Alexander v Starr Surplus Lines Ins. Co.
2020 NY Slip Op 30297(U)
February 3, 2020
Supreme Court, New York County
Docket Number: 653072/2019
Judge: O. Peter Sherwood
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SUPREME COURT OF THE STATE OF NEW YORK
COUNTY OF NEW YORK: COMMERCIAL DIVISION PART 49
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MARIE ALEXANDER,

Plaintiff,

-against-

STARR SURPLUS LINES INSURANCE COMPANY,

Defendant.
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DECISION AND ORDER
Index No.: 653072/2019

Motion Sequence No.: 001

O. PETER SHERWOOD, J.:

I. BACKGROUND

In this declaratory judgment action, plaintiff Marie Alexander ("Alexander" or "plaintiff") seeks to obtain reimbursement of defense costs under the terms of a directors and officers liability insurance policy written by defendant Starr Surplus Lines Insurance Company ("Starr") to plaintiff's former employer Avaago, Inc. ("Avaago") in connection with claims brought against her by former investors in Avaago. The underlying litigation was brought by Joshua Berkowitz ("Berkowitz") who alleges Alexander fraudulently induced him to invest in Avaago. He is joined in that complaint by Eastern Port Company, LLC ("EPC"), a noteholder.

In this case, Alexander alleges Starr wrongfully refused to provide coverage for these claims. Starr refused coverage citing an exclusion in the policy for claims brought by investors who own or control 10% or more of the outstanding voting stock of the company (the "Major Shareholders Exclusion"). Alexander maintains the exclusion does not apply to the claims against her because Berkowitz was not a major shareholder of Avaago either at the time of the alleged wrongful acts or at the time the policy was issued. According to Alexander, the alleged wrongful acts all occurred in 2016 and 2017, with the last such acts occurring on April 29, 2017, prior to issuance of the policy. Alexander states that on March 9, 2017, Barkowitz, who held Series A promissory notes, executed agreements to convert the notes into equity (Aff. of Marie Alexander ¶ 13, attached as Ex. E to Affm. of Peter Stroili, Doc. No. 26).[1] Berkowitz received his stock on August 9, 2017, when the company first issued stock (*see* Alexander Aff ¶ 9, Doc. No. 10).

[1] The designation "Doc. No." followed by a number is the location of the referenced document in this case in the New York State Electronic Filing System.

On this motion, Alexander seeks a mandatory preliminary injunction directing Starr immediately to begin paying her defense costs.

II. DISCUSSION

The issuance of a preliminary injunction is governed by CPLR 6301, which provides, in pertinent part:

> "A preliminary injunction may be granted in any action where it appears that the defendant threatens or is about to do, or is doing or procuring or suffering to be done, an act in violation of the plaintiffs rights respecting the subject of the action, and tending to render the judgment ineffectual . . ."

"The party seeking a preliminary injunction must demonstrate a probability of success on the merits, danger of irreparable injury in the absence of an injunction and a balance of equities in its favor" (*Nobu Next Door, LLC v Fine Arts Hous., Inc.*, 4 NY3d 839, 840 [2005]). "The decision to grant or deny provisional relief, which requires the court to weigh a variety of factors, is a matter ordinarily committed to the sound discretion of the lower courts" *(id.)*.

A. Likelihood of Success on the Merits

The applicable New York law governing insurance contracts is well settled. The duty of an insurer to defend is broader than its duty to indemnify (*Utica First Insur. Co. v Star-Brite Painting & Paperhanging*, 36 AD3d 794, 796 [2d Dept 2007]). The duty "arises whenever the allegations contained in the complaint against the insured, liberally construed, potentially fall within the scope of the risks which the insurer has undertaken" *(id.)*. "An insurer may be obligated to defend its insured even if, at the conclusion of an underlying action, it is found to have no obligation to indemnify its insured," since the duty arises whenever there is "a reasonable possibility of coverage" (*Global Costr. Co. LLC v Essex Ins. Co.*, 52 AD3d 655, 655-6 [2d Dept 2008]; *see Savik, Murray & Aurora Constr. Mgt. Co., LLC, v ITT Hartford Ins. Grp.*, 86 AD3d 490, 494 [1st Dept], *app dismissed* 17 NY3d 901 [2011][insurer has duty to defend even though facts outside four corners of pleadings indicate claim may not be covered]; *Zurich-American Ins. Cos. v Atlantic Mut. Insu. Cos.*, 139 AD2d 379, 384 [1st Dept 1988], *affd* 74 NY2d 621 [1989] [duty not contingent on duty to indemnify but rests on whether any facts bring action within protection purchased]). As long as an issue resolving coverage remains unsolved, the insurer has a duty to defend the insured (*Zurich-American, id.* at 385).

Under a directors and officers liability policy calling for reimbursements of defense expenses . . . insurers are required to make contemporaneous interim advances of defense expenses where coverage is disputed, subject to recoupment in the event it is ultimately determined no coverage was afforded" (*Fed Ins. Co. v Koslowski*, 18 AD3d 33, 40 [1st Dept 2005]). Moreover, the law regarding interpretation of exclusionary clauses contained in insurance policies "is highly favorable to insureds" (*Pioneer Tower Owners Ass'n. v State Farm Fire & Cas. Co.*, 12 NY3d 302, 306 [2009]).

> "[W]henever an insurer wishes to exclude certain coverage from its policy obligations, it must do so in clear and unmistakable language. Any such exclusions or exceptions from policy coverage must be specific and clear in order to be enforced. They are not to be extended by interpretation or implication, but are to be accorded a strict and narrow construction. Indeed, before an insurance company is permitted to avoid policy coverage, it must satisfy the burden which it bears of establishing that the exclusions or exemptions apply in the particular case, and that they are subject to no other reasonable interpretation."

(*id.* at 307 citing to *Seaboard Surety Co. v Gillette Co.*, 64 NY2d 304, 311 [1984]). Hence, policy exclusions must "have a definite and precise meaning, unattended by danger of misconception ... and concerning which there is no reasonable basis for a difference of opinion" (*id.*). Any ambiguity will be interpreted in favor of the insured (*Belt Paining Corp. v TIG Ins. Co.*, 100 NY2d 377 [2003]; *Ins. Co. of Greater NY v Clermont Armory, LLC*, 84 AD3d 1168 (2d Dept), lv denied 17NY3d 714 [2011]). The insurer bears the burden of proving the allegations in the underlying claim "cast the pleadings wholly within exclusion, that the exclusion is subject to no other reasonable interpretation, and that there is no possible factual or legal basis upon which the insurer might be eventually obligated to indemnify the insured" (*Frontier Insulation Contractors, Inc. v Merchants Mut. Ins. Co.*, 91 NY2d 169, 175 [1997]).

But for the Major Shareholder Exclusion, Alexander would be entitled to coverage of her defense costs in the Berkowitz and EPC litigation. The Major Shareholder Exclusion provides:

> This policy shall not cover Loss in connection with any Claim against any Insured which is made by the individual(s) or entity (ies) that own or control (whether legally or beneficially, directly or indirectly) **10%** or more of the outstanding voting stock of the **Company**, (hereinafter **"Major Shareholder"**); or by any security holder of the **Company**, whether directly or derivatively, unless such security holder's Claim is investigated and continued totally independent of, and totally without the solicitation of, or assistance of, or active participation of, or intervention of any **Major Shareholder**

(Policy, Directors and Officers Section, Endorsement 7 [hereinafter Doc. No. 11 "MSE Clause"] *[Bold in original]*). It is undisputed that at the time Berkowitz filed suit he was the owner of 15.3% of the shares of the Company (*see* Berkowitz Compl. ¶ 13, Doc. No. 16).

Starr argues the Major Shareholder Exclusion unambiguously applies to any "claim against any insured which is made by the individual(s) . . . that own or control . . . 10% or more of the outstanding voting stock of the Company" *(id.)*. Starr emphasizes this is a "claims made" policy under which "coverage is determined when the claim is made, not when the conduct forming the basis of the claim occurred" (Opp at 13 citing *Exclusive Risks Indem, Inc. v Pepper Hamilton LLP*, 13 NY3d 313, 320, n. 1 [2009]).

Plaintiff argues that "regardless of Berkowitz's status as a shareholder, Alexander almost certainly will prevail on the determination that Starr must cover EPC's claims" (Pl. at 11). Starr responds that the Major Shareholder Exclusion applies to the EPC claim as well, even though it conceded that EPC held debt and was not a shareholder. Starr asserts the provision applies to bar coverage for a claim "by any security holder of the **Company** . . .unless such security holder's **Claim** is instigated or continued *totally independent of, and totally without the solicitation of a assistance of, or active participation of, or intervention of any **Major Shareholder***" (MSE Clause, Doc. No. 11 [*bold original; italics added*]). The parties dispute whether Berkowitz and EPC "participated" together in the litigation or separately (Compare Pl. at 10 ["EPC is proceeding on its own; it is an entirely separate entity, owner and controlled by unrelated individuals, it is represented by separate counsel . . . and it has articulated its own distinct claims based on a separate debt instrument and based on distinct factual allegations"] with Opp at 17 ["It is undisputable that Berkowitz 'participated' in the Claim by bringing and pursuing the claim together with EPC . . . Berkowitz is the driving force of the Pending Action and the bulk of the allegations in the Pending Complaint are alleged on his behalf"]). Upon such hotly disputed facts, plaintiff has not shown a likelihood of success on the merits based on the basis that EPC is merely a senior noteholder.

Plaintiff argues the Major Shareholder Exclusion is ambiguous, as it fails to specify as of what date ownership should be measured. She states the Exclusion applies only to shareholders who own at least 10%, of Avaago's stock at the time the policy was issued.

The assertion is well taken. The Major Shareholder Exclusion provision in this case is similar to that analyzed in *EMSI Acquisition, Inc. v RSUI Indemnity Co.* (306 F. Supp 3d 647 [D. Del 2018] aff'd F3d Appx, 2019 US App LEXIS 28332 [2019] [hereinafter "EMSI-A"])[2]. The respective clauses provide:

EMSI Exclusion	The Insurer shall not be liable to make any payment for Loss arising out of or in connection with any Claim brought by or on behalf of individuals or entitles that own, beneficially or directly, five percent (5%) or more of the outstanding stock of the Insured Organization.
Avaago Exclusion	This policy shall not cover Loss in connection with any Claim against any Insured which is made by the individual(s) or entity (ies) that own or control (whether legally or beneficially, directly or indirectly) 10% or more of the outstanding voting stock of the Company. . .

(Pl at 12). The arguments made in *EMSI-A* were the same as those advanced by the parties here. That court considered the present tense formulation of the policy was subject to more than one construction - - "owns" at what point in time? Given the ambiguity, the court interpreted the contract against the insurer and agreed that ownership of the shares could be measured on either the dates of the alleged wrongful acts or the date the policy was issued.[3] Accordingly, the court held the exclusion did not apply.

Starr argues that the nature of the Policy mandates the conclusion that coverage is barred (Opp at 13). As to this issue, the *EMSI-A* court said "the ambiguity in the [Exception] is not a matter of whether the [policy] bar[s] claims by Major Shareholders, but instead, is a function of who those Major Shareholders are" (*id.* at 657). The Third Circuit concurred and added that [i]f the Major Shareholder Exception bars the major shareholders at the time the policy was issued,

[2] Although *ESMI-A* was decided under Delaware law, the common law contract interpretation discussed there is equally applicable under New York law. In fact, in the insurance contract context, New York law appears to accord the insured greater protections than Delaware law (compare discussion of law in *EMI-A*, 306 F Supp3d at 652-53, with that in *DuPree*, 2012 WL 2914174* 3-4, New York Sup. Ct.., [NY Cty June 28, 2012] [Kornreich, J.]).

[3] The ambiguity found in *ESMI-A* was absent in *Paraco Gas Corp. v Travelers Cas. & Sur. Co*, (51 F Supp 3d 379 [SDNY 2014]) as the "clear and unambiguous" Ownership Percentage Exclusion provision of the policy there referred to "any person . . . which owns or did own . . . more than 5% of [Paraco]" (*id.* at 389). The exclusion applied regardless of whether the claimant was a major shareholder at the time the policy was issued or at the time the claim was made. *Paraco*, on which Starr relies, is inapposite.

then the question of whether the policy was claims-made or occurrence-based is irrelevant, the same set of shareholders would be excluded no matter how the policy is characterized" (*EMSI-A*, 2019 US App LEXIS 28332 *8 [3d Cir Del, Sept. 19, 2019]).

Plaintiff has shown a likelihood of success on the merits.

B. Irreparable Harm

New York courts have consistently held that "the failure to receive defense costs under an [insurance] policy at the time they are incurred constitutes an immediate and direct injury sufficient to satisfy the irreparable harm requirement" for a preliminary injunction (*XL Specialty Ins. Co. v. Level Glob. Inv'rs, L.P.*, 874 F. Supp. 2d 263, 272 [S.D.N.Y. 2012] [collecting cases]). As explained in a prominent case issuing a preliminary injunction to pay defense costs under a Directors and Officers policy:

> The failure to receive defense costs when they are incurred constitutes an immediate and direct injury. To hold otherwise, would not provide insureds with protection from financial harm that insurance policies are presumed to give. . . . Every party, including each director defendant, requires effective representation. It is impossible to predict or quantify the impact on a litigant of a failure to have adequate representation . . . . The ability to mount a successful defense requires competent and diligent representation. The impact of an adverse judgment will have ramifications beyond the money that will necessarily be involved. There is the damage to reputation, the stress of litigation, and the risk of financial ruin—each of which is an intangible but very real burden.

(*In re WorldCom. Inc. Sec. Litig.*, 354 F. Supp. 2d 455, 466–67 [S.D.N.Y. 2005]; *see also QBE Americas, Inc. v. ACE Am. Ins. Co.*, 44 Misc. 3d 1224[A])] [Sup. Ct. New York County 2014] ["With pending litigation, there is a concern that an insured's inability to procure legal fees will hamper its ability to put forth the best possible defense."]; *Sid Harvey Indus., Inc. v. Commerce & Indus. Ins. Co.*, 14 Misc. 3d 1233[A] [Sup. Ct. New York County 2006] [Ramos, J.] [granting preliminary injunction requiring insurer to continue coverage on ground that discontinuation of defense could result in "loss of settlement opportunities."]).

Alexander argues, and Starr does not dispute, that she faces multimillion dollar claims against her brought by well-funded and vindictive adversaries. She states she is not independently wealthy and will not be able to afford to pay the costs of her attorneys' fees through trial in the underlying action (*see* Alexander Aff. ¶¶ 15-16). She asserts that if a preliminary injunction is not entered, she faces the threat of irreparable harm that her counsel will be forced to withdraw for non-payment, leaving her to litigate *pro se* or make do with less informed, less experienced, and cheaper substitute counsel (*see XL Specialty*, at 874 F. Supp. 2d 273-44 [finding irreparable harm in part because "new counsel, starting from scratch in a highly complex matter, will not have, and may not be able to quickly acquire, predecessor counsel's familiarity with the evidence, legal principles, strategy, and witnesses . . . A defendant without substantial assets to pay for counsel also has no assurance that the new counsel will have the talent and experience of the predecessor, with price now potentially a decisive factor in choosing counsel"]).

Starr maintains the court should withhold a preliminary injunction where, as here, plaintiff's alleged irreparable injury is entirely economic. Noting that plaintiff does not allege she is unable to pay her defense costs but would have to borrow from her retirement savings account, Starr offers that "[w]hile nobody wants to invade their retirement savings for what they perceive as vexatious litigation, it constitutes money damages for which plaintiff can be fully compensated if she prevails in this Coverage Action" (Opp at 20).

Although generally, irreparable harm cannot be demonstrated where the claimant can be fully compensated in money if she prevails (*see Scotto v Mei*, 219 AD2d, 181, 184 [1st Dept 1996]), Starr ignores other precedent which provides that where the likelihood of success on the merits is high, the requirement of irreparable harm may be relaxed (*see Danae Art Int'l, Inc. v Stallone*, 163 AD2d 81, 82 [1st Dept]). This is such a case and the court may properly exercise its discretion in finding the existence of irreparable harm (*see e.g., Siegel*, D, New York Practice [4th ed], p. 525; *Automated Waste Disposal, Inc. v Mid-Hudson Waste, Inc.*, 50 AD3d 1072 [2d Dept 2008]).

C. Balance of Equities

"The 'balancing of the equities'. . . requires the court to look to the relative prejudice to each party accruing from a grant or a denial of the requested relief" (*Ma v Lien*, 198 AD2d 186, 187 [1st Det 1993]). Here, plaintiff has shown both a likelihood of success on the merits and irreparable harm. Starr will suffer no meaningful prejudice from issuance of the injunction plaintiff seeks (*see XL Specialty*, 874 F Supp 2d at 263). If it is finally determined that the insurer was not obligated to cover defense costs, it may seek recovery from the insured.

Accordingly, plaintiff having satisfied the requirements of CPLR 6301, a preliminary injunction shall issue. Plaintiff shall settle order on five (5) days notice.

This constitutes the decision and order of the court.

DATED: February 3, 2020

ENTER,

O. PETER SHERWOOD J.S.C.