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IN THE SUPREME COURT OF THE STATE OF DELAWARE

XL SPECIALTY INSURANCE COMPANY, *et al.*,

Defendants-Below,
Appellants,

v.

WMI LIQUIDATING TRUST,

Plaintiff-Below,
Appellee

Appeal No. 449, 2013

Court Below: Superior Court for the State of Delaware
C.A. N12C-10-087 MMJ CCLD

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Dated: December 17, 2013

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NATURE OF PROCEEDINGS

Washington Mutual, Inc. ("WMI"), paid over $15 million in premiums for $250 million in insurance coverage under a series of insurance policies (the "Policies") purchased from the defendant insurers (the "Insurers"). WMI purchased these Policies to provide liability insurance coverage for itself, and its directors and officers (the "D&Os") for claims against them in their capacity as D&Os. Because the Insurers have repudiated coverage, WMI has been forced to reserve $18.2 million to cover claims against the D&Os and thereby continue to accrue interest on and withhold payment to its beneficiaries on their claims.

WMI Liquidating Trust (the "Trust"), WMI's legal successor, sued to vindicate the contract right to coverage for a $500 million claim (the "Asserted Claim"), which the Insurers have denied. Despite the Insurers' repudiation of coverage obligations, the Trust's status as purchaser of the Policies, and a concrete dispute over the applicability of the exclusions on which the Insurers rely, the Insurers moved to dismiss the Trust's action on standing and ripeness grounds. The Superior Court's Order of July 30, 2013 denied the Insurers' motion (the "Order," attached as Ex. A to the *Appellants' Opening Brief* ("AOB")). The Superior Court, on August 23, 2013, and this Court, on September 9, 2013, granted leave for an interlocutory appeal.

SUMMARY OF ARGUMENT

1. **Denied**. The Trust, the purchaser of the Policies, denies that it lacks standing to sue for breach of contract and declaratory relief based on the Insurers' repudiation of their defense and indemnity obligations. Insurance policy purchasers, like all promisees, may sue for breach of contract when their promisors repudiate their contractual obligations. This is as true of liability policies as it is of any other contract involving an intended third-party beneficiary: such contracts are enforceable by ***both*** the promisee and any intended third party beneficiary. *Wedtech Corp. v. Fed. Ins. Co.*, 740 F.Supp. 214 (S.D.N.Y. 1990); *Fed. Sav. & Loan Ins. Corp. v. Oldenburg*, 671 F.Supp. 720 (D. Utah 1987). That insurance proceeds will be payable to or for the benefit of D&Os rather than the Trust if coverage is established does not diminish the harm that is being ***suffered by the Trust*** on account of the Insurers' wrongful withholding of that insurance coverage. The Trust has suffered monetary damages from the Insurers' denial of coverage for the Asserted Claim, being required to reserve $18.2 million otherwise distributable to the beneficiaries of the Trust to indemnify the D&Os from claims for losses covered by the Policies. These monies can be released from reserve only if the Trust establishes the existence of insurance coverage.

2. **Denied**. The Trust denies that no actual controversy exists between it and the Insurers.

(a) The Trust denies that in seeking to establish coverage it is asserting the rights of D&Os, rather than its own rights as the purchaser of the Policies. There is nothing speculative or otherwise "unripe" about the harm the Trust has suffered by the Insurers' coverage denial. That harm is its present obligation to maintain $18.2 million of otherwise distributable funds in reserve in respect of indemnity claims filed by WMI's former D&Os until coverage of the Asserted Claim is established.

(b) The Trust denies that the Superior Court abused its discretion in finding the Trust's coverage claims to be sufficiently ripe to warrant declaratory relief. A "Claim" within the meaning of the Policies has been properly tendered, and the parties to this action dispute coverage of that Claim. The Asserted Claim is based on the wrongful transfer of $500 million in WMI funds to an insolvent affiliate shortly before its seizure by federal authorities. The D&Os' potential liability for that wrongful act is measured by the amount of assets so wasted—$500 million. The Policies afford only $250 million in coverage; the potential liability here greatly exceeds all policy limits. As the Superior Court determined, there is a reasonable possibility that the disputed insurance will be practically implicated, which supports a finding that the Trust's coverage claims are ripe for adjudication.

STATEMENT OF FACTS

A. WMI Purchased $250 Million of Coverage from the Insurers

Before its bankruptcy, WMI purchased the Policies from the Insurers for $15,156,500 in premiums. The Policies cover "Claims" reported from May 1, 2008 to May 1, 2009. A17-25. The Policies define "Claims" to include "a written demand for monetary or non-monetary relief." A48, A103. "Defense costs" or "defense expenses" incurred in connection with written demands, not only lawsuits, are covered "losses" under the Policies. *See, e.g.*, A49-50, A104-05.

B. The Insurers Denied Coverage of the Timely Asserted Claim

On September 10, 2008, during the Policies' term, the D&Os approved the "September Downstream," a transfer of $500 million from WMI to Washington Mutual Bank ("WMB"). A14. The D&Os knew or should have known that the September Downstream was "purposeless, reckless and wasteful." A14-15

On September 26, 2008, WMI filed for bankruptcy in the Bankruptcy Court for the District of Delaware (the "Bankruptcy Court"). A27. On April 27, 2009, also during the Policies' term, the Creditors Committee in WMI's bankruptcy case, acting as the authorized representative of WMI's bankruptcy estate, gave written notice to WMI and certain D&Os that the September Downstream was a source of liability. A14, A28. WMI and the D&Os in turn provided timely notice to the Insurers of the circumstances giving rise to a potential claim brought to their attention by the Committee. A28-29. After further investigation, on October 13,

2011, the Committee and WMI gave written notice of their intent to sue the D&Os in the absence of a negotiated resolution of the D&Os' liability in connection with the September Downstream. A14, A29.

Several D&Os and WMI sought coverage for the Asserted Claim under the Policies. A15. In response, the Insurers denied coverage, arguing that the Asserted Claim fell into (i) the "Interrelated Claims Exclusion" because it related to shareholder class action suits filed before the Policy period began; and (ii) the "Insured v. Insured Exclusion." A15. In the present procedural posture, this Court must assume that these exclusions are inapplicable to the Asserted Claim, and that the denial of the Asserted Claim resulted in a breach of the Policies in bad faith, as has been specifically alleged in the Complaint. A31, A34-35.

C. The Trust Must Reserve $18 Million for the D&Os' Defense Costs Because the Insurers Improperly Denied Coverage

After WMI filed for bankruptcy, each of the D&Os filed a proof of claim in WMI's bankruptcy case asserting claims for indemnification and advancement of defense costs with respect to investigations and threatened or pending litigation (the "D&O Claims"). A32-33. The Trust disputes its obligations to indemnify the D&Os, but the Bankruptcy Court required the Trust to establish a cash reserve of $18,239,734 (the "Reserve") to cover any D&O Claims arising from the Trust's prosecution of the Asserted Claim. The Reserve will be released if, *inter alia*, the Trust establishes coverage in this lawsuit. *Id.*

Maintenance of the Reserve adversely affects all creditors entitled to distributions under the Plan. Because of the Reserve, unsatisfied claims continue to accrue interest against the Trust, thereby depriving valid creditors of potential distributions and depleting their potential recoveries. A15-16.

D. WMI Files the Bankruptcy Court Adversary Proceeding

Faced with maintaining the Reserve and the Insurers' intransigence, on March 15, 2012, WMI filed suit in the Bankruptcy Court. But the Bankruptcy Court found that it lacked federal bankruptcy jurisdiction under 28 U.S.C. § 1334 to consider the coverage complaint because WMI already had confirmed its plan of reorganization and "[p]ost-confirmation, a bankruptcy court only has jurisdiction over a claim that has 'a close nexus to the bankruptcy plan or proceeding' such as one which 'affects the interpretation, implementation, consummation, execution, or administration of a confirmed plan or incorporated litigation trust agreement.'" *In re Washington Mut., Inc.*, 2012 WL 4755209, at *2 (Bankr. D. Del. Oct. 4, 2012). In dismissing, the Bankruptcy Court declined to address the Insurers' arguments that there was no "case or controversy" or that the complaint failed to state a claim. *Id.* at *5 n.5. Nothing the Bankruptcy Court decided bears on the issues here, as its

ruling was premised solely on the bankruptcy-specific question noted above, not lack of standing or ripeness.[1]

E. The Superior Court Decision

Following dismissal of the adversary proceeding in the Bankruptcy Court, the Trust filed this action in the Superior Court.

The Complaint asserts three claims for relief. Count I alleges that the Insurers breached the Policies by denying coverage for the Asserted Claim. A33. Count II alleges that the Insurers have breached their obligations of good faith and fair dealing by denying their coverage obligations in bad faith. A34-35. Count III alleges that there is an actual controversy between the Insurers and the Trust regarding the scope of the Insurers' obligations under the Policies and seeks a judicial declaration of the parties' rights. A35-37.

The Insurers moved to dismiss this Complaint on standing and ripeness grounds asserting that the Trust was really suing as a potential claimant against the D&Os and would not suffer any harm from the denial of coverage until it had prevailed against the insured D&Os in respect of the Asserted Claim. A138-39.

In denying the motion to dismiss, the Superior Court applied well-recognized legal standards governing prudential standing, Order at 6-7 (citing

[1] The Bankruptcy Court also ruled it was premature to adjudicate the Insurers' potential subrogation claims until coverage was established. 2012 WL 4755209, at *6; *see infra* Argument, Section I.C.v.

Dover Historical Soc'y v. City of Dover Planning Comm'n, 838 A.2d 1103 (Del. 2003); *Lujan v. Defenders of Wildlife*, 504 U.S. 555, 560-61 (1992); and *Soc'y Hill Towers Owners' Ass'n v. Rendell*, 210 F.3d 168, 175-76 (3d Cir. 1998)), and declaratory relief. *Id.* at 14 (citing *Rollins Int'l., Inc. v. Int'l Hydronics Corp.*, 303 A.2d 660, 662-63 (Del. 1973)).

Addressing standing, the Superior Court rejected the Insurers' attempt to recharacterize the capacity in which the Trust had brought this action. The Trust filed suit as successor to WMI, the purchaser of the Policies, not as a holder of the Asserted Claim. As purchaser, the Trust had standing as was held in *Oldenburg*, 671 F.Supp. 720, and *Wedtech*, 740 F.Supp. 214, also involving legal successors to the purchasers of D&O liability policies that had filed coverage actions against issuing insurers. The Superior Court quoted approvingly from *Wedtech*:

> The policies are clearly third party beneficiary contracts, in which [the insurer] is the promisor, Wedtech is the promisee and the officers and directors third party beneficiaries. Under New York law, a promisee for the benefit of third parties may enforce the promise on behalf of the third parties....Wedtech can clearly bring this action in an effort to enforce [the insurer's] obligation to pay the directors and officers.

Order at 11 (quoting *Wedtech*, 740 F.Supp. at 219).

With respect to actual controversy and ripeness, the Superior Court rejected the Insurers' assertions that the insurance coverage at issue was not implicated by the $500 million Asserted Claim, Order at 19-20, and that the coverage dispute could not be ripe so long as disputed obligations of the Trust with respect to any

self-insured retention ("SIR") under the Side B coverage were not first paid. *Id.* at 20-21. It then found that the denial of coverage directly caused harm to the Trust by, *inter alia*, requiring the Reserve in respect of the D&O Claims arising out of the Asserted Claim. *Id.* at 21. The Superior Court further determined that so long as coverage remained disputed the Reserve must remain in place and interest will continue to accrue on unpaid creditor claims to the Trust's detriment. *Id.*

Accordingly, the Trust had standing to bring the action and had stated sufficient cognizable harms that were presently ripe for declaratory judgment. *Id.* at 22.

This appeal followed.

ARGUMENT

I. THE TRUST HAS STANDING TO SUE UNDER THE POLICIES

A. Question Presented

Whether the Trust, as purchaser of the Policies, has standing to sue under the Policies if their breach causes the Trust harm.

B. Standard and Scope of Review

Where the alleged lack of standing is closely related to the merits of the underlying claim, a motion to dismiss should be evaluated under Superior Court Rule 12(b)(6) rather than Rule 12(b)(1). *Appriva S'holder Litig. Co. v. EV3, Inc.*, 937 A.2d 1275, 1285-86 (Del. 2007). A trial court must "deny the [Rule 12(b)(6)] motion unless the plaintiff could not recover under any reasonably conceivable set of circumstances susceptible of proof." *Cent. Mortg. Co. v. Morgan Stanley Mortg. Capital Holdings LLC*, 27 A.3d 531, 536 (Del. 2011). In this procedural posture, this Court must take the facts as alleged in the Trust's Complaint, A13-38, as true, draw every reasonable inference favorable to the Trust from those allegations, and consider those allegations and inferences in the light most favorable to the Trust. *Doe v. Cahill*, 884 A.2d 451, 458 (Del. 2005). Rulings on motions to dismiss are reviewed de novo. *Ramirez v. Murdick*, 948 A.2d 395, 399 (Del. 2008).

C. Merits of Argument

i. The Trust has Standing Under the *Lujan* Test

Although Delaware standing requirements are prudential rather than constitutional in nature, *Dover*, 838 A.2d at 1110-11, Delaware courts in determining standing apply the same three-part test adopted by the federal courts:

> First, the plaintiff must have suffered an injury in fact—an invasion of a legally protected interest which is (a) concrete and particularized, and (b) actual or imminent, not conjectural or hypothetical. Second, there must be a causal connection between the injury and the conduct complained of—the injury has to be fairly . . . trace[able] to the challenged action of the defendant, and not . . . the result [of] the independent action of some third party not before the court. Third, it must be likely, as opposed to merely speculative, that the injury will be redressed by a favorable decision.

Lujan, 504 U.S. at 560-61 (internal quotation marks and citations deleted).

The Trust easily meets this standard: (1) the requirement to reserve rather than distribute $18.2 million to creditors (with concurrently accruing interest) until the Trust establishes coverage under the Policies is plainly injury in fact that is concrete and actual; (2) the Insurers' wrongful denial of coverage is a cause of the Reserve requirement and is therefore fairly traceable to it; and (3) damages to compensate for the delay in making the distribution and a final judicial declaration that coverage exists will provide redress for the harm.

Appellants never directly confront or refute this basic standing analysis. Instead, the Insurers insist, in the teeth of the allegations of the Complaint, A33-37, that the Trust is covertly seeking to establish coverage in its capacity as a claimant

or as a third-party representative of the D&Os. But the Complaint is expressly to the contrary. The Trust's standing is predicated solely on the allegation, which must be assumed to be true, that the Insurers made a contractual promise to the Trust, breached it and thereby harmed the Trust.

ii. Corporations May Enforce Liability Policies They Buy to Insure Their Directors and Officers

The Trust's rights as purchaser and promisee under all of the Policies entitle it to enforce the Insurers' obligations under the Policies. WMI purchased the Policies not only to protect its D&Os from claims against them, but also to protect itself. A48. The Insurers have harmed the Trust by failing to advance defense costs to the D&Os, thereby forcing the Trust to maintain the Reserve.

The Policies are considered part of the property of a bankruptcy estate, *ACandS, Inc. v. Travelers Cas. & Sur. Co.*, 435 F.3d 252, 260 (3d Cir. 2006), and vested in the Trust pursuant to the Plan, *Engebretson v. Humana Ins. Co.*, 2005 WL 1458077, at *9 (E.D. Wis. June 20, 2005), principles that the Insurers appear to concede. *See, e.g.*, AOB at 7, 16-17, 28 (referring to the Trust as WMI's "successor").

It is black letter law that a party to a contract has the substantive and procedural right to enforce performance under that contract – even if the benefits of performance flow entirely to another party. As Corbin explains:

In the sometimes dubious precedent of early English cases, a

> promisee's right to sue on a contract designed to benefit a third party was considered either doubtful or nonexistent. A few American cases made the same mistake, but there were contrary early holdings. ***Currently, there is no longer any doubt that a promisee has the same right to performance in a contract for the benefit of a third party as any other contract promisee.***

Corbin on Contracts § 46.2 (2012) (emphasis added).

Washington and Delaware are in accord. In *Kim v. Moffett*, 234 P.3d 279 (Wash. Ct. App. 2010), Kim was the contracting party, but the benefits of Moffett's architectural services flowed to an entity owned by Kim's sons. *Id.* at 281. When Kim sued Moffett for breach of contract, the trial court dismissed the claims for lack of standing, but the Court of Appeals reversed:

> A party to a contract is entitled to enforce it and to sue in his own name. … As a party to the architectural services contract, Kim had standing to sue based on an alleged breach of that contract. [¶] As a contracting party, Kim could bring a claim alleging breach of his contract with Moffett for architectural services.

Id. at 284-85 (citations omitted); *see also Eastlake Const. Co. v. Hess*, 655 P.2d 1160, 1162 (Wash. Ct. App. 1982) ("As a party to the contract, Hess is entitled to enforce it and to sue in his name."); *Newport Yacht Club v. City of Bellevue*, 2011 WL 5417126 (W.D. Wash. Nov. 9, 2011) (same). Delaware authorities are to like effect. *John Julian Const. Co. v. Monarch Builders, Inc.*, 306 A.2d 29, 34 (Del. Super. Ct. 1973) ("The modern and, in the Court's mind, better view is that where, in a third party beneficiary contract, the promisor has breached its duty to perform an act for the benefit of a creditor beneficiary, the promisee – the original obligor –

has a right to recover the full value of the promised performance from the promisor."), *aff'd*, 324 A.2d 208 (Del. 1974); *Madison Realty Partners 7, LLC v. Ag ISA, LLC*, 2001 WL 406268, at *4 (Del. Ch. Apr. 17, 2001). *See also* Del. Super. Ct. Civ. R. 17 (promisee for the benefit of a third party is real party in interest). None of these cases requires that the promisee show any separate injury in order to maintain standing, even though the Trust has alleged such injury here.

Applying the above-stated principle in the insurance context, courts have repeatedly held that the purchaser of insurance may enforce the policy irrespective of whether policy proceeds are payable to the purchaser.

In *Oldenburg*, 671 F.Supp. 720, the FSLIC, as successor to State Savings, *id.* at 722, made demands on State Savings's D&Os and sued Federal Insurance Co. ("Federal") for declaratory relief as to coverage under a D&O policy. *Id.* Federal moved to dismiss, claiming (as the Insurers do here) that the FSLIC had no standing to enforce the coverage provided to the D&Os (the equivalent of Side A coverage). The district court rejected Federal's argument:

> Federal contends that since the officers and directors are the only insured persons under Clause 1, the FSLIC does not have standing to bring an action on Clause 1. [¶] However, FSLIC has all the rights of State Savings. State Savings purchased the insurance policy for the benefit of the directors and officers. Even though the effect of this action is to allow FSLIC to receive a declaration that the directors FSLIC is suing have insurance coverage for their wrongful acts, procedurally FSLIC is bringing this action as the contracting party seeking to enforce the third party beneficiary rights of the directors.

> A person who makes a contract for the benefit of a third party can enforce the contract.

Id. at 725.

In *Wedtech*, 740 F.Supp. 214, Wedtech, a debtor in bankruptcy, sought a declaratory judgment that insurance it purchased before bankruptcy provided coverage for its directors and officers. *Id.* at 217. Federal moved to dismiss on the ground that Wedtech lacked standing to enforce the rights of the officers or directors unless it indemnified them (just as the Insurers argue here). *Id.* The court rejected Federal's argument, explaining that "a promisee for the benefit of third parties may enforce the promise on behalf of the third parties …. Wedtech can clearly bring this action in an effort to enforce Federal's obligation to pay the directors and officers." *Id.* at 219 (citations omitted); *accord Precision Door Co., Inc. v. Meridian Mutual Ins. Co.*, 353 F.Supp. 2d 543, 554 (E.D. Pa. 2005) (holding purchaser of insurance policy has standing to sue for failure to defend named insured because named insured was a third-party beneficiary and "both a promisee and an intended third party beneficiary may sue to enforce a contract").

iii. The Insurers' Argument That the Trust's "True Interest" is as a Potential Claimant is Irrelevant

The Insurers assert, AOB at 9-10, that "[i]n reality, the Trust is not acting as an insured entity seeking to protect the Directors and Officers from litigation," and suggest that this Court disregard the Trust's "attempt to cloak itself in th[is] guise."

Yet no case the Insurers cite holds that a policy purchaser that also is a potential claimant cannot sue for a breach of the policy. *See infra* Argument, Section I.C.vi.

The Insurers' argument for secret motive review is unsupported, not properly considered on a motion to dismiss (if ever relevant), and contrary to established precedent. *See, e.g.*, *Eureka Fed. Sav. & Loan Ass'n v. Am. Cas. Co. of Reading, Pa.*, 873 F.2d 229, 230 (9th Cir. 1989) (Purchaser of D&O insurance policy granted declaratory relief, even though it was seeking relief to facilitate settlement of an action that it was bringing against its own officers); *Branning v. CNA Ins. Cos.*, 721 F.Supp. 1180, 1182 & 1185 (W.D. Wash. 1989) (granting the FSLIC summary judgment in its action for declaratory relief as to the scope of insurance policies which the FSLIC was pursuing); *Oldenburg* (discussed above). Simply put, the Trust's motives, like its interests as a claimant are irrelevant, given its separately enforceable legal rights as promisee.[2]

iv. The D&Os' Right to Proceeds Does Not Negate Trust Standing

The Insurers argue in the alternative that to the extent the Trust is not suing in its capacity as the holder of the Asserted Claim, it must be (improperly)

[2] The Insurers' overwrought contentions, AOB at 9-10, that the decision below will somehow fundamentally alter the nature of litigation implicating insurance that arises out of bankruptcy is belied by the fact that *Oldenburg*, *Wedtech* and *Eureka*, all in harmony with the decision below and more than twenty years old, have had no such effect.

asserting the third party rights of the insured D&Os. AOB at 15-19. Like the "Trust-as-claimant" argument, this ignores the Trust's actual position.

That the D&Os (not the Trust) are the parties entitled to policy proceeds if denial of coverage is found wrongful is irrelevant. This suit is not about the disposition of policy proceeds, it is about the Reserve that the Trust has been required to maintain in respect of the D&O Claims. That Reserve is directly traceable to the Insurers' denial of coverage.[3] If the Policies were funding the Asserted Claim defense, the Reserve would not be necessary, interest would cease to accrue on the claims that would be satisfied from the Reserve, and the Reserve funds would promptly flow to the Trust's beneficiaries. A266-67, A272-73.

The Insurers' argument that the Trust would be obligated to expend the Reserve in defense of the Asserted Claim even if the Trust prevailed here depends entirely on the Insurers' misinterpretation of the SIR provisions of the Policies. AOB at 15-18. The Insurers argue that the $50 million SIR applies, pointing to XL Specialty Policy ("XL Policy") section IV.(D). *Id.* at 5-6, 15. Citing that section,

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[3] The Insurers also argue, AOB at 18, that because the Reserve was the product of a stipulation between the D&Os and the Trust, there can be no injury-in-fact. This misconstrues the "independent action of some third party" qualification, which "does not exclude injury produced by determinative or coercive effect upon the action of someone else." *Bennett v. Spear*, 520 U.S. 154, 168-69 (1997); *Mattaponi Indian Tribe v. Commonwealth*, 541 S.E.2d 920, 925 (Va. 2001) (citing *Bennett* and holding that "the 'fairly traceable' prong does not mean that 'the defendant's actions are the very last step in the chain of causation'"). As the Insurers issued the Policies but then refused to honor them, the harm due to the Reserve requirement is fairly traceable to the Insurers' breach and can be remedied by a decision that coverage applies. *See Energy Corp. of Am. v. Bituminous Cas. Corp.*, 543 F. Supp. 2d 536, 541 (S.D. W. Va. 2008).

the Insurers contend that the Trust is required to expend $50 million in SIR before their obligations under the Policies are triggered, draining the entire Reserve. *Id.* at 17. The Insurers miss the mark for several reasons.

First, "Delaware clearly recognizes indemnification and advancement as two distinct legal rights," *Majkowski v. Am. Imaging Mgmt. Servs., LLC*, 913 A.2d 572, 580 (Del. Ch. 2006), and the Insurers conveniently ignore the fact that the SIR does not apply to advancement, only indemnification, and then only if "indemnification [by the Trust] … is legally permissible." A52-53. The Policy further provides that "[u]pon the written request of an Insured, the Insurer will ***advance*** Defense Expenses on a current basis in excess of the applicable Retention, ***if any***, before the disposition of the Claim for which this policy provides coverage…." A53 (emphasis added).[4] This matters because until the underlying claims are adjudicated, payment of defense costs entails ***only*** advancement, not indemnification, *Kaung v. Cole Nat'l Corp.*, 884 A.2d 500, 509 (Del. 2005), and the harm suffered by the Trust stems from the failure to advance.

Second, even if XL Policy § IV.(D) were read to conflate advancement and indemnification, the SIR still only applies to loss "as to which indemnification by [WMI] is legally permissible" unless indemnification is not being provided "solely

[4] Importantly, the XL Policy, A40, provides for no SIR under Side A of the policy (i.e., the coverage for the D&Os), but for a $50 million SIR under Side B (i.e., the coverage for WMI).

by reason of [WMI's] financial insolvency." A53. Although the term "financial insolvency" is not defined in the XL Policy, in interpreting an undefined term, courts give the language of the insurance policy "the same construction that an 'average person purchasing insurance' would give the contract." *Woo v. Fireman's Fund Ins. Co.*, 164 P.3d 454, 459 (Wash. 2007). Here, WMI filed one of the largest bankruptcy cases in history. WMI's subsidiary bank was not eligible for bankruptcy, but was seized by federal regulators in a federal receivership proceeding. The term "financial insolvency" cannot possibly exclude WMI's bankruptcy; indeed, the term is broad enough to cover both WMI's bankruptcy and the seizure of its bank subsidiary, and it makes perfect sense for the XL Policy to use the broad term "financial insolvency" to cover both such circumstances. Because of WMI's bankruptcy, the D&Os' ability to obtain any payment is subject to the claims allowance process of 11 U.S.C. § 501 and Fed. R. Bankr. P. 3003(c)(2). The D&Os have filed claims and WMI objected to those claims on multiple grounds (preserving its rights to assert other grounds, including explicitly the Asserted Claim). A270-72. As a result, the D&O Claims are "Disputed Claims" and shall remain so unless and until deemed otherwise "pursuant to a final order of the Bankruptcy Court or unless otherwise ordered by the Bankruptcy Court." A270. This means the D&Os currently have no allowable amount that can be paid from WMI's bankruptcy estate, *see* 11 U.S.C. § 502(a), and the Trust is

not legally permitted to indemnify or to advance costs to the D&Os until and unless the D&O Claims are allowed.

Third, whether or not indemnification is "legally permissible," and non-payment is solely due to WMI's bankruptcy, the SIR still would not apply. The second sentence of XL Policy § IV.(D) unequivocally provides that "[i]n the event of financial insolvency, the Retention(s) applicable to INSURING AGREEMENT (A) [i.e., no retention] shall apply." A53. Under Washington law, "the court should attempt to give effect to each provision in the policy." *Allstate Ins. Co. v. Peasley*, 932 P.2d 1244, 1346 (Wash. 1997). Thus, under the plain language of the XL Policy, the SIR does not apply if there is a financial insolvency.[5]

v. The Requested Coverage Determination Presents Redressable Injury Despite Possible Subrogation Disputes

The Insurers note that under the Stipulation, A272-73, release of the Reserve is further conditioned on a resolution of any subrogation claim asserted by the Insurers should they be required to fund defense and indemnity under the Side A

[5] Even if the Trust must satisfy the SIR to obtain coverage under the XL Policy, the Columbia Casualty Policy, the third layer of coverage here, and all the Policies in excess thereof, cannot be so construed as they are Side A only policies to which no SIR is applicable. Thus, if WMI fails or refuses to indemnify the D&Os for a loss and XL Specialty either refuses to meet its Policy obligations or is not liable for the loss, Columbia Casualty and the nine Side A Insurers offering excess coverage are required to pay the loss. This is no accident. Side A excess insurers often provide coverage broader than the underlying policies, with the result that Side A coverage "drops down" when it is broader than the ABC coverage. *See* 4 Dan A. Bailey et al., *Appleman on Insurance* § 26.10 (2013). Under the broad coverage provided by the Side A Insurers, exhaustion of the underlying policies is not required. As such, any debate about whether payment of the SIR is necessary to trigger coverage has no bearing on whether the Side A Insurers are liable under their separate policies.

coverage. AOB at 19. This, the Insurers suggest, *id.*, means that even a favorable determination of the coverage dispute for the Trust will not necessarily result in immediate release of the Reserve. In making this argument, the Insurers wish to place the Trust in an impossible situation. The Bankruptcy Court has already determined that it will not address any subrogation claim by the Insurers unless and until coverage is established. *In re Washington Mut., Inc.*, 2012 WL 4755209, at *6. Therefore, the only path available to the Trust for obtaining release of the Reserve is to first establish coverage in this action.

It cannot be the law that (i) the subrogation issues cannot be determined in the Bankruptcy Court until coverage is first established in Superior Court, and (ii) coverage cannot be determined in Superior Court until subrogation issues are first settled by the Bankruptcy Court. Redressability has been found to exist in similar circumstances, where a promisee asks to enforce an insurance contract made for the benefit of another and the alleged injury can be fairly traced to the insurer. *See Energy Corp.*, 543 F.Supp. 2d at 541. Because a decision in the Trust's favor in these proceedings is a predicate to and thereby makes the ultimate release of the Reserve more likely, the Trust has the standing required to continue forward.

vi. The Authorities Cited by the Insurers are Inapposite.

In light of the substantive right of a contract party to enforce promises made to it, the Insurers' argument that the Trust does not meet the three elements for

standing set forth in *Lujan* and *Dover* is easily refuted. The cases cited by the Insurers – none of which applies Washington law or deals with liability insurance coverage – are inapposite and address situations where the putative plaintiff suffered no identifiable injury in fact.

The Insurers rely on *HLSP Holdings Corp. v. Fortune Mgmt, Inc.*, 2010 WL 528470 (Del. Feb. 15, 2010), AOB at 13-14, an order denying standing to a corporation to enforce registration rights with respect to certain stock it received in a merger and then redistributed to its shareholders in-kind. The failure to register assertedly impaired the value and marketability of the stock now held by the plaintiff shareholders. This Court affirmed the dismissal of the corporation's breach of contract suit for lack of any injury-in-fact to the corporation, because the failure to register harmed only the shareholders holding the stock, not the corporation serving only as a conduit for redistribution. *Id.* at *4. Here however, the Insurers' denial of coverage has resulted in concrete and identifiable pecuniary harm to the Trust in the form of the required Reserve. *See supra* Statement of Facts, Section C.

Similarly, *Rosen v. Tennessee Comm'r of Fin. & Admin.*, 288 F.3d 918, 931 (6th Cir. 2012), AOB at 14, held that the plaintiffs lacked standing to challenge Tennessee's Medicaid implementation even though they were parties to a consent decree. *Rosen*, like *HLSP*, is inapposite because there was no possibility of harm

to the plaintiffs' self-defined class, unlike the continual harm to the Trust occasioned by the Insurers' failure to provide coverage.

In *In re Fontainebleau Las Vegas Contract Litig.*, 716 F.Supp. 2d 1237 (S.D. Fla. 2010), *aff'd sub nom. Avenue CLO Fund Ltd. v. Bank of America, NA*, 2013 WL 617060 (11th Cir.), AOB at 14, the court found that term lenders under a multi-party credit agreement could not enforce the obligation of revolving lenders to advance funds to a borrower, because the obligation was intended to benefit the borrower, not the term lenders. *Id.* at 1249-50. Here, the Insurers' promise to provide coverage to the D&Os was made to WMI for WMI's own benefit: to enable it to attract and retain its directors and officers, and to insure itself against its statutory and contractual obligations to indemnify them. Romano, *What Went Wrong With Directors' and Officers' Liability Insurance?*, 14 DEL. J. CORP. L. 1, 4 (1989). WMI was bargaining for insurance coverage to protect its own interests, unlike the term lenders in *Fontainebleau* who sought to enforce rights and obligations flowing only between other lenders (the revolving lenders) and the borrowers.

Finally, *Alexander v. United States*, 640 F.2d 1250, 1253 (Ct. Cl. 1981), AOB at 14, held that donees of real estate did not have enforceable rights to require donors to pay the debt on the donated property because the donor's promise was made to the lender, not the donees. Here, the Insurers' promise to provide

coverage was made directly to WMI and the Trust is directly injured by the Insurers' failure to perform their promises. The Policies cover defense costs incurred by the D&Os, which the D&Os are now seeking to collect from the Trust via indemnity claims against WMI. The Trust must reserve millions for those costs that would otherwise be paid to the Trust's beneficiaries; the Reserve will be released if the Trust prevails in this proceeding. The Trust satisfies all the traditional requirements of standing.[6]

vii. The Insurers Fail to Distinguish the Trust's Authorities

The Insurers suggest, AOB at 20-24, that the authorities applying the settled principle of promisee standing to the purchaser of a D&O liability policy are distinguishable. They attack *Oldenburg*, *supra*, pointing to a large number of circumstances irrelevant to the question of the FSLIC's standing as successor to the corporate purchaser of the D&O policy: (i) the collateral dispute over the *Oldenburg* policies' "regulatory exclusion"; (ii) that in *Oldenburg* the insured claim for which coverage was denied was in the form of a lawsuit rather than, as here, a formal written demand (iii) that the insured directors and officers were

[6] Even absent the Reserve, the Trust would have standing here to enforce the Insurers' good faith obligations under Washington insurance law. The separate duty of the Insurers to act in good faith is "not dependent on the duty to indemnify, settle, or defend." *St. Paul Fire & Marine Ins. Co. v. Onvia, Inc.*, 196 P.3d 664, 669 (Wash. 2008). Even if the SIR were applicable and no amounts were required to be paid for defense costs, the Insurers' bad faith failure to acknowledge coverage or participate in settlement negotiations would still constitute an actionable breach. *Moratti ex rel. Tarutis v. Farmers Ins. Co.*, 254 P.3d 939, 942 (Wash. Ct. App. 2011), *cert. denied*, 133 S. Ct. 198 (2012).

parties in *Oldenburg*; (iv) that the legal successor to the purchaser of the policies in *Oldenburg* was a government agency (FSLIC) rather than a bankruptcy trustee; (v) that the FSLIC enjoyed certain statutory powers under 12 U.S.C. § 1454 that the Trust does not have. None of this is the least bit relevant to the *Oldenburg*'s dispositive standing holding:

> [P]rocedurally FSLIC is bringing this action as the contracting party seeking to enforce the third party beneficiary rights of the directors. A person who makes a contract for the benefit of a third party can enforce the contract.

Oldenburg, 671 S. Supp. at 725.[7]

The Insurers also try to distinguish *Wedtech*, *supra*, which held that the corporate purchaser of a D&O policy had standing to sue based on the insurer's anticipatory repudiation of the policy. The only distinction the Insurers can muster is that the scope of the repudiation in *Wedtech* was broader than the repudiation here. AOB 22-23. But standing to sue for breach cannot turn on the scope of the breach; if the breach causes harm, whatever its scope, the injured promisee can bring suit to redress that harm.

[7] Implicitly recognizing the weakness of their flailing distinction of *Oldenburg*, the Insurers suggest that *XL Specialty Ins. Co. v. Perry*, 2011 WL 9700995 (C.D. Cal. Nov. 30, 2011) ("*IndyMac*") rejected *Oldenburg*. AOB at 21. But *IndyMac* never even cites *Oldenburg* and rightly so. The FDIC in that case did not stand in the shoes of the corporate purchaser of the D&O policy, but of a subsidiary that held claims against the purchaser's directors and officers. *IndyMac* is not a purchaser standing case at all.

II. THE TRUST HAS ADEQUATELY ALLEGED THE ELEMENTS FOR DECLARATORY RELIEF

A. Question Presented

Whether the Superior Court abused its discretion in concluding that the Trust's request for declaratory relief with respect to the scope of the coverage exclusions relied upon by the Insurers to deny coverage for the Asserted Claim presents an actual controversy that is ripe for judicial determination.

B. Standard and Scope of Review

The decision to entertain an action for declaratory relief is a matter entrusted to the discretion of the trial court and reviewable on appeal only for abuse of discretion. *Gannett Co. v. Bd. of Managers of the Del. Crim. Justice Info. Sys.*, 840 A.2d 1232, 1237 (Del. 2003) ("This Court reviews for abuse of discretion the Superior Court's decision to exercise declaratory judgment jurisdiction over a case."); *Ubiquitel Inc. v. Sprint Corp*., 2006 WL 44424, at *2 (Del. Ch. Jan. 4, 2006) (citing *N. Am. Philips Corp. v. Aetna Cas. & Surety Co.*, 565 A.2d 956, 961 (Del. Super. Ct. 1989) ("When deciding whether an issue is ripe for adjudication the Court must do a balancing test. The Court must use its judicial discretion based on the factors of each case. . . .")).

Exercise of declaratory judgment discretion is informed by a practical evaluation of the legitimate interest of the plaintiff in prompt resolution of the question presented and the hardship that further delay may threaten. *Schick, Inc. v.*

Amalgamated Clothing & Textile Workers Union, 533 A.2d 1235, 1239 (Del. Ch. 1987). Other considerations include the prospect of future factual development that might affect the decision; the need to conserve resources, and a due respect for identifiable policies of the law touching upon the subject matter of the dispute. *Id.*

C. Merits of Argument

i. The Superior Court Properly Exercised Its Discretion In Finding the Presence of Actual Controversy

In exercising its discretion and practically evaluating whether this insurance coverage dispute meets the requirements for declaratory relief, the Superior Court was faced with a concrete claim, the Asserted Claim, alleging the transfer of $500 million beyond the reach of WMI's creditors that was authorized by the D&Os on the eve of its bankruptcy. That claim arose during the 2008-09 Policy Period (the transfer occurred in September, 2008, four months after the Policies were issued) and was asserted in writing and noticed to the Insurers during the same period. A28. Moreover, the Insurers had unequivocally denied coverage of the Asserted Claim in writing. *See supra* Statement of Facts, Section B.

Accordingly, the dispute before the Superior Court involved the interpretation and application of specific contractual exclusions in the Policies with reference to a particularized claim. The issues were clear and sharp, and the Trust was suffering harm due to the Reserve requirement. *See supra* Statement of Facts, Section C.

The Superior Court evaluated whether to hear the dispute before it under the recognized standard governing declaratory relief set out in *Schick*, 533 A.2d at 1238 (quoting *Rollins*, 303 A.2d at 662). Applying this standard, Order at 19-22, the Superior Court found that the Trust has stated claims upon which relief can be granted and determined this matter to be ripe for declaratory relief.

ii. The Trust Asserts its own Rights as Promisee Under the Policies

For the same reasons that the Trust has standing to prosecute this action, as set forth *supra* at Argument, Section I.C, this action involves the rights and other legal relations of the Trust, which are real and adverse to the Insurers.

In *Mt. Hawley Insurance Co. v. Jenny Craig, Inc.*, 668 A.2d 763 (Del. Super. Ct. 1995), an insurer requested declaratory judgment against Jenny Craig, Inc. ("JCI") to determine if it was liable to provide coverage under a D&O policy issued to JCI. The Court noted it was "undisputed" that "[a]s the other party to the D&O insurance contract, JCI has a direct interest in contesting this action" and that the contractual "obligation represents interests that are real and adverse." *Id.* at 766. Like JCI, the Trust has insurance contracts with each Insurer and might be liable to the D&Os if there is no coverage. And as in *Mt. Hawley*, this action will determine whether obligations under the Policies have been fulfilled.

Contrary to the Insurers' claims, the Trust is not seeking the "rights of absent third parties." AOB at 26. The rights of the Trust and the harm to the Trust

caused by the Insurers are both real and direct. The Insurers breached a contractual promise and the Trust is now suffering a harm. *See supra* Statement of Facts, Section C. This creates an action appropriate for declaratory relief, as was accurately determined by the Superior Court in the exercise of its discretion.

iii. Judgment or Settlement is Not Required Prior to a Coverage Determination

The Insurers wrote the Policies, which on their face do not require a settlement or judgment, or even a lawsuit, to give rise to a "Claim," *supra* Statement of Facts, Section A. Additionally, the Insurers have denied coverage on the Asserted Claim, and the Trust is suffering cognizable harm. Nonetheless, the Insurers contend that settlement or final judgment is a predicate to the existence of an actual controversy. AOB at 31-34. In addition to being unsupported by the language of the Policies or the facts as alleged, this argument is belied by countless litigations often brought by insurers (*e.g.*, *Mt. Hawley*, *supra*) in advance of final resolution of the underlying claims.

> Insurance companies file declaratory relief actions against their policyholders for a number of reasons: (a) to obtain rulings on whether they have an obligation to defend the policyholders; (b) to attempt to avoid, or minimize the likelihood of, a bad faith claim for failure to defend; (c) to seek a favorable forum; or (d) simply as part of an overall strategy for resolving a coverage claim.

1 Benedict M. Lenhart et al., *Appleman on Insurance* § 7.05 (2013).

Delaware's state and federal courts regularly entertain and decide insurance coverage declaratory judgment actions in such situations. *See, e.g., Terra Nova Ins. Co. v. Nanticoke Pines, Ltd.*, 743 F.Supp. 293 (D. Del. 1990) (insurer initiated declaratory relief action to determine lack of duty to defend or indemnify); *Scottsdale Ins. Co. v. Lankford*, 2007 WL 4150212 (Del. Super. Ct. Nov. 21, 2007), *aff'd*, 947 A.2d 1121 (Del. 2008) (same); *Nat'l Union Fire Ins. Co. of Pittsburgh, Pa. v. Rhone-Poulenc Basic Chemicals Co.*, 1992 WL 22690 (Del. Super. Ct. Jan. 16, 1992), *aff'd*, 616 A.2d 1192 (Del. 1992) (insurer seeking declaratory judgment determination of duty to defend or indemnify insured in connection with three pending environmental cases).

The Insurers cite several distinguishable cases to suggest that the Trust's request for declaratory relief as to the scope of the Policies is not ripe absent a final judgment or settlement of the Asserted Claim. In *The Cincinnati Ins. Co. v. Jianas Bros. Packaging Co.*, 2010 WL 2710732 (W.D.Mo. July 7, 2010), an insurer brought a declaratory judgment action to determine coverage rights with respect to potential liability involving the insured's products. At the time of the action only two customer complaints had been received and there was no basis to estimate whether or to what extent the insured would be liable. The court declined to determine coverage for the "highly speculative" potential liability and deferred declaratory relief until significant harm could be established. *Id.* at *2. Denial of

declaratory relief in such circumstances has no bearing on whether the Superior Court abused its discretion in finding the issues pertaining to the application of Policy exclusions to the well-defined Asserted Claim were ripe for judicial determination. Nothing in *Cincinnati Ins.* suggests that judgments or final settlements are a predicate to coverage determinations generally.

Amazon.com, Inc. v. Underwriters at Lloyds London, 2005 WL 1312046 (W.D.Wash. June 1, 2005) and *Wal-Mart Stores, Inc. v. AIG Life Ins. Co.*, 901 A.2d 106, 117 (Del. 2006), similarly involved only an exercise of discretion to withhold declaratory relief on particular facts and do not suggest that the ripeness of a coverage dispute requires a prior final resolution of the underlying claim.[8]

Finally, *Maryland Ins. Co. v. Attorneys' Liab. Assurance Soc., Ltd.*, 748 F.Supp. 627 (N.D. Ill. 1990), relies on a particularly rigid interpretation of Seventh Circuit law in finding the inter-insurer dispute before it non-justiciable absent a final settlement. In doing so, it rejects contrary cases from the Third, Ninth, Tenth and DC Circuits that adopted a more pragmatic view of ripeness. *Id.* at 630. But even *Maryland Ins.* noted a crucial difference between the advancement of defense costs and indemnity for final judgments. *Id.* at 630 n.3. This case, unlike *Maryland Ins.*, involves the advancement of defense costs.

[8] To the contrary, the *Amazon.com* court explicitly relied on its discretion in such matters and acknowledged that "the difference between an abstract question and controversy is one of degree." 2005 WL 1312046 at *2.

iv. The Superior Court Did Not Abuse its Discretion in Finding this Action Ripe

In determining that the Trust's claims are ripe for judicial determination, the Superior Court referred to *Hoechst Corp. v. National Union Fire Ins. Co. of Pittsburgh, Pa.*, 623 A.2d 1133 (Del. Super. Ct. 1992), where a ripe controversy was determined to exist in an insurance coverage dispute that was much less developed than this one. Order at 19-20. In *Hoechst*, Hoechst Celanese Corp. ("HCC") filed a declaratory judgment action to determine the duties of numerous liability insurers for policies spanning multiple years with respect to products liability claims against HCC. 623 A.2d at 1134. HCC's excess insurers sought dismissal, arguing it was unlikely that there would be any claim against them because HCC had not exhausted its primary coverage and most of the excess policies contained no duty to defend. *Id.* at 1138. HCC argued that it could invoke a single year of coverage to satisfy all liability, which, if true, would implicate the excess coverage. *Id.* at 1140. On that slender reed, the Court denied a motion to dismiss, as there was a "substantial controversy between the parties of sufficient magnitude and immediacy to warrant [the insurers'] continued presence in this declaratory judgment action." *Id.*

Similarly, in *N. Am. Philips v. Aetna Cas., supra*, an insurance dispute was deemed to be ripe, despite the claims of excess carriers that the odds of triggering the coverage underlying their policies in any given policy year was remote. 565

A.2d at 958. The Superior Court held it "should afford a prompt resolution of this matter for the plaintiff to avoid delayed, sporadic and costly litigation." *Id.* at 962.

The Superior Court cannot be considered to have abused its discretion in making the ripeness determination below, as this dispute involves a much riper controversy than was presented in *Hoechst* and *N. Am. Philips*. The Trust has alleged a claim against the D&Os based on their approving or allowing the waste of $500 million of WMI's assets. A14-15. While the D&Os' liability in connection with the September Downstream has not been established and no suit has been filed, the Policies do not require suit, merely the assertion of a "Claim." The Asserted Claim, as set out fully in writing, satisfies the triggering requirement and is amply detailed and particularized to give notice of the factual bases for the cause of action and state the claim. The damages alleged are at least $500 million, double the $250 million in coverage that the Insurers sold WMI. This controversy, which is identical under all the Policies, implicates all of them, as all the Insurers rely on the very same exclusions. Just as in *Hoechst* and *N. Am. Philips*, judicial economy strongly weighs in favor of resolution of all interpretive disputes in one action rather than *seriatim* cases.

In short, this coverage dispute should be resolved now. The Superior Court evaluated the legitimate interest of the Trust in prompt resolution of the question presented (release of the Reserve to Trust beneficiaries) and the hardship that

further delay may threaten (including further interest accruals on unpaid creditor claims). Any future factual development relating to the interpretation of the Policy exclusions at issue and their application to the Asserted Claim could readily take place in the context of the action before the Superior Court. Moving forward towards resolution of the coverage questions will facilitate efficient overall resolution of the complex claims among the parties and thereby conserve scarce resources. Resolving those substantial claims promptly and efficiently is certainly consistent with the identifiable policies of the law touching upon the due administration of the Trust whose operations affect thousands of creditor-beneficiaries and arise out of the resolution of one of the largest insolvency cases in US history.

CONCLUSION

For all the reasons set forth above, the Court should affirm the Superior Court's order denying the Insurers' Motion to Dismiss and remand this case for a final determination of the Trust's causes of action for breach of the Policies and the Insurers' obligation of good faith, and for declaratory relief regarding coverage of the Asserted Claim.

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