UNITED STATES DISTRICT C OURT
EASTERN DISTRICT OF KENTUCKY AT LONDON

To Be Filed Electronically

Ins2 [redacted] INSURANCE COMPANY and Ins1 [redacted] INSURANCE COMPANY Plaintiffs v. Client [redacted] Client [redacted] ET AL Insured Defendants	MEMORANDUM IN SUPPORT OF MOTION FOR PARTIAL SUMMARY JUDGMENT AGAINST Ins4 [redacted] NO. [redacted]

Come the Defendants and Third- Party Plaintiffs, Client [redacted] ("Client [redacted] James C. Client [redacted] ("Mr. Client [redacted] and L. Ray Client [redacted] ("Mr. Client [redacted] (collectively the "Insured Defendants") by and through counsel, and for their Motion for Summary Judgment against Ins4 [redacted] Indemnity Company ("Ins4 [redacted] and state as follows:

INTRODUCTION

Ins4 [redacted] entered into a contract to provide insurance to the Insured Defendants pursuant to the terms, conditions, and exclusions of Policy No. [redacted] ("the Policy") (attached at Exhibit 1). Ins4 [redacted] has not fulfilled its duties to indemnify and defend the Insured Defendants under the Policy, attempted to make an agreement which would require Client [redacted] to pay part of Ins4 [redacted] defense obligation contrary to the requirements of the Policy, and forced the Insured Defendants to institute litigation to compel Ins4 [redacted] performance under the Policy.

The Policy affords coverage to the Directors and Officers of Client as well as to Client itself pursuant to its insuring agreements.[1] Both Mr. Client and Mr. Client meet the definition of Directors and Officers contained in the Policy:

> any person who was, now is, or shall become: (a) a duly elected or appointed director, officer, or similar executive of the Company, or any member of the management board of the Company; (b) a person who was, is or shall become a full-time or part-time employee of the Company; and (c). the functional equivalent of directors or officers of a Company incorporated or domiciled outside the United States of America.
>
> (Ins4 D&O Policy Exhibit 1 at Page 2).

As described on the Client website, a printed copy of which is attached at Exhibit 2, Mr. Client is the President and Chairman of Client and Mr. Client is a director of Client Each of these men is covered by the Directors and Officers coverage, yet Ins4 has never appointed counsel to defend Mr. Client or otherwise met its defense obligations to him.

Ins4 duties to indemnify and defend the Insured Defendants were triggered by the commencement of three separate but intimately related actions against the Insured Defendants for allegedly wrongful conduct arising out of the purchase of certain repossessed assets. These actions are:

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[1] The Insuring Agreement states: (1.) The Insurer shall pay the Loss of the Directors and Officers for which the Directors and Officers are not indemnified by the Company and which the Directors and Officers have become legally obligated to pay by reason of a Claim first made against the Directors and Officers during the Policy Period or, if elected, the Extended Period, and reported to the Insurer pursuant to Section E.1. herein, for any Wrongful Act taking place prior to the end of the Policy Period. (2) The Insurer shall pay the Loss of the Company for which the Company has indemnified the Directors and Officers and which the Directors and Officers have become legally obligated to pay by reason of a Claim first made against the Directors and Officers during the Policy Period or, if elected, the Extended Period, and reported to the Insurer pursuant to Section E.1. herein, for any Wrongful Act taking place prior to the end of the Policy Period. and (3.) The Insurer shall pay the Loss of the Company which the Company becomes legally obligated to pay by reason of a Claim first made against the Company during the Policy Period or, if applicable, the Extended Period, and reported to the Insurer pursuant to Section E.1. herein, for any Wrongful Act taking place prior to the end of the Policy Period

- [redacted] *Inc. v* [redacted] *et al.* filed the 7th day of January, 2013 in Jefferson Circuit Court, Jefferson County, Kentucky as Civil Action No. [redacted] ("the [redacted] Action")

  [redacted] *v* [redacted] *et al.* filed the 6th day of March 2013 in the Eastern District of Kentucky as Civil Action No. [redacted] ("the [redacted] Equipment Action") and

- [redacted] *v* [redacted] *et al.* filed in the Court of Common Pleas of [redacted] County, Pennsylvania, removed to the Middle District of Pennsylvania, and ultimately transferred to the Eastern District of Kentucky and consolidated with the [redacted] Equipment Action (the "[redacted] Inventory Action").

The actions set forth above are collectively referred to herein as the "Foreclosure Actions." The claims alleged by the plaintiff in the [redacted] are: (Count I) Breach of Contracts, (Count II) Breach of Oral Contracts, (Count III) Fraud, (Count IV) Tortious Interference with Contract Between [redacted] and [redacted] (Count V) Tortious Interference with [redacted] Contract (Count VI) Conversion of [redacted] Property, (Count VII) Declarations of Rights (Count VIII) Tortious Interference with Contract Between [redacted] and [redacted] (Count IX) Tortious Interference with Prospective Business Advantage, (Count X) Breach of Fiduciary Duty (Count XI) Defamation (Count XII) Intentional Conduct by Defendants, [redacted] for Punitive Damages (Count XIII) Tortious Interference With Contract Between SC Fundamental And [redacted] (Count XIV) Injunctive Relief (Count XV) Attorney Fees (Count XVI) Violation Of RICO, Section 1962 (C) (XVII) Violation of Kentucky Uniform Trade Secrets Act KRS 365.880- 365-900, (Count XVIII) Aiding and Abetting Breach of Fiduciary Duty Against [redacted]

The claims asserted in the [redacted] Equipment Action are (Count I) Declaration of Rights that Defendants Do Not Possess Any Right Title or Interest to the [redacted] Equipment, (Count II) Tortious Interference with a Contract by [redacted] (Count III) Tortious interference

with a Contract by Client and Client (Count IV) Conversion of the Smith Equipment by Client (Count V) Conversion of the Smith Equipment by Client or Client (Count VI) Intentional Conduct by Client Supporting Punitive Damages, (Count VII) Intentional Conduct by Client and Client Supporting Punitive Damages. The Claims Asserted In The Smith Inventory Action Are: (Count I) Declaration Of Rights That Defendants Do Not Possess Any Right Title Or Interest To The [redacted] Inventory, (Count II) Conversion Of The [redacted] Inventory By Client and (Count III) Replevin.

Virtually every conceivable business related tort is alleged either directly or indirectly in the Foreclosure Actions. The wrongful acts on the part of Insured Defendants alleged in these lawsuits (even though the allegations are false) are exactly the kind of claims for which Client purchased insurance from Ins4 As shown below, Ins4 arguments against coverage are without merit, and with the duty to provide coverage comes the even broader duty to defend the claims made in the Underlying Litigation.

STATEMENT OF FACTS[2]

From approximately February 2012 to August 2012, Client through its president, Mr. Client engaged in negotiations with [redacted] president of Acme Inc., regarding the possible organization of a joint venture for the manufacture and sale of insulated building panels using Acme designs. The plan was that Client would provide the manufacturing space (in [redacted] Kentucky), employees, manufacturing expertise, and necessary working capital (to move equipment, repair equipment, buy raw materials, pay employees, etc.) and that Acme would contribute its manufacturing equipment, inventory and patents to the joint venture. The joint venture ultimately never occurred. Mr. Client a member of the board of directors of Client (and former chief financial officer of Client participated on behalf of Client to a limited degree in

[2] Many of the factual allegations contained herein are supported by the Affidavit of Counsel attached at Exhibit 3.

these negotiations. At the time, Mr. [redacted] was also executive vice president of [redacted] a lending institution with its principal offices in London, Kentucky.

The [redacted] manufacturing equipment was located in a leased building in [redacted], Pennsylvania. The [redacted] manufacturing operations terminated in approximately 2006 because of lack of funding. [redacted] was insolvent, had no significant sales or long-term contracts, and had secured debt of approximately $7 Million owed to [redacted] I, LP ([redacted]").

Sometime after the negotiations terminated, [redacted] purchased the [redacted] indebtedness to [redacted] which was in default, and repossessed the [redacted] assets in [redacted] After notice to [redacted] sold those assets on January 24, 2013 to [redacted], LLC. a wholly owned subsidiary of [redacted] ([redacted] has since been dissolved and all of its assets and liabilities have been transferred to [redacted]

[redacted] filed its lawsuit in the Jefferson Circuit Court on January 7, 2013 against [redacted] ("[redacted]"), [redacted], [redacted] and [redacted] was later added as a party. The original [redacted] has been amended three times, and the most up to date version, containing 18 numbered counts, and 199 numbered paragraphs, is attached at Exhibit 4. It alleged, among other things, that: (a) the roll former repossessed and sold belonged to [redacted] and that this repossession interfered with [redacted] contracts with Mr. [redacted] (Exhibit 4 at ¶141), and (b) the [redacted] panel inventory repossessed and sold belonged to [redacted] investments, LLC ("[redacted]") and that this repossession interfered with [redacted] contracts with [redacted]

[redacted] (Exhibit 4 at ¶ 169). On or around March 6, 2013, Mr. Smith brought his own lawsuit against Client [redacted] Client and Client [redacted] for conversion of the roll former in this Court (Case: 6:13-cv-00047-DLB). The Complaint in this action is attached at Exhibit 5. Still later, Mr. Smith purchased the [redacted] inventory claims and filed an action in Pennsylvania against Client [redacted] Client and Client [redacted] for conversion of the inventory. The Complaint in that action is attached at Exhibit 6. That lawsuit was removed to the U.S. District Court for the Middle District of Pennsylvania, was transferred to this Court (Case: [redacted]), and was consolidated with Mr. Smith 's roll former claim. Mr. Smith 's inventory claims have been settled.

At the time of the alleged wrongful repossession and sale, Client had policies with the following insurers in addition to the Ins4 Policy: Ins2 [redacted] and Ins3 [redacted] Company.

Client [redacted] Client (and Mr. Client [redacted] and Mr. Client in the Acme Action) have selected their own independent counsel[3] (hereafter "Independent Counsel") to defend the Foreclosure Actions and have demanded that each of their insurers pay for the costs and fees of Independent Counsel. No insurer has yet agreed to pay Independent Counsel. Independent Counsel has done the bulk of all the legal work done in all of the Foreclosure Actions – all of the discovery requests, all of the discovery answers, virtually all of the briefing, substantially all of the questioning in all of the depositions taken in all of the Foreclosure Actions.

In a letter (attached as Exhibit 7), dated May 14, 2014 Ins4 [redacted] listed the following reasons for its failure to indemnify and pay defense costs for the Insured Defendants: (i) the Policy excludes claims arising from breach of contract, (ii) the Policy excludes claims involving

[redacted], P.S.C. and Duane Cook and Associates, PLC.

misappropriation of a copyright, patent, trademark or trade secret, (iii) the Policy excluded claims brought by a joint venture participant, (iv) that Mr. Client is not an insured, (v) the Policy excludes claims arising from packaging, selling marketing and distributing of products, (vi) the Policy excludes claims arising from an Officer or Director's service in companies other than Client (vii) the Policy excludes claims arising from fraud or dishonest conduct of Client or gaining a profit through deceit by the Directors and Officers, (viii) the Policy excludes claims based on property damage, including the loss of use of property, whether or not such property is physically injured, (ix) the Policy excludes claims arising from rendering or failing to render professional services, and (x) Ins4 is not liable for any sums which do not constitute covered loss.

In the May 14, 2014 letter, Ins4 also proposed a 50% allocation of fees of Smith [redacted], a law firm engaged by Ins4 to represent Client Ins4 refused to pay the Insured Defendants counsel in the Foreclosure Actions, and indeed refused to pay fully for the counsel Ins4 itself hired. Client never agreed to any allocation of defense costs, insisting that all such costs be paid by Ins4 as provided in the Policy.

In a second letter dated November 10, 2014 (attached as Exhibit 8), Ins4 sent an additional letter detailing its interpretation of the coverage issues in the Smith cases, and once again reserving its rights. It asserted that it had no duty under the Policy because (i) the Policy excludes claims based on property damage, including loss of use of property (identical to (viii) above), (ii) the Policy excludes claims arising from fraud or dishonest conduct of Client or gaining a profit through deceit by the Directors and Officers, (identical to (vii) above) and (iii) Ins4 is not liable for any sums which do not constitute covered loss, (identical to (x) above).

ARGUMENT

I. Ins4 HAS A DUTY TO INDEMNIFY THE INSURED DEFENDANTS.

The coverage under the Policy may be summed up very simply: wrongful acts are covered unless excluded. As shown below, none of the alleged wrongful acts asserted in the Foreclosure Actions are excluded. Therefore, Ins4 has a duty to cover all of the alleged wrongful acts asserted in the Foreclosure Complaints.

Ins4 reasons (i), (ii), and (v) listed above, and contained in its May 14, 2014 letter all stem from exclusions which by their own terms apply only to insuring clause A.3 which provides coverage for Client under the Officers and Directors coverage. (See footnote 1 above). These exclusions do not affect the coverage of Mr. Client and Mr. Client in any way.

(i) Breach of contract exclusion

While some claims, such as Acme claims for breach of the non-circumvention/non-disclosure agreements do assert a breach of contract, or arise from such alleged breach, a majority of the claims asserted in the Foreclosure Actions are unconnected to any alleged contract breach. Conversion, which is at the heart of each of the Foreclosure Actions is not a claim which arises from a breach of contract. As the 5th Circuit pointed out, in a case involving Ins4 "the duty not to convert another's property is imposed as a matter of law without regard to the existence of a contract." *Alert Centre, Inc. v. Alarm Protection Services, Inc.*, 967 F.2d 161, 165 (5th Cir. 1992). In that case, Ins4 breach of contract exclusion was found not to apply to conversion, because though the conversion claim was related to a contract, it did not arise from or result from a breach of contract. If the contract language is ambiguous, it must be liberally construed to resolve any doubts in favor of the insured. *Jones v. Bituminous Casualty Corp.*, 821 S.W.2d 798, 802 (Ky. 1991).

> "Results from" language in an exclusion in an insurance policy is construed as requiring that the underlying claim "not have arisen but for" the excluded type of claim or the underlying claim "necessarily arises from" the excluded misconduct. "Arising out of" is ambiguous and, when used in an exclusion, should be construed as requiring but for causation since that favors the insured.

Axiom Ins. Managers, LLC v. Capitol Specialty Ins. Corp., 876 F. Supp. 2d 1005, 1007 (N.D. Ill. 2012).

Here, the claims for conversion against Client arise from a purchase of equipment and inventory. Acme cannot claim that the purchase of its equipment is in any way related to the agreements Client entered with Acme Mr. Smith's claims for conversion do not relate to any contract at all, as Client never had a contract with him which it could possibly breach. The genesis of his claims against Client are that Client or its subsidiary purchased equipment from Client [redacted] which that entity had no right to sell. As Mr. Smith claims that Acme had no interest in the inventory and equipment in which he asserts a right, the claims against Client for conversion could not possibly arise from OVC's contracts with Acme Neither Acme nor Mr. Smith can argue that but for Client breaching some contract, that their conversion claims would not exist.

Additionally, the fraud claim as asserted in Acme complaint does not rely on any agreement between the parties or otherwise, but rather on representations allegedly made by the Insureds in emails. Acme claims for defamation likewise arise from acts which did not breach any contract. The duties not to defame and not to commit fraud come not from any contract, but from state tort law and the common law.

(ii) Patent and Proprietary intellectual property exclusion

This exclusion again applies only to Client having no effect on coverage for Mr. Client or Mr. Client As shown below, this exclusion is inapplicable to any claims in the Underlying

litigation. Ins4 asserted in its May 14, 2014 letter that the Acme Action is "based upon, arises out of, is attributable to, directly or indirectly results from, is in consequence of, and involves defendants' infringement and/or misappropriation of Acme patented and proprietary intellectual property." This statement is meant to exclude coverage on the basis of the exclusion contained at Section C.2.b.i of the Policy, but is in fact mistaken. While many of Acme claims relate to the taking of proprietary information, this exclusion applies specifically to the taking of intellectual property of "products, technologies or services". See Section C.2.b.i.

Acme claims consist primarily of the alleged wrongful taking of financial information, customer lists and information about potential contracts and business relations of Acme The alleged misappropriation of this type of information is outside the specific language of the exclusion Section C.2.b.i.

(iii) Exclusion for claims made by a joint venture participant

Ins4 asserted in its letter of May 14, 2014 that as Acme had alleged that it and Client been involved in joint venture discussions with regard to Client Manufacturing, that exclusion C. l.e. applied to exclude coverage for the claims of Acme A thorough review of Acme complaint reveals that it never alleged it was a joint venture participant with Client In fact it alleged that it could not conclude a deal to become a joint venture participant: "During the summer and early fall of 2012, Acme concluded that no deal was possible." Numerical paragraph 14 of Acme original complaint.

(iv) Mr. Moncrief's status as an insured.

Mr. Client is covered by the Ins4 Directors and Officers coverage because he is a Director of Client This argument has already been addressed in the introduction by way of reviewing the definition of Officers and Directors, and no further comment needs to be made.

(v) Exclusion for liability based on sale, manufacture, or production of products.

While Acme apparently alleges that Client has sold the repossessed Acme inventory, the exclusion for products sold, contained at Section C.2.b.ii. of the Ins4 policy is no bar to coverage. First, it is important to note that no plaintiff in the Foreclosure Actions has alleged that the equipment supposedly converted from Acme and from Mr. Smith has been sold. The only allegations of sales by Client relate to inventory. This ends the inquiry of whether this exclusion bars coverage for the conversion claims in the Foreclosure Actions, because these claims are based in part on conversion of property which has never been alleged to be sold.

Moreover, the claims for conversion of the inventory remain covered regardless of whether the inventory has been sold by Client The exclusion uses the same "resulting from" language as discussed in *Axiom Ins. Managers, LLC v. Capitol Specialty Ins. Corp*., 876 F. Supp. 2d 1005, 1007 (N.D. Ill. 2012), supra. This language has been interpreted to require but-for causation. Here the conversion claims exist based on the **purchase** by Client of the allegedly converted inventory, and any subsequent sale of the inventory is irrelevant to whether the claim would exist. Consequently, Ins4 cannot say that any alleged sale by Client is the but-for cause of the claims for conversion, thus this exclusion is inapplicable.

(vi) Exclusion for liability based on acts of an Officer or Director While Serving in an Outside Entity.

At most this exclusion could only apply to claims involving Mr. Client Mr. Client did not serve in any other entity to give rise to any claims in the Foreclosure Actions. This exclusion cannot affect OVC's coverage, given the clause at the conclusion of the exclusions section of the D&O coverage which states: "No Wrongful Act of one or more Insureds shall be imputed to any other Insureds for the purpose of determining the applicability of any of the

above exclusions." While this exclusion could only potentially apply to Mr. Client it seems inapplicable to him, as well, as no claims against him in the underlying Action depend upon his involvement in the transaction in his role with Client In fact, in Acme Complaint, Client is alleged to be a third-party signatory of the NDAs, "as a result of his relationships with Client and Client

(vii) Exclusion for Fraudulent or Dishonest Acts.

Ins4 exclusion at Section C.1.f states that Ins4 will not be liable for any dishonest, deliberately fraudulent, or criminal act of any insured, or the gaining of any profit, remuneration or financial advantage to which any directors and officers were not legally entitled. This exclusion by its own terms does not apply "unless and until there is a final judgment… as to such conduct" C.1.f. This exclusion cannot justify a denial of coverage at this stage as no final judgment has been reached in any of the Foreclosure Actions. This section in fact contemplates Ins4 paying defense costs notwithstanding this exclusion, as it provides a method to recover such costs from the insureds if a final judgment is eventually entered against them. Moreover, even if such a final judgment were to ever be reached, the Policy states that "No Wrongful Act of one or more Insureds shall be imputed to any other Insureds for the purpose of determining the applicability of any of the above exclusions." Even if a final judgment against one of the Insured Defendants was entered, the coverage of the remaining insureds would remain unaffected.

(viii) Exclusion for Property Damage

None of the plaintiffs in the Foreclosure Actions has alleged any cause of action which appears to be or purports to be property damage. It is therefore odd to find the property damage exclusion contained in Section C.1.a listed as a justification for refusal to provide coverage or to

defend the Insured Defendants. Perhaps Ins4 [redacted] interprets the claims of conversion alleged in each of the Foreclosure Actions as property damage within the meaning of the exclusion. If so, that has repeatedly been shown to be a mistake. “Three state supreme courts and two other courts of appeal have held that "conversion" is not "property damage." Rather, noted these courts, "conversion" is the taking or deprivation of property.” *Collin v. American Empire Ins. Co.*, 21 Cal. App. 4th 787, 817 (Cal. App. 2d Dist. 1994). In *Collin*, the trial court interpreted a similar definition of property damage to Ins4 [redacted] and was scolded for making the same mistake Ins4 [redacted] appears to have made: “Despite the overwhelming weight of cases from other states holding that "conversion" is not "property damage," the trial court found that "conversion" constitutes "loss of use" of property, and thus falls within the second prong of the "property damage" definition.” *Id* at 817.

The Court in *Westport Ins. Corp. v Cotten Schmidt, LLP* 605 F. Supp. 2d 796 (N.D. Tex. 2009), explained the interpretation of property damage exclusions as they relate to conversion this way:

> In the current case, the Court is faced with interpreting "loss of use" in the context of an exclusion. An insurance policy's exclusions are construed against the insurer in favor of coverage. See Barnett, 723 S.W.2d at 666. The Court concludes that if "loss of use" does not include conversion-type claims when construed favorably to the insured, a fortiori, the phrase cannot be taken to exclude coverage for conversion type claims when being construed against the insurer.

Westport Ins. Corp. v. Cotten Schmidt, LLP, 605 F. Supp. 2d 796, 809 (N.D. Tex. 2009).

(ix) Exclusion for claims arising from the rendering of or failure to render professional services.

This exclusion cited by Ins4 [redacted] as a potential reason to deny coverage is inapplicable to any of the claims in the Foreclosure Actions, and is no bar to coverage.

(x) The definition of Loss

Ins4 did not identify any amounts which fall outside the definition of "Loss" in the Policy. The Insured Defendants have no reason to believe any amounts sought in the Foreclosure Actions fall outside the definition, and consequently all amounts sought appear to be covered.

II. Ins4 HAS A DUTY TO DEFEND THE INSURED DEFENDANTS IN THE FORECLOSURE ACTIONS, AND TO PAY FOR INDEPENDENT COUNSEL CHOSEN BY THE INSUREDS.

Kentucky courts are clear that the duty to defend is broader than the duty to indemnify. *James Graham Brown Found., Inc. v. St. Paul Fire & Marine Ins. Co.*, 814 S.W.2d 273, 279–80 (Ky.1991). Indeed, an insurer has a duty to defend if allegations are made which "potentially, possibly or might come within the coverage of the policy." *Id.* at 279 (citing *O'Bannon v. Aetna Cas. & Sur. Co.*, 678 S.W.2d 390, 392 (Ky.1984)). (Emphasis supplied). As discussed in the coverage section above, it is beyond clear that some allegations at least potentially fall within coverage. In fact most fall squarely within the coverage provided by the Policy, but under Kentucky law, if even one claim might be potentially covered, Ins4 duty is to defend all claims. "In most cases, this means that an "insurer must bear the entire costs of defense when 'there is no reasonable means of prorating the costs of defense between the covered and not-covered items." Forty-Eight Insulations, 633 F.2d at 1224 (quoting Nat'l Steel Constr. Co. v. Nat'l Union Fire Ins. Co., 14 Wn. App. 573, 543 P.2d 642, 644 (Wash. Ct. App. 1975)). *Ky. League of Cities Ins. Servs. Ass'n v. Argonaut Great Cent. Ins. Co.*, 2013 U.S. Dist. LEXIS 2663, 11-12 (W.D. Ky. Jan. 7, 2013).

In addition to the duty to defend as a general proposition, Kentucky law and multiple other authorities have made clear that where a conflict exists between the insurer and insured, the insured is entitled to independent counsel of his own choosing. See, *O'Bryan v. Leibson*, 446

S.W.2d 643 (1969). This is certainly true where an insurer defends under reservation of rights and the underlying litigation contains allegations of claims that are covered and claims that are not covered under the liability policies. Such is the case here. In such a case the insurer must provide independent defense counsel chosen by the insured.

The American Law Institute has been developing the *Principles of the Law of Liability Insurance* for several years now. When completed, this work will be the American Law Institute's definitive statement of what it believes the law should be on liability insurance. The chief difference between the *Principles* and a *Restatement*, is that the *Restatements* are declarative: summarizing what the law is in areas where there is a general consensus. Principles on the other hand are normative: seeking to set forth best practices, and declare what the ALI, through its deliberative process thinks the law ought to be. See, Aylward and Masters "A "Principled Approach to Coverage? *The American Law Institute and Its "Principles of the Law of Liability Insurance"* Insurance Coverage and Practice (DECEMBER 2013). The quoted sections were approved by the Members at the 2014 meeting, and according to the ALI website: "These sections may be cited as representing the Institute's position until the official text is published."

> (1) When an insurer with the duty to defend provides the insured notice of a ground for contesting coverage under § 17 and when there are common facts at issue in the claim and the coverage defense such that the claim could be defended in a manner that would advantage the insurer at the expense of the insured, the insurer must provide an independent defense of the claim.

Principles of the Law of Liability Insurance § 18 TD No 2 (March 28, 2014).

In the following section, § 19, the Principles of the Law of Liability Insurance discusses this duty further:

> When an independent defense is required under § 18: (1) The insurer does not have the right to defend the claim; (2) The insured may select defense counsel and related service providers; (3) The insurer is obligated to pay the reasonable fees of the defense counsel and related service providers on an ongoing basis in a timely manner.

Principles of the Law of Liability Insurance § 19 TD No. 2 (March 28, 2014).

The Official Comment to § 19 above states: "[t]he rule giving the insured the right to select the independent defense counsel is the majority rule." Principles of the Law of Liability Insurance § 19 Comment (a) TD No. 2 (March 28, 2014).

> Many conflict of interests cases arise in the situation where the complaint filed against the insured contains allegations which are potentially both within and outside policy coverage. Often in such a situation the insurer will seek to defend only on the grounds that remove the insured from coverage, whereas the insured will seek a defense on any grounds. The courts have almost uniformly concluded that the existence of such a conflict obligates the insurer to assume the cost of retaining independent counsel for the insured.

50 A.L.R.4th 932 "Duty of insurer to pay for independent counsel when conflict of interest exists between insured and insurer."

From the standpoint of pure practicality, in this case the counsel chosen by the Insured Defendants has a long-standing relationship with the Insured Defendants, is familiar with the facts of the underlying cases and with the transactions which gave rise to the claims asserted therein. Nobody is more capable of representing the Insured Defendants in the Foreclosure Actions. In fact, Counsel selected by the Insured Defendants can try the Foreclosure Actions more efficiently than can multiple insurance company hired law firms and lawyers who have to get up to speed on the underlying cases, and who through sheer numerosity have difficulty even coordinating their efforts. It is inconceivable that this case could be more effectively tried by committee than by the Counsel chosen by the Insured Defendants.

Ins4 has a duty to pay the defense counsel chosen by Mr. Client because it failed to tender a defense to Mr. Client at all, even after being informed he was covered by the Policy. While the Policy states that "It shall be the duty of the Insurer and not the duty of the Insureds to defend any Claim", any right granted to Ins4 by that statement was waived when Ins4 chose to breach its contract with the Insured Defendants and abandon Mr. Client

III. THE WRONGFUL ACTS ALLEGED IN THE FORECLOSURE ACTIONS ARE INTERRELATED.

Clearly all the claims in all the Foreclosure Actions arise "out of the same [allegedly] wrongful act, interrelated [allegedly] wrongful acts, or a series of similar or related [allegedly] wrongful acts" – the purchase by Client of the Acme indebtedness to Fortress and the subsequent repossession of the Acme collateral and sale of that collateral to Client Manufacturing and ultimately to Client The primary defense to all the claims made in all the Foreclosure Actions will be (and in the case of the Smith Inventory Action was) that Client had the right to purchase the Acme indebtedness from Fortress and the right to then repossess and sell the Acme collateral.

This relatedness of the claims and defenses in the Foreclosure Actions will have a number of consequences. First, the defense costs incurred in the Smith Inventory Action will be covered by the D&O Policy even though that action was filed after the end of the coverage period. (The D&O Policy Period extended from July 1, 2011 to July 1, 2013 [See, Exhibit 1 "Common Policy Declarations"] and the Smith Inventory Action was filed February 25, 2014.)

Second, the inter-relatedness of the claims will severely complicate (for the insurance companies) the allocation of settlement costs or losses should Acme or Mr. Smith recover anything on their claims. Counsel will be filing summary judgment motions against other

insurance carriers in this action. All have a duty to defend their insureds in the Foreclosure Actions and all have a duty to pay for counsel chosen by the insureds. As will be shown, the Insured Defendants have coverage to the limits on each of their policies.[4] Unless and until the losses of any one insured defendant exceed the coverage limits of the applicable policy or polices (which seems unlikely), no insured defendant will have any material insurance coverage gap in these cases. The policies issued to the Insured Defendants provide coverage of substantially all the claims made in Foreclosure Actions – imposing a duty to indemnify the Insured Defendants. The insurance companies must pay for the defense of these cases and must pay counsel chosen by the Insured Defendants; the insurance companies can recover their costs of defending claims that are clearly not potentially covered only if those costs were incurred solely in defense of the non-covered claims. See, *Buss v. Superior Court*, 939 P.2d 766 (CA. 1997) and *Travelers Property Cas. Co. of America v. Hillerich & Bradsby*, 598 F.3d 257 (6th Cir. 2010) (applying *Buss*, *supra*, in a Kentucky case). However, all the claims and defenses in these cases are so interconnected that there will not be any costs or fees that can be said to have been incurred solely in connection with a non-covered claim. In other words, at the end of the day, all of the insurance companies are going to have the duty to defend, the duty to pay Independent Counsel and the duty of indemnify all of the Insured Defendants with respect to all or virtually all of the claims made in the Foreclosure Actions. The allocation of defense costs and losses among the insurers will be an issue for another day. This brief addresses only the responsibility of Ins4 [redacted] which will more likely than not overlap the responsibilities of the other insurers.

[4] Another effect of the interrelated nature of the claims asserted in the Underlying Actions is that rather than Ins4 [redacted] being required to pay to the limits of its coverage three times, it would only have to pay to the limits of its coverage once.

CONCLUSION

This Court should grant Insured Defendants summary judgment against [redacted] and hold: (a) that [redacted] is obliged to reimburse Insured Defendants for its defense costs incurred in the Foreclosure Actions to date (including fees paid by Insured Defendants to Independent Counsel) in an amount to be hereafter determined by the Court after the submission and review of costs and billings of Independent Counsel (b) that [redacted] is obliged to advance defense costs incurred by Insured Defendants and Independent Counsel hereafter in defending against the Foreclosure Actions, and (c) that [redacted] is obliged to cover any losses incurred by Insured Defendants or Mr. [redacted] in connection with any claim made in the Foreclosure Actions.

Respectfully Submitted,

/s/ D. Duane Cook

D. Duane Cook
John M. Sosbe
Duane Cook and Associates
135 N. Broadway
Georgetown, KY 40324
Telephone: (502) 570-0022
Facsimile: (502) 570-0023
duane@duanecookandassociates.com
john@duanecookandassociates.com

Counsel for Insured Defendants

CERTIFICATE OF SERVICE

I hereby certify that on April 30, 2015, a copy of the foregoing was filed with the Clerk of Court via the Court's ECF system, which will serve notification of such filling on all counsel of record.

/s/ D. Duane Cook