case. *Id.* at 325. The material in the record must be viewed in a light most favorable to the nonmoving party. *Adickes v. S.H. Kress & Co.*, 398 U.S. 144, 157 (1970).

After the movant has met its burden under Rule 56(a), the burden of production shifts and

the nonmoving party "must do more than simply show that there is some metaphysical doubt as to the material facts." *Matsushita Elec. Indus. Co. v. Zenith Radio Corp.*, 475 U.S. 574, 586 (1986). "A party asserting that a fact cannot be or is genuinely disputed must support the assertion by: (A) citing to particular parts of materials in the record . . .; or (B) showing that the materials cited do not establish the absence or presence of a genuine dispute, or that an adverse party cannot produce admissible evidence to support the fact." Fed. R. Civ. P. 56(c)(1)(A) and (B).

Essentially, so long as the non-moving party has had an ample opportunity to conduct discovery, it must come forward with affirmative evidence to support its claim. *Anderson v. Liberty Lobby, Inc*., 477 U.S. 242, 257 (1986). "A mere 'scintilla' of evidence supporting the opposing party's position will not suffice; there must be enough of a showing that the jury could reasonably find for that party." *Walker v. Darby*, 911 F.2d 1573, 1577 (11th Cir. 1990). If the evidence advanced by the non-moving party "is merely colorable, or is not significantly probative, then summary judgment may be granted." *Anderson*, 477 U.S. at 249-50 (internal citations omitted).

III. DISCUSSION

A. Legal Obligation to Pay

In its Motion for Partial Summary Judgment, Twin asks the Court to enter partial summary judgment in its favor on Sun's claim for indemnity as to Sun's alleged settlement damages. Twin argues that the settlement damages are not a covered "Loss" under the Policy because Sun was not legally obligated to pay the settlement amount. Twin asserts that Sun did not fund any of the payments for the settlement amount and that, at most, Sun's liability was in the nature of a mere guarantee. In its Motion for Partial Summary Judgment, Sun asks the Court to enter partial summary judgment in its favor on the related but different issue of whether Twin may justify its alleged breach

under the Policy if Sun's legal obligation to pay was satisfied by a third party. Because the requests are related, the Court will handle these items in tandem.

1. Twin's summary-judgment motion: Sun's Legal Obligation to Pay

Under the Policy, Twin agreed to "pay[,] on behalf of the Insured Organization[,] Loss, which the Insured Organization is *legally obligated to pay* and which arises from any Claim first made against [Sun] during the Policy Period for a Wrongful Act." (DE 250-2, at 3 (emphasis added).) The underlying Settlement Agreement states, in relevant part, as follows:

> On the Closing Date (as defined in paragraph 14 below), on behalf of the Defendants, JDA Agent, LLC (the "Defendant Payment Agent"), shall pay, or direct the payment of, the aggregate sum of $166,000,000 (One Hundred Sixty-Six Million) to the Debtors' estates payable as follows: (a) the release of Sun Escrowed Funds to the Debtors' estates; (b) the release of the MDS Escrowed Funds to the Debtors' estates; and (c) cash from the Defendant Payment Agent to the Debtors' estates in an amount to be determined two Business Days prior to the Closing Date (defined below) based upon the amount of the Sun Escrowed Funds, and the amount of the "Administrative Discount" (as defined in paragraph 10 below and allocated in accordance with paragraph 11 below); (the payments referenced in (a) – (c) are, collectively, the "Settlement Payment"). The "Sponsor Defendants," shall be jointly and severally liable for the Settlement Payment and the Estate Parties shall have no recourse or claim against any individual Defendant other than the Sponsor Defendants for any portion of the Settlement Payment.

(DE 299-6, at 6-7 (footnote omitted).) It is undisputed that Sun is included in the definition of "Sponsor Defendants."

Under New York law,[2] "[a] settlement agreement is a contract which is subject to the ordinary rules of contract construction." *Texas 1845, LLC v. Kyaw*, 986 N.Y.S.2d 574, 576 (App. Div. 2014). "A written agreement that is complete, clear and unambiguous on its face must be enforced according to the plain meaning of its terms." *Sears v. Sears*, 30 N.Y.S.3d 770, 771 (App.

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[2] The Settlement Agreement contains a choice-of-law provision that states that New York law shall apply. (DE 299-6, at 16.)

Div. 2016) (citation omitted). "When interpreting a contract . . . , the court should arrive at a construction that will give fair meaning to all of the language employed by the parties to reach a practical interpretation of the expressions of the parties so that their reasonable expectations will be realized." *Id.* (citation omitted). Furthermore, "[i]n adjudicating the rights of parties to a contract, courts may not fashion a new contract under the guise of contract construction." *Id.* (citation omitted). "A court should not, under the guise of contract interpretation, imply a term which the parties themselves failed to insert or otherwise rewrite the contract." *Bowman v. Bowman*, 14 N.Y.S.3d 69, 71 (App. Div. 2015) (citation omitted).

Based upon a reading of the plain and unambiguous language of the Settlement Agreement, the Court finds that the Settlement Agreement establishes Sun's obligation to pay. The Settlement Agreement establishes Sun's liability by way of the following provisions: (i) it establishes Sun's liability for the Settlement Payment through the clause that provides "the 'Sponsor Defendants,' shall be jointly and severally liable for the Settlement Payment"; (ii) it identifies the sources of payment that satisfy that liability in the first full sentence of the Settlement Payment paragraph and provides that "the payments referenced . . . are, collectively, the 'Settlement Payment'"; and, finally, (iii) it provides that Sun remains liable even if the sources of payment designated in the agreement are bypassed by the underlying plaintiffs (in favor of a direct demand against Sun)[3] or fall short for any reason through the clause that provides that "the Estate Parties shall have no recourse or claim against any individual Defendant other than the Sponsor Defendants for any portion of the

[3] The Court notes that if the underlying plaintiffs had refused to utilize the payment mechanism set forth in the agreement and attempted to pursue payment directly from Sun, Sun might have had a breach of contract claim against plaintiffs but nothing in the Settlement Agreement released Sun's legal obligation to pay.

Settlement Payment." (DE 299-6, at 6-7 (footnote omitted).) In the Court's review, these provisions collectively impose upon Sun a legal obligation to pay.

Despite this clear and unambiguous language, Twin argues that the settlement amount is not a covered Loss for two primary reasons: (1) the Settlement Agreement allegedly did not create an obligation for Sun to pay the settlement amount, and (2) Sun's obligation was allegedly in the nature of a guarantee that never ripened into a legal obligation. The Court is not persuaded by either argument.

First, the fact the Settlement Agreement identifies the sources of payment that satisfy Sun's liability does not mean that the Settlement Agreement does not create Sun's obligation to pay, even assuming *arguendo* for purposes of this Order only, that none of the payment sources enumerated in the agreement required direct payment from Sun. There is nothing in the Policy that requires Sun to pay the liability or suffer out-of-pocket loss as a condition to coverage. Rather, coverage applies under this liability Policy "as soon as the insured incurs the liability for the loss." *In re WorldCom, Inc. Sec. Litig.*, 354 F. Supp. 2d 455, 464 (S.D.N.Y. 2005) ("It is a general principle under insurance law, that the obligation to pay under a liability policy arises as soon as the insured incurs the liability for the loss . . . .").

Moreover, although the Settlement Agreement establishes three sources of payment, the Settlement Agreement specifically provides that Sun is jointly and severally liable for those payments and there is nothing in the Settlement Agreement that purports to release Sun from its liability absent full satisfaction of the settlement amount. On the contrary, the Settlement Agreement specifically provides that Sun remains responsible even if the closing does not occur or the payment sources fall short, by stating that "the Estate Parties shall have no recourse or claim against any

individual Defendant *other than the Sponsor Defendants* for any portion of the Settlement Payment." (DE 299-6, at 6-7 (emphasis added).) The Court reads this language as confirming Sun's ongoing liability to pay for any portion or amount of the Settlement Payment.

Twin's construction of the agreement would require the Court to focus on the payment provisions of the Settlement Agreement to the exclusion of the sentence establishing Sun's "joint[] and several[] liabil[ity]" and providing for recourse against Sun. (DE 299-6, at 6-7.) Such a construction of the agreement would violate New York law, which provides that an "interpretation of a contract that has the effect of rendering at least one clause superfluous or meaningless . . . is not preferred and will be avoided if possible." *LaSalle Bank Nat. Ass'n v. Nomura Asset Capital Corp.*, 424 F.3d 195, 206 (2d Cir. 2005) (citing New York law) (internal citation and quotation marks omitted). The Court's reading of the Settlement Agreement, on the other hand, gives effect to the entire agreement.

Second, a reading of the plain language of the Settlement Agreement does not permit a characterization of Sun's obligation as a guarantee or contingent one.[4] The terms of the Settlement Agreement do not contain any words expressing that Sun's liability is in the nature of a guarantee or conditional on default of another. Nowhere in the Settlement Agreement is there any provision

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[4] Under New York law, a guaranty is "the promise to answer for the payment of some debt or the performance of some obligation, on default of such payment or performance, by a third person who is liable in the first instance. . . . It is an obligation to answer for the debt of another." *Terwilliger v. Terwilliger*, 206 F.3d 240, 246 (2d Cir. 2000) (applying New York law) (internal citation and quotation marks omitted). A guaranty "is a contract of secondary liability . . . Thus, a guarantor will be required to make payment only when the primary obligor has first defaulted." *Weissman v. Sinorm Deli, Inc.*, 669 N.E.2d 242, 246 (N.Y. 1996) (internal citation and quotation marks omitted). A guaranty is a promise to fulfill the obligations of another party, and is subject "to the ordinary principles of contract construction." *Cooperatieve Centrale Raiffeisen-Boerenleenbank, B.A. v. Navarro*, 36 N.E.3d 80, 85 (N.Y. 2015).

that Sun will pay if another defaults on the Settlement Amount, and the Court cannot imply terms that are not there. *Bowman*, 14 N.Y.S.3d at 71.

The provision in the Settlement Agreement that directs JDA Agent, LLC ("JDA Agent"), a mere payment agent, to make the payments does not alter the fact that the Settlement Agreement imposes primary liability on Sun and the other Sponsor Defendants. Indeed, at oral argument, when Twin's counsel was asked who is primarily liable for the settlement damages if (as Twin has argued) the Sponsor Defendants are only secondarily liable, Twin's counsel could not identify a single entity or party who would be primarily liable for the settlement damages based upon Twin's proposed construction of the Settlement Agreement. Furthermore, it would be nonsensical to construe Sun's liability, which is expressly defined in the first instance by reference to the payment sources enumerated in the agreement, as contingent on those payments not being made. The express terms of the Settlement Agreement created Sun's liability, and, as discussed above, there is no basis for finding that Sun's liability was only secondary to any other person or entity.

For the reasons given above, the Court finds that Sun was legally obligated to pay the settlement amount, even though that obligation was allegedly satisfied by third-party sources pursuant to the terms of the Settlement Agreement. Because the Court concludes that Sun was legally obligated to pay under the plain terms of the Settlement Agreement, the Court must deny Twin's Motion for Partial Summary Judgment as to the issue of loss.

2. Sun's summary-judgment motion: Third-Party Payment

In its Motion for Partial Summary Judgment, Sun makes the closely related argument that Twin cannot justify its alleged breach based upon the alleged fact that someone other than Sun paid for the settlement amount. The Court agrees. Under the Policy, Twin agreed to "pay[,] on behalf

of the Insured Organization[,] Loss, which the Insured Organization is *legally obligated to pay* and which arises from any Claim first made against [Sun] during the Policy Period for a Wrongful Act." (DE 250-2, at 3 (emphasis added).) As the Court alluded to above, there is nothing in the language of this liability Policy that requires Sun to pay the loss to trigger coverage. Rather, coverage applies "as soon as the insured incurs the liability for the loss." *In re WorldCom, Inc. Sec. Litig*., 354 F. Supp. 2d 455, 464 (S.D.N.Y. 2005) ("It is a general principle under insurance law, that the obligation to pay under a liability policy arises as soon as the insured incurs the liability for the loss, in contrast to an indemnity policy where the obligation is to reimburse the insured for a loss that the insured has already satisfied."). The alleged fact that Sun did not pay the liability is not a ground to excuse Twin's alleged breach of the Policy. As such, the Court must grant Sun's Motion for Partial Summary Judgment as to the first issue insofar as Sun asks for a ruling that Twin cannot justify its alleged breach based upon the assertion that someone other than Sun satisfied Sun's legal obligation to pay.[5]

B. Exhaustion

In its Motion for Partial Summary Judgment, Sun requests a ruling that Twin may not challenge Houston Casualty Company's exhaustion of the primary policy limit on uncovered claims. Twin, however, argues that its liability under the Policy does not attach until after payment and

[5] Because the plain language of the Policy establishes that an insured need not have suffered actual loss to trigger coverage, the Court need not reach the issue of whether New York's collateral source rule applies. In addition, the Court notes that Sun has worded its request for partial summary judgment relative to this first issue in various ways throughout its briefs (and, for example, at times asks the Court to make a ruling that touches upon Twin's "liability"), but the Court intentionally confines its ruling to the issue of whether Twin can justify its alleged breach based upon the assertion that someone other than Sun paid Sun's legal obligation to pay. As discussed above, Twin cannot so justify its alleged breach.

exhaustion of the primary policy limit for covered "Loss" and since HCC allegedly paid defense expenses applicable to uncovered claims, Sun must pay the difference. Sun disagrees, arguing that Twin must pay under the excess Policy when the HCC policy limit is exhausted without regard to whether the losses for which HCC paid constitute covered "Loss."

Here, the parties' disagreement as to whether Twin can challenge HCC's exhaustion arises as a result of an alleged inconsistency between Endorsement No. 5 to the Policy, which replaced Section II(A), and existing Section II(B) of the Policy, which remains unchanged. To resolve the parties' disagreement, the Court first turns to the language of these provisions.

Endorsement No. 5, which is entitled "Exhaustion of Underlying Insurance," reads in relevant part as follows:

> It is expressly agreed that liability for any covered Loss shall attach to the Underwriters only after the Primary and Underlying Excess insurers or the Insured shall have paid the full amount of their respective liability for such **covered Loss**. If the Insured shall pay, in the applicable legal currency, any such covered Loss, then the Underwriters shall recognize such payment for the depletion of the respective limits of liability of the Underlying Insurance. In no way shall such payment by the Insured constitute a waiver of any terms, conditions or exclusions of the Underlying Insurance or this policy. The Underwriters shall then be liable to pay only such additional amounts up to the Limit of Liability set forth in Item C of the Declarations, which shall be the maximum liability of the Underwriters in each Policy Period.

(DE 250-1, at 14 (emphasis added).) The endorsement then states that "[a]ll other terms and conditions remain unchanged." (*Id.*)

The original Section II(A), before the alteration made by Endorsement No. 5, read as follows:

> It is expressly agreed that liability for any loss shall attach to the Underwriters only after the Primary and Underlying Excess insurers shall have paid the full amount of their respective liability (hereinafter referred to as the "Underlying Insurance") or the Insured(s) shall have paid the full amount of such liability due to the financial insolvency of an insurer of the Underlying Insurance. The Underwriters shall then be liable to pay on such additional amounts up to the Limit of Liability set forth in

> Item C of the Declarations, which shall be the maximum liability of the Underwriters in each Policy Period.

(DE 250-1, at 4.)

A comparison of the original policy text and the language in Endorsement No. 5 demonstrates that both provided, in relevant part, that Twin's liability would attach once the primary insurer paid the full amount of the primary insurer's liability, the difference being that the endorsement requires that those payments be for "covered Loss" before Twin's liability attaches while the original text triggered Twin's liability even if the primary insurer's payments were not for covered Loss.

There is no question that the Endorsement No. 5 replaced the original policy text in Section II(A), but the difficulty lies in reconciling that change with an unaltered provision in the policy that continues to refer to exhaustion of the primary insurer's liability limit by reason of "losses paid." Specifically, Section II(B) of the Policy provides as follows:

> In the event of the reduction or exhaustion of the aggregate limits of liability under the Primary and Underlying Excess Policy(ies) by reason of **losses paid thereunder** for claims first made while this policy is in force, this policy shall (1) in the event of such reduction, continue in force excess of the reduced Primary and Underlying Insurance, or (2) in the event of exhaustion, continue in force as primary insurance, subject to the Underwriters' Limit of Liability and to the other terms, conditions and exclusions of this policy, provided always that in the latter event this policy shall only pay excess of the retention/deductible applicable to such primary insurance as set forth in the Primary Policy, which shall be applied to any subsequent loss in the same manner specified in such primary insurance. Notice of exhaustion of Underlying Insurance shall be given the Underwriters upon such exhaustion. Nothing herein shall be construed to provide for any duty on the part of the Underwriters to defend any Insured or to pay defense or any claim expenses in addition to the Limit of Liability set forth in Item C of the Declarations.

(DE 250-1, at 4 (emphasis added).)

This Court agrees that there is a conflict between Endorsement No. 5 and Section II(B) of

the Policy. Endorsement No. 5 provides that liability attaches only when the underlying insurers have made payments for "Loss," while Section II(B) provides that the Twin Policy shall apply when the underlying insurer has made payments for "losses," which is not a defined term in the Policy and therefore encompasses uncovered losses. Notably, Endorsement No. 5 does not state that it replaces, alters, or nullifies Section II(B), but instead provides only that "Section II. . . A., is deleted and replaced." (*Id.*) Moreover, as noted above, the operative endorsement contains the language that "[a]ll other terms and conditions remain unchanged." (DE 250-1, at 14.) As such, the replacement of the word "loss" with the words "covered Loss" by virtue of Endorsement No. 5 for purposes of Section II(A) is clearly and unequivocally limited to Section II(A) and does not alter the words "losses paid" in Section II(B). *See Birnbaum v. Jamestown Mut. Ins. Co.*, 83 N.E.2d 128 (N.Y. 1948) ("It is equally true that if an indorsement attached to a policy expressly provides that it is subject to 'all the terms, limitations and conditions of the policy,' the policy and indorsement must be read together and an indorsement in such a case does not abrogate or nullify any provision of the policy unless so stated in the indorsement." (citation omitted)); *see also Response Pers., Inc. v. Hartford Fire Ins. Co.*, 812 F. Supp. 2d 309, 315 (S.D.N.Y. 2011) ("The Endorsement modifies the Policy by adding a supplemental "Insuring Agreement," but it does not replace, alter or even refer to the Policy's Discovery Clause. After listing additional provisions and terms which replace other sections of the Policy, the Endorsement explicitly states that '[a]ll other terms and conditions [of the Policy] remain unchanged.' [I]n construing an endorsement to an insurance policy, the endorsement and the policy must be read together, and the words of the policy remain in full force and effect

except as altered by the words of the endorsement." (citation omitted) (applying New York law)).[6]

Neither party has presented the Court with any reasonable construction of the Policy that would reconcile the conflicting language in the Endorsement No. 5 with the language in Section II(B). It is well-established under New York law that an endorsement controls over a policy form to the extent that the endorsement is irreconcilably inconsistent with the form. *Murphy v. Allied World Assur. Co.*, No. 08 CIV. 3821 (GEL), 2009 WL 1528527, at *2 (S.D.N.Y. May 29, 2009) ("The New York Court of Appeals similarly held that an endorsement controls over a policy form to the extent that the endorsement is irreconcilably inconsistent with the form. *Birnbaum v. Jamestown Mut. Ins. Co.*, 298 N.Y. 305 (1948)."); *Pan Am. World Airways v. Port Auth. of New York & New Jersey*, No. 86 CV 938, 1988 WL 101337, at *5 (E.D.N.Y. Sept. 21, 1988) ("[W]here there exists an 'irreconcilable conflict' between the terms of an endorsement and the terms of the policy, the language of the endorsement controls the policy's interpretation."); *Taylor v. Kinsella*, 742 F.2d 709, 711 (2d Cir. 1984) (applying New York law) ("As a general rule, where a certificate or endorsement states expressly that it is subject to the terms and conditions of the policy, the language of the policy controls.").

Sun argues that ambiguities should be resolved in favor of the insured. While that is a correct statement of the law, there is no ambiguity in Endorsement No. 5, and it is also true, and more directly relevant here, that under New York law when an endorsement and the body of a policy present an irreconcilable conflict, the endorsement controls. *Accord JCD Int'l Gem Corp. v. Evanston Ins. Co.*, No. 94 CIV. 5315 (MBM), 1995 WL 491337, at *2 (S.D.N.Y. Aug. 17, 1995)

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[6] This Court previously determined that New York law applies to this breach of contract action. (DE 206.)

("Plaintiff asserts that under New York law, ambiguous terms of an insurance contract must be read in the light most favorable to the insured. Although this is an accurate general statement of the law, it is also true, and more directly relevant to the issue here, that where typewritten endorsements and printed standard contract language are in conflict, the typewritten endorsements, which are supposed to reflect terms negotiated between the parties, should be given effect.").

Because of the irreconcilable conflict in the Policy language between Endorsement No. 5 and unaltered Section II(B), the Court concludes that Endorsement No. 5 controls. As a result, the Court concludes that Twin's liability as an excess insurer only applies when the liability limit of the primary policy has been exhausted because the underlying insurer has made payments for "covered Loss" and therefore Twin can challenge HCC's exhaustion on the basis that certain payments were allegedly not for "covered Loss." Accordingly, Sun's Motion for Partial Summary Judgment is denied as to the exhaustion issue.

C. Allocation

At oral argument, both parties indicated that they agree that some portion of the settlement damages are not recoverable because they relate to fraudulent conveyance claims that are deemed uninsurable under New York law. Twin's position is that Sun's costs incurred in defending the fraudulent conveyance claims are also not recoverable. In its Motion for Partial Summary Judgment, Sun, however, requests a ruling that the Policy does not allow for allocation of defense costs between uncovered and covered claims and therefore Twin must pay for all defense costs, even those incurred in the defense of the uninsurable claims.

The Court concludes that Sun's request is foreclosed by New York law. It is well-established under New York law, that under an indemnity policy, there is no obligation to indemnify defense

costs incurred in defending non-covered uninsurable claims. *Vigilant Ins. Co. v. Credit Suisse First Boston Corp*., 782 N.Y.S.2d 19, 20 (App. Div. 2004) ("The policy defines defense costs as a component of "Loss," which "shall not include matters which are uninsurable under the law pursuant to which this coverage section of this policy shall be construed. . . . Thus, defense costs are only recoverable for covered claims."); *Millennium Partners, L.P. v. Select Ins. Co.*, 882 N.Y.S.2d 849, 853 (Sup. Ct.) ("[D]isgorgement of ill-gotten funds is not insurable under the law because such disgorgement does not constitute damages or a loss as those terms are used in insurance policies. 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." (internal citation and quotation marks omitted)), *aff'd*, 889 N.Y.S.2d 575 (App. Div. 2009); *see also* 70A N.Y. Jur. 2d Insurance § 2221 ("Where defense costs are a component of an uninsurable loss, a party may not be reimbursed for those costs as they are only recoverable for covered claims.").

Here, the Policy includes defense costs (and settlement damages) within the definition of "Loss," but specifically provides that "Loss" shall not include "matters deemed uninsurable under the law pursuant to which this Policy shall be construed."[7] (DE 250-2, at 30.) Under this Policy language and under the New York case law discussed above, to the extent that defense costs were incurred in defending non-covered uninsurable claims, Sun is not entitled to recover those costs. *Vigilant Ins.*, 782 N.Y.S.2d at 20; *Millennium*, 882 N.Y.S.2d at 853.

Sun's arguments to the contrary are availing. Sun's reliance on *Julio & Sons Co. v. Travelers Casualty and Surety Co.*, No. 08CV3001(RJH) (S.D.N.Y. Feb. 13, 2009) (applying Texas law) is

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[7] Sun appears to concede that settlement damages are allocable between covered and uncovered uninsurable claims under the definition of "Loss."

trumped by the aforementioned New York case law. Further, Sun's reliance on the Allocation provision in the Policy is misplaced because, among other reasons, the Allocation provision does not apply to the allocation of costs between covered and uninsurable losses.

For these reasons, Sun's request for partial summary judgment is denied as to the issue of allocation.[8]

D. Remaining Issues

As to the remaining issues raised by the parties in their cross motions, which pertain to indemnification and settlement, the Court finds that there are genuine disputes of material fact and therefore the motions are denied as to the remaining issues.

IV. CONCLUSION

Based upon the foregoing, the Court concludes that Sun is entitled to partial summary judgment in Sun's favor on the first issue presented in Sun's motion: Twin cannot justify its alleged breach based upon the allegation that someone other than Sun satisfied Sun's legal obligation to pay. The cross Motions for Partial Summary Judgment as to the following issues are denied on the merits at this time: (1) Twin's request for entry of partial summary judgment in its favor on Sun's claim for indemnity under the Policy issued by Twin as to Sun's alleged settlement damages; (2) Sun's request for entry of partial summary judgment in its favor as to Twin's liability for costs incurred in the defense of the uninsurable claims; and (3) Sun's request for entry of partial summary judgment in it favor as to whether Twin can challenge HCC's exhaustion on the basis that the payments were allegedly not for covered loss. The cross Motions for Partial Summary Judgment are denied due to

[8] The Court does not reach the separate issue of the proper basis for allocation of defense costs at this time.

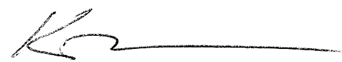
the presence of genuine issues of material fact on the following issues: (1) Sun's request for entry of partial summary judgment as to the consent-to-settle provisions; and (2) Twin's request for entry of partial summary judgment as to whether Sun increased Twin's exposure and/or released Twin's subrogation rights.

Accordingly, it is **ORDERED AND ADJUDGED** that Plaintiff Sun Capital Partners, Inc.'s Motion for Partial Summary Judgment (DE 252) is **GRANTED** in part and **DENIED** in part, consistent with this opinion, and Defendant Twin City Fire Insurance Company's Motion for Partial Summary Judgment (DE 280) is **DENIED**.

In addition, the parties' related motions (DE 333, 335) are **DENIED** as moot. The unopposed motion to seal (DE 253) is **GRANTED**.

Within fourteen (14) days of the entry date of this Order, the parties shall confer and file with the Court a Joint Notice with proposed pretrial and trial dates for this action and 15-81361-CIV-MARRA.

DONE AND ORDERED in Chambers at West Palm Beach, Palm Beach County, Florida, this 15th day of January, 2018.



KENNETH A. MARRA
United States District Judge