Alvarez v XL Specialty Ins. Co.
2020 NY Slip Op 33917(U)
November 27, 2020
Supreme Court, New York County
Docket Number: 655391/2019
Judge: Andrea Masley
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SUPREME COURT OF THE STATE OF NEW YORK
COUNTY OF NEW YORK: COMMERCIAL DIVISION PART IAS MOTION 48EFM

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CESAR ALVAREZ, BRUCE BERKOWITZ, ALESIA HAAS, KUNAL KAMLANI, EDWARD LAMPERT, STEVEN MNUCHIN, THOMAS TISCH, PAUL DEPODESTA, WILLIAM KUNKLER, ANN REESE, JOSEPH JORDAN, LAWRENCE MEERSCHAERT, LEENA MUNJAL, SCOTT HUCKINS, ROBERT RIECKER, and ROBERT SCHRIESHEIM

Plaintiffs,

- v -

XL SPECIALTY INSURANCE COMPANY, QBE INSURANCE CORPORATION,

Defendants.

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INDEX NO. 655391/2019

MOTION DATE

MOTION SEQ. NO. 004

DECISION + ORDER ON MOTION

HON. ANDREA MASLEY:

The following e-filed documents, listed by NYSCEF document number (Motion 004) 2, 3, 57, 86, 87, 88, 89, 90, 91, 92, 93, 94, 95, 96, 97, 98, 99, 100, 101, 102, 103, 104, 105, 106, 107, 108, 110, 111, 112, 115, 117, 118,[1] 134, 138, 139, 140, 141, 142, 143, 145, 146, 149, 151, 154, 155, 159, 186, 187, 198 were read on this motion to/for JUDGMENT - SUMMARY

This motion for summary judgment on plaintiffs' complaint for declaratory relief that plaintiffs have a right to coverage under insurance policies issued by XL Specialty Insurance Company (XL) for the policy periods of 2015-16 and 2017-24 is granted.

XL issued directors and officers (D&O) insurance policies to Sears Holdings Corp. (Sears) for the 2015-16 and 2017-24 policy periods. (NYSCEF Doc No. [NYSCEF] 90 and 91, XL Policies).

[1] XL's opposition, filed on the docket at NYSCEF 118, was considered by the court for this decision though it is not linked to plaintiffs' motion for summary judgment, motion sequence 04. To ensure an appealable order, the parties are directed to properly file motion papers linked to this motion. (*See also* NYSCEF 57, 117).

Plaintiffs Cesar Alvarez, Bruce Berkowitz, Paul DePodesta, Alesia Haas, Scott Huckins, Joseph Jordan, Kunal Kamlani, William Kunkler, Edward Lampert, Lawrence Meerschaert, Steven Mnuchin, Leena Munjal, Ann Reese, Robert Riecker, Robert Schriesheim, and Thomas Tisch, officers or directors of Sears at the relevant times, were named as defendants by the creditors of Sears (Creditors' Committee) in an adversary proceeding filed on April 17, 2019 in the United States Bankruptcy Court for the Southern District of New York, *Sears Holdings Corp., et al. v. Edward Scott "Eddie" Lampert, et al.*, (No. 19-08250-rdd [Bankr SD NY]) (Underlying Action), which arises from the bankruptcy of Sears. (NYSCEF 107, Amended Complaint ¶¶ 1, 10-25). The Creditors' Committee asserts 35 causes of action related to three transactions: (1) Sears' 2014 spin-off of Lands' End to Sears' shareholders (NYSCEF 93, Underlying Action Complaint ¶¶ 8-9); (2) Sears' 2015 sale-and-lease-back transaction with Seritage (Seritage Transaction) (*id.* at ¶¶ 10-14); and (3) loans approved by the Sears Board and made to Sears between April 2016 and September 2018 (Related Party Loans) (*id.* at ¶¶ 15-17).

XL denied coverage under the 2017-24 XL Policy, asserting that the Underlying Action and a shareholder derivative action challenging the Seritage Transaction "arise from Interrelated Wrongful Acts," and therefore XL considers the entire Underlying Action and the prior Seritage action as a single "Claim" first made during the 2015-16 Policy Period. (NYSCEF 5, XL Letter dated May 24, 2019 at 4-7; NYSCEF 103, XL Letter dated Feb. 7, 2020 at 3). In its letter denying coverage to plaintiffs under the 2017-24 XL Policy, XL cited allegations in the Underlying Action related to the Seritage Transaction and asserted on that basis that the Underlying Action "appears to be a

Claim first made during the 2015-2016 Policy Period," because the Underlying Action and the prior Seritage Transaction action "arise from" Interrelated Wrongful Acts. (NYSCEF 5, May 24, 2019 XL Letter at 5; NYSCEF 103, Feb. 7, 2020 XL Letter at 3).

A shareholder derivative action was filed in the Delaware Court of Chancery on May 29, 2015 and challenged the Seritage Transaction (Derivative Action). (NYSCEF 94, *Matter of Sears Holdings Corp. Stockholder & Derivative Litig.*, July 19, 2016, C.A. No. 11081-VCL [Del Ch Ct]). Shareholders in the Derivative Action alleged that Sears' former Chairman, CEO and controlling stockholder, plaintiff here Edward Lampert, engaged in an "ongoing strategy to strip [Sears] of its valuable core assets" for the benefit of Lampert and his affiliates, including his associates who were also on the Sears board, and related entities who controlled Sears' stock. (*Id.*, ¶¶ 6-7, 28, 54). The shareholders alleged that Sears' board breached their fiduciary duties by approving the Seritage Transaction whereby Sears' valuable real estate holdings were siphoned off for the benefit of Lampert and his associates. (*Id.*, ¶ 1). Sears allegedly sold $2.25 billion worth of real estate, including 235 of Sears' retail stores, for less than its actual value in a sale-leaseback transaction to Seritage, a real estate investment trust, which was controlled by Lampert and his related entities. (*Id.*, ¶¶ 1, 4). Sears also allegedly transferred 31 joint venture properties to Seritage at a discount. (*Id.*, ¶¶ 32, 69, 73, 101). Lampert and his related entities controlled 80% of Sears stock. (*Id.*, at ¶ 141). The Seritage Transaction allegedly harmed Sears because (i) Sears received no or inadequate consideration for the properties transferred; (ii) Sears failed to give meaningful consideration to alternatives; (iii) Sears was insolvent or became insolvent as a result of the transaction; and (iv) the transaction favored Seritage at Sears'

expense. (*Id.*, at ¶¶ 75, 77-78, 163, 168, 179). The Derivative Action was settled by stipulation. (NYSCEF 17, Stipulation). XL contributed $12 million of its $15 million limit of liability under the XL 2015 to 2016 Policy towards this settlement. (NYSCEF 117, XL's Rule 19-b Counterstatement of Material Facts ¶16).[2] XL claims that the Derivative Action exhausted XL's 2015-16 policy. (NYSCEF 178, Argument 8/17/20 Tr. 20:21-24).

In a 2014 transaction, Sears spun off Lands' End, one of Sears' most lucrative assets, to Sears' shareholders. (NYSCEF 93, Underlying Action Complaint ¶¶8, 229). In the Underlying Action, the Creditors' Committee alleges that the Lands' End Spin-off was "for no consideration and left Sears Holdings and Sears Roebuck, Lands' End's parent company, with unreasonably small capital and incapable of paying their existing and intended future debts." (*Id.*, ¶8). For example, it is alleged that a Sears dividend pre-spin-off, used funds borrowed by Lands' End. (*Id.*, ¶ 230). The Creditors' Committee also alleges that when the Sears board members, plaintiffs in this action, approved the Lands' End Spin-off, the board members owned 70% of the stock and thus received 70% of the equity of the profitable Lands' End. (*Id.*, ¶¶ 227, 228). Accordingly, the Creditors' Committee concludes these conflicts made the Lands' End transaction an improper transfer to insiders. (*Id.*, ¶ 228).

The related party loans occurred between 2016 and 2018. In the Underlying Action, the Creditors' Committee alleges that the interest rate on the loans was excessive and the loans themselves were a sham intended to disguise Sears' looming bankruptcy. (*Id.*, ¶¶ 717, 364, 367). They also charge that the Related-Party were not loans at all, but equity contributions and plaintiffs here attempted to "paper them" as

[2] XL's Counterstatement was not submitted as part of the record on this motion.

loans. (*Id.*, ¶¶364-412). Sears could not obtain financing from traditional sources due to its precarious financial position and the insiders knew Sears could not repay the alleged loans. (*Id.*, ¶¶ 367, 368). Rather, the Creditors' Committee alleges that the related party loans were intended to protect Lampert and the insiders, not Sears. (*Id.*, ¶¶ 369, 371-380). The Creditors' Committee alleges that the board members, plaintiffs in this action, breached their fiduciary duties by engaging in this self-dealing and approval of these loans that Sears could never afford. (*Id.*, p. 147).

In this action, issue was joined September 14, 2020 when XL answered the March 9, 2020 Amended Complaint. (NYSCEF 158, Answer). XL agreed that the narrow insurance coverage dispute here can be decided without discovery. (NYSCEF 106, April 14, 2020 XL Letter, at 1). The issues presented on this motion are whether (1) the underlying action constitutes a single claim or multiple claims; and (2) whether the claim was first made in the 2015-16 period or 2017-24 period.

Under CPLR 3212, where "the terms and conditions of an insurance policy are clear and unambiguous, the construction of the policy presents a question of law to be determined by the court, and the court may properly grant summary judgment." (*Slattery Skanska Inc. v Am. Home Assur. Co.*, 67 AD3d 1, *14 [1st Dept 2009][internal quotation marks omitted]). "[U]nambiguous provisions of an insurance contract must be given their plain and ordinary meaning." (*Gilbane Bldg. Co./TDX Constr. Corp.* v *St. Paul Fire & Mar. Ins. Co.*, 31 N.Y.3d 131, 135 [2018] [internal quotation marks omitted]). "Where an insured has met its burden of showing that a valid insurance policy was in full force and effect and that it incurred a presumptively covered loss, the burden of proof shifts to the insurer to demonstrate that an exclusion contained in the policy

defeats the claim." (*Throgs Neck Bagels v GA Ins. Co. of N.Y.*, 241 AD2d 66, 71 [1st Dept 1998]).

The court rejects XL's position that all claims in the Underlying Action are covered only under the 2015-16 XL Policy, and therefore, no part of the Underlying Action is eligible for coverage in the 2017-24 policy period because the entire Underlying Action arises out of Interrelated Wrongful Acts with the prior Derivative Action, and all of the transactions alleged in the Underlying Lawsuit are parts of "a single on-going scheme." (NYSCEF 118, XL Opp. at 8, 17-20.) Rather, based on the clear unambiguous language and plain meaning of the policies, the claims in the Underlying Action are covered by the 2017-24 XL policy, but the Seritage claims are excluded from such coverage. Instead, the Seritage claims are covered by the 2015-16 policy.

The XL Policies both define a "Claim" as:

> (1) "a written demand for monetary or non-monetary relief;
>
> (2) any civil or criminal judicial proceeding in a court of law or equity, arbitration or other alternative dispute resolution; or
>
> (3) a formal civil, criminal, administrative, or regulatory proceeding or formal investigation."

(NYSCEF 90, XL Policy 2015-16 at II[C]).[3] However, a claim arising from an "Interrelated Wrongful Act," "shall be deemed to constitute a single **Claim** and shall be deemed to have been made at the earliest time at which the earliest such **Claim** is made ..." (*NYSCEF 90, XL Policy* 2015-16 at II[J]). The policy defines "Interrelated Wrongful Acts" as "Wrongful Acts based on, arising out of, directly or indirectly

[3] The 2017-24 policy follows form and thus includes an identical provision with identical citations. (NYSCEF 91, 2017-24 XL Policy at II(C)).

resulting from, in consequence of, or in any way involving any of the same or related, or series of related, facts, circumstances, situations, transactions, or events." (*NYSCEF 90, XL Policy* 2015-16 at IV[G]). But the XL Policies exclude from coverage "that portion of" any Claim:

> "[B]ased upon, arising out of, directly or indirectly resulting from, in consequence of, or in any way involving any fact, circumstance or situation, transaction, event or Wrongful Act which, before the Inception Date of this Policy, was the subject of any notice accepted under any management liability insurance policy, directors' and officers' liability insurance policy, or fiduciary liability insurance policy."

(*NYSCEF 90, XL Policy* 2015-16 at III[B][2], as modified by Endorsement Nos. 14 & 15, p. 32/67).

The "Exclusions" provisions of the XL policies were each amended by endorsement to add the words "that portion of" before "Claim" and exclude from coverage loss in connection with "that portion of" any "Claim" "which, before the Inception Date of this Policy, was the subject of any notice accepted under any ... directors' and officers' liability insurance policy ..." (NYSCEF 90, 2015-16 XL Policy at III[B][2], as amended by Endorsement Nos. 14 & 15). The addition of the words "that portion of" makes clear that even if the term "Claim" could otherwise be construed to refer to an entire action, the parties here intended that any exclusion from coverage under the XL Policies be assessed narrowly on a cause-of-action by cause-of-action basis, not as one whole action.

As to the first issue, the court finds that the Underlying Action consists of multiple claims: claims arising from the Seritage Transaction and all other claims. XL's attempt to interpret "claim" as the entire lawsuit is rejected as an "unduly rigid construction" of the term "claim" which ignores "the realities of litigation." *(Westpoint*

Intl., Inc. v American. Intl. S. Ins. Co., 71 AD3d 561, 562 [1st Dept 2010]; *see also Home Ins. Co. of Illinois (New Hampshire)* v *Spectrum Info. Tech., Inc.*, 930 F Supp 825, 846 [ED NY 1996]["'[C]laim' and 'suit' ... are treated as separate concepts by the plain language of the [insurance policy]," because "there may be a 'claim' without the institution of a 'suit' (*e.g.*, by demanding arbitration without or before filing a suit), or a 'suit' that does not necessarily constitute a 'claim' (*e.g.*, by filing a suit after arbitration has been demanded)."]) Here, the "Exclusions" provisions of the XL policies in Endorsement 14 make crystal clear that where a civil proceeding involves multiple causes of action, each cause of action must be analyzed individually to determine whether it can be excluded from coverage.

As to the second issue, the Seritage claims were made under the 2015-16 policy. The claims against plaintiffs in the Underlying Action regarding the Seritage Transaction "aris[e] out of" or "involv[e]" the same transaction that was at issue in the Derivative Action: Sears' sale of its interest in 266 real properties to Seritage, and its subsequent lease-back of 224 of those properties. Both the shareholders in the Derivative Action and the Creditors' Committee in the Underlying Action allege that the former officers and directors of Sears, plaintiffs here, violated their fiduciary duties to Sears by agreeing to the Seritage Transaction. Indeed, the Creditors' Committee seeks to unwind the settlement agreed to in the Derivative Action and the judgment entered by the Delaware Court approving that settlement and the release it provided. (NYSCEF 93, Underlying Action Complaint ¶¶ 554-576). Accordingly, the claims against plaintiffs in the Underlying Action based on the Seritage Transaction and the

claims in the Derivative Action constitute a single Claim made in May 2015, within the 2015-16 Policy Period.

However, the remaining claims were made under the 2017-24 policy. Simply joining claims in one lawsuit does not establish a "factual nexus between the claims." (*Seneca Ins. Co.* v. *Kemper Ins. Co.*, 2004 WL 1145830, *7-8 [SD NY, May 21, 2004], *affd* 133 Fed Appx 770 [2d Cir 2005]). The Lands' End spin-off is not part of the Seritage Transaction as it preceded the Seritage Transaction in time. Further, while the Lands' End spin-off was mentioned in one of the derivative complaints, it is not mentioned in the settlement agreement's seven pages of factual recitals. (NYSCEF 142, Stipulation). Rather, the Delaware Chancery Court recognized those complaints as having raised derivative claims relating to "Seritage transaction and/or the Rights Offering." (*NYSCEF 142*, Stipulation at 3). Likewise, the Related Party loans are not part of the Seritage Transaction which are also temporally separate.

Finally, the court rejects XL's argument that all of the claims by the Creditors' Committee are one scheme arising out of the Seritage Transaction. Such "bald allegations of conspiracy are insufficient to enmesh otherwise distinct claims. (*Home Ins.*, 930 F Supp at 851; *see also Glascoff v OneBeacon Midwest Ins. Co.*, 2014 WL 1876984, *6 [SD NY, May 8, 2014][finding claims not interrelated where they arise from the "same deficient corporate structure or Plaintiffs' lack of oversight," which is essentially the same charge here]).

The court has considered the parties' remaining arguments and finds them unavailing, without merit, or otherwise not requiring an alternate result.

Accordingly, it is

ORDERED that plaintiffs' motion for summary judgment against defendant XL is granted; and it is further

ORDERED and ADJUDGED, that the court declares that plaintiffs have a right to coverage for the claims against them (and for their fees and expenses incurred in defending those claims) in the Underlying Action, except any claims arising from the Seritage Transaction, under the 2017-24 XL Policy, and defendant XL has the obligation to pay the defense fees and expenses as loss under the terms of the 2017-2024 policy; and it is further

ORDERED and ADJUDGED that the Seritage claims in the Underlying Action (and the fees and expenses incurred by Plaintiffs in defending the Seritage claims) are not covered by the 2017-24 XL Policy and that XL must pay such fees and costs subject to the limits and other terms of the 2015-16 XL Policy unless that policy was exhausted.

Motion Seq. No. 004:

11/27/2020
DATE

ANDREA MASLEY, J.S.C.

CHECK ONE:	[x]	CASE DISPOSED		[ ]	NON-FINAL DISPOSITION		
	[ ]	GRANTED	[ ] DENIED	[x]	GRANTED IN PART	[ ]	OTHER
APPLICATION:	[ ]	SETTLE ORDER		[ ]	SUBMIT ORDER		
CHECK IF APPROPRIATE:	[ ]	INCLUDES TRANSFER/REASSIGN		[ ]	FIDUCIARY APPOINTMENT	[ ]	REFERENCE