SCANNED ON 4/25/2007

SUPREME COURT OF THE STATE OF NEW YORK — NEW YORK COUNTY

PRESENT: HELEN E. FREEDMAN, *Justice* — PART 39

Fed. Ins. Co.,

Plaintiff,

- v -

Tyco Intl., Ltd. et al.,

Defendants

INDEX NO. 601416/04

MOTION DATE

MOTION SEQ. NO. 11

MOTION CAL. NO.

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

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

Cross-Motion: ☐ Yes ☒ No

The motions numbered #009 and #011 are consolidated for joint disposition

Motion by plaintiff to be discharged and for other relief is decided in accordance with the accompanying memorandum decision.

Dated: April 20, 2007

Helen E. Freedman, *J.S.C.*

Check one: ☐ FINAL DISPOSITION ☒ NON-FINAL DISPOSITION

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

SUPREME COURT OF THE STATE OF NEW YORK
COUNTY OF NEW YORK: PART 39

----------X

Federal Insurance Company,

Plaintiff,

-against- Index No. 601416/04

Tyco International, Ltd. et al.,

Defendants.

----------X

HELEN E. FREEDMAN, J:

The motions numbered #009 and #011 are consolidated for joint disposition.

Plaintiff Federal Insurance Company ("Federal") filed this interpleader action to resolve competing claims for proceeds of an Executive Protection Policy (the "Policy") that Federal had issued on behalf of defendant Tyco International, Ltd. ("Tyco") and its officers and directors. The remaining claimants — Tyco, defendant Mark Belnick, and defendant Frank E. Walsh, Jr. — seek reimbursement for costs they have incurred in numerous civil and criminal proceedings (the "Defense Costs").

Pursuant to this Court's prior decisions and orders[1], Federal has paid a total of $ 20,710,664 out of the $ 25 million Policy limit for Executive Liability and Indemnification coverage ("ELI Coverage") to Tyco and Belnick for Defense Costs. In motion # 011, Federal now moves pursuant to CPLR § 1006(f) for an order discharging it after it pays the remaining $ 4,289,336 of ELI Coverage (the "Proceeds") to defendants as directed, or deposits that amount into Court. Federal also seeks a declaration that said payment or deposit exhausts Federal's

[1]For the sake of concision, I will assume the reader's familiarity with the history of this action, which a prior decision sets forth in detail. *See Fed. Ins. Co. v. Kozlowski*, Aug. 15, 2006, slip op. (the "Prior Decision"). I will only summarize those details here. Any additional statements of fact derive from undisputed statements in the motion papers.

liability for ELI Coverage, and an injunction restraining defendants "from taking any action, outside the context of [this case], to obtain payment under the Policy."

In motion sequence # 009, Walsh moves for an order granting him partial summary judgment and declaring that he is entitled to receive all of his Defense Costs, both past and future, from the Proceeds in connection with about sixteen civil proceedings ("the Underlying Lawsuits"). The Underlying Lawsuits include this interpleader action and an action before this Court in which Federal seeks rescission of the Policy. *Fed. Ins. Co. v. Tyco Intl., Inc.*, Index no. 600507/03, Sup. Ct. N.Y. Co. In addition, Walsh seeks a declaration that Federal must defend Walsh in a civil proceeding involving ERISA (the "ERISA Action"), pursuant to the "Fiduciary Coverage" that the Policy provides in addition to ELI Coverage. In opposition, Tyco seeks the entire balance of the Proceeds after Belnick is paid, and contends that Walsh's felony conviction for an offense he committed while serving as a Tyco director bars him from ELI Coverage. Tyco further argues that, in any event, Walsh lost any priority for his claims by submitting his invoices to Federal well after Tyco had begun to submit its invoices.

Although Walsh designates his motion as an application for a declaratory judgment, in effect he seeks an order directing that he be paid both a specific amount for Defense Costs he incurred by October 30, 2006 and the as yet undetermined Defense Costs that Walsh has incurred and will incur after that date. Accordingly, Walsh's motion will be treated as an application for payment, and, as discussed here, all the Proceeds will be apportioned at this time.

Background: underlying claims against Walsh -- The remaining dispute among the parties centers on whether Walsh is eligible for coverage, and if so, whether Tyco's or Walsh's claims to the Proceeds have priority. Walsh served as a director of Tyco and its predecessor in

interest from 1992 to 2002. In December 2002, he pled guilty in New York State Supreme Court to the felony offense of violating the "Martin Act", GBL § 352-c(c)(6), because he had failed to disclose to the Board of Directors that Tyco had paid him a finder's fee of $ 20 million in connection with Tyco's acquisition of The C.I.T. Group, Inc. The Court sentenced Walsh to a conditional release from prison if he returned the finder's fee payment to Tyco and paid New York State, New York City, and the District Attorney of New York County a total of $ 1.5 million as restitution.

The Underlying Lawsuits were brought by and on behalf of Tyco shareholders. The thrust of their claims is that Tyco, Walsh, and the other defendants in the Underlying Lawsuits (the "Underlying Defendants") deceived the shareholders by concealing the size of Tyco's liabilities and inflating its profits, by filing false or misleading statements with the SEC and by using improper accounting practices. Plaintiffs in the Underlying Lawsuits assert claims against the Underlying Defendants based on Federal and state securities law, as well as claims sounding in common law fraud, negligent misrepresentation, breach of fiduciary duty, and waste of corporate assets. Each complaint in the Underlying Lawsuits includes an allegation that Walsh wrongfully received an undisclosed finder's fee.

The ERISA Action was brought on behalf of participants of employee benefit plans that Tyco and its affiliates offered. The complaint alleges that Walsh breached his fiduciary duty to the plans and their beneficiaries by negligently misrepresenting or omitting material information about how the plans managed their assets, and by permitting the plans to imprudently invest in the Tyco Stock Fund. The ERISA Action complaint also refers to Walsh's receipt of his finder's fee.

Invoiced Costs – To date, Federal's payments for ELI Coverage relate to invoices that Belnick and Tyco submitted by January 1, 2006. Since then, Belnick and Tyco have submitted additional invoices, and Walsh submitted invoices for the first time (starting in March 2006). In its motion papers, Federal states that it audited the invoices that the claimants submitted from January 1, 2006 through October 31, 2006 (the "New Invoices") to determine whether they reflect covered Defense Costs and whether the expenses are reasonable. It concludes that Belnick submitted New Invoices reflecting covered Defense Costs of $ 987,261, and that Tyco submitted New Invoices reflecting covered Defense Costs that "substantially exceed" the balance of the Proceeds. Federal adds that Walsh's New Invoices reflect costs totaling $ 1,825,532.21, but makes clear that its audit "does not reflect a determination that Walsh is entitled to coverage under the Policy." Moreover, Federal states that it did not allocate between Walsh's covered and uncovered costs pursuant to Section 12 of the ELI Section of the Policy (the "Allocation Provision"), which provides that, where a "[c]laim. . . includes both covered and uncovered matters," Federal is only required to "advance on a current basis Defense Costs allocated to the covered [l]oss." The Policy further provides that Federal and the claimant will allocate by agreement, or, if they cannot agree, the allocation will be "judicially determined."

Motion for discharge – Tyco and Walsh have consented to Federal's discharge, and Belnick failed to respond to Federal's motion. Accordingly, Federal shall be discharged from liability for ELI Coverage after it pays the defendants the amounts set forth here.

Apportionment of Proceeds – Both Tyco and Walsh acknowledge that Belnick is entitled to receive $987,261 to reimburse his Defense Costs. Accordingly, Federal shall pay that amount to Belnick from the Proceeds. Both Tyco and Walsh lay claim to the balance of $ 3,302,075.

Walsh contends that, before Tyco is paid, he is entitled to receive all Defense Costs incurred through October 31, 2006 ($ 1,825,532.21), as well as Defense Costs incurred since that date. In support, Walsh points to Endorsement No. 14 to the ELI Coverage provision in the Policy, which in relevant part provides that when "Loss, including Defense Costs, from any claim . . . exceeds the remaining available limits of liability" of ELI Coverage, Federal will reimburse individual insureds before reimbursing Tyco (the "Priority Provision").

In response, Tyco first argues that Walsh's criminal conviction excludes him from any ELI Coverage. Tyco points to an exclusion in the Policy for "fraud" that is

> based upon, arising from, or in consequence of any deliberately fraudulent act or omission or any willful violation of any statute or regulation by such [insured person], if a judgment or other final adjudication establishes such a deliberately fraudulent act or omission or willful violation.

Policy, ELI Section at par. 6(b) (the "Fraud Exclusion"). Tyco further relies on a Policy exclusion for claims "based upon, arising from, or in consequence of such [insured person] having gained any personal profit, remuneration or advantage to which such insured person was not legally entitled." Policy, ELI Section at par. 6(c) (the "Personal Profit Exclusion"). Tyco contends that Walsh's Martin Act violation is so interrelated with the other claims against him in the Underlying Lawsuits that the Fraud and Personal Profit Exclusions bar all coverage.

Walsh concedes that the Policy does not cover Defense Costs arising from his Martin Act violation. However, most of the allegations against Walsh in the Underlying Lawsuits are factually and legally distinct from that violation. The plaintiffs in the Underlying Lawsuits allege that Walsh participated with other Tyco directors and officers in misrepresenting Tyco's finances in its public filings and employing improper accounting procedures, and approved excessive cash

and stock bonuses for and interest-free loans to defendants other than Walsh. Those claims bear no direct connection with Walsh's undisclosed receipt of a fee.

Tyco further asserts that, since it submitted certain claims to Federal before Walsh submitted claims, Walsh forfeited his rights under the Priority Provision. Tyco contends that the principle of "first in time, first in right" controls when multiple claimants compete for a limited amount of insurance proceeds. Tyco misapplies the principle. Pursuant to this Court's prior orders, Federal has already paid Tyco more than $ 13 million for invoices Tyco submitted on or before January 1, 2006, and Tyco and Walsh now only seek to be paid for invoices submitted after that date. Tyco makes no showing that it submitted invoices after January 1, 2006 but before Walsh had submitted his.

In any event, the general principle of "first in time, first in right" does not preclude a court from exercising its equitable power when apportioning insurance proceeds among claimants in an interpleader action. *Agric. Ins. Co. v. Matthews*, 301 A.D.2d 257, 260 (1st Dept. 2002); *Boris v. Flaherty*, 242 A.D.2d 9, 13 (4th Dept. 1998). Here, full payment to Walsh would reflect the intent of the Priority Provision to give the claims of Tyco officers and directors priority over those of the company. Moreover, Tyco has recourse to excess insurance coverage if the Proceeds do not fully satisfy its claims.

Accordingly, the Policy covers Walsh for Defense Costs that are not connected with the Martin Act violation. Walsh's total Defense Costs may be allocable between those that are connected with the Martin Act violation, which are excluded from coverage, and those that are connected with the unrelated claims against Walsh, which are covered. However, regardless of the Allocation Provision, Walsh is entitled to be paid for all of his Defense Costs as he incurs

them. If a later judicial allocation determines that Walsh was overpaid, the excess payments can be recovered by Tyco in partial satisfaction of its claim. *See Fed. Ins. Co. v. Kozlowski*, 18 A.D.3d 33, 42 (1st Dept. 2005) (ruling on the timing of payment, allocation, and recoupment for ELI Coverage under the Policy).

Thus all of the audited Defense Costs that are itemized in the invoices Walsh submitted through October 31, 2006 ($ 1,825,532.21) are now payable to him. Walsh is also entitled to future reimbursement for Defense Costs that he incurred after October 2006. In its motion, Federal states that "[i]n the event the Court concludes that an audit of any invoices submitted since October 2006 is necessary to resolve the defendants' competing claims to the remaining [Proceeds], Federal, at the Court's direction, will audit those invoices." Such an audit is necessary, and accordingly Federal is directed to (1) audit the invoices that Walsh submitted from November 2006 through the date of this decision and (2) after paying Belnick and Walsh as directed below, retain the balance of the Proceeds pending the further distribution order of the Court.

Finally, Walsh applies for a declaration that the Fiduciary Coverage in the Policy requires Federal to defend Walsh in the ERISA Action. The application is denied because this is the wrong action in which to seek that ruling. This interpleader action only concerns the proceeds of ELI Coverage. Walsh may pursue his application elsewhere.

Settle order (1) directing that Federal be fully discharged from liability for ELI Coverage under the Policy once it has (a) paid Belnick $987,261 and Walsh $ 1,825,532.21 from the

Proceeds and (b) within 30 days of the date of this decision, audited the claims for ELI Coverage that Walsh has submitted from November 2006 through the date of this decision and report on its audit to the parties and the Court; and (2) further directing that upon discharge Federal shall retain the balance of the Proceeds to the credit of this action pending the further order of the Court.

The parties are directed to appear for a status conference before the Court on June 5, 2007 at 9:30 a.m.

Dated: April 23, 2007

Enter:

Helen E. Freedman, J.S.C.