IN THE SUPERIOR COURT OF THE STATE OF DELAWARE

IN AND FOR NEW CASTLE COUNTY

AT&T, Plaintiff, v. Clarendon America Ins. Co., Federal Ins. Co., Genesis Ins. Co., Gulf Ins. Co., Certain Underwriter's at Lloyd's, London, National Union Fire Ins. Co. of Pittsburgh, PA, New Hampshire Ins. Co. Ltd., North American Specialty Ins. Co., Twin city Fire Ins. Co., and Zurich American Ins. Co. Certain London Market Insurance Companies, Defendants.	)	C.A. No. 04C-11-167-JRJ

Date Submitted: January 11, 2008
Date Decided: February 11, 2008
Opinion Issued: June 25, 2008

OPINION

Upon AT&T's Motion for Partial Summary Judgment Regarding Defense Costs and Settlement of the Common Stock Litigation: **GRANTED**

INTRODUCTION

AT&T has moved for partial summary judgment with respect to the obligations of National Union Fire Insurance Company of Pittsburgh, PA ("National Union") to pay the settlement, defense fees and costs incurred by AT&T in connection with the "Common Stock Litigation."[1] By its motion, AT&T seeks a declaration that the fraudulent acts exclusion in the applicable directors and officers policy is an "adjudicated" fraud exclusion and does not bar coverage for the settlement of the Common Stock Litigation. In opposition, National Union argues that the fraudulent acts exclusion is an "in fact" fraud exclusion which precludes coverage. National Union further argues that even if the exclusion is an "adjudicated" fraud exclusion, it precludes coverage here because no non-fraud allegations remained in the Common Stock Litigation at the time it was settled.

I. BACKGROUND

A. The Lloyd's 1997-2001 Policy

The excess insurance policy at issue here was purchased by AT&T from National Union and follows form to a primary Directors and Officers ("D&O")

[1] The "Common Stock Litigation" is a consolidation of various shareholder class action lawsuits filed against AT&T and certain of its directors and officers under sections 10(b) and 20(a) of the Securities and Exchange Act of 1934 and Rule 10b-5. A detailed procedural history of this litigation is set forth in AT&T Corp.'s Opening Br. in Supp. of its Mot. for Partial Summ. J. Regarding Defense Costs and Settlement of Common Stock Litigation ("AT&T Opening Br.") at 6-8, Docket Item ("D.I.") 102 and Resp. Br. of Nat'l Union in Opp'n to Mot. by AT&T for Partial Summ. J. at 3-8, D.I. 245. Defendant Federal Insurance Company was dismissed from this suit on November 16, 2006, D.I. 247.

policy sold to AT&T by Certain Underwriters at Lloyd's, London, which promised that:

> A. Underwriters shall pay on behalf of the **Directors and Officers Loss** resulting from any **Claim** first made during the **Policy Period** for a **Wrongful Act**.
>
> B. Underwriters shall reimburse the **Company** for **Loss** which the **Company** pays as indemnification to any of the **Directors and Officers** resulting from any **Claim** first made during the **Policy Period** for a **Wrongful Act**.
>
> C. Underwriters shall reimburse the **Company** for **Loss** resulting from any **Securities Action Claim** first made during the **Policy Period** against the **Company** for a **Wrongful Act.**[2]

"**Loss**" includes "damages, settlements and **Costs, Charges and Expenses**."[3] "**Costs, Charges and Expenses**" include "reasonable and necessary legal fees and expenses."[4] Accordingly, "**Loss**" encompasses defense fees and costs. All such **Loss** is reimbursable to AT&T upon "final disposition of any **Claim**."[5] "**Wrongful Act**" is defined as:

> "any actual or alleged act, error, omission, misstatement, misleading statement, neglect or breach of duty by . . . the **Company** in the purchase or sale or offer to purchase or sell any securities of the **Company** or in preparing materials of the **Company** filed with the Securities and Exchange Commission or any similar state agency or in rendering any other public statements regarding the

[2] Lloyd's 1997-2001 Policy, I, and End. 1, Clause 17. According to AT&T, a copy of what it believes to be a true and correct copy of Lloyd's Policy No. 509/QB298597 is annexed to the Affidavit of John E. James, Esq., sworn to May 6, 2005 ("James Aff."), as Exhibit 1 to AT&T's Opening Br., D.I. 102. Unless otherwise noted, bolded terms contained in policy language quoted in this opinion are bold in the original and indicate terms defined in the policy.
[3] Lloyd's 1997-2001 Policy, End. 1, Clause 22.
[4] Lloyd's 1997-2001 Policy, End. 1, Clause 21.
[5] Lloyd's 1997-2001 Policy, End. 1, Clause 25.

> **Company,** which is alleged in any **Securities Action Claim**."[6]

"**Securities Action Claim**" is defined as:

> any judicial or administrative proceeding initiated against any of the **Directors and Officers** or the **Company** based on, arising out of, or in any way involving the Securities Act of 1933, the Securities Exchange Act of 1934, rules and regulations of the Securities Exchange Commission under either or both Acts, similar securities laws or regulations of any state, or any common law relating to any transaction arising out of, involving, or relating to the sale of securities which they may be subjected to a binding adjudication of liability for damages or other relief, including any appeal therefrom.[7]

Exclusion G of the Lloyd's 1997-2001 Policy in its original form provided that:

> Underwriters shall not be liable to make any payment in connection with any Claim: brought about or contributed to in fact by any dishonest, fraudulent or criminal act or omission, or any personal profit or advantage gained by any of the Directors and Officers to which they were not legally entitled. . . .[8]

Exclusion G was deleted and replaced by Endorsement No. 1. Pursuant to Endorsement No. 1., Exclusion G provides that National Union is obligated to pay any claim:

> brought about or contributed to in fact by any *deliberate* dishonest, fraudulent or criminal act or omission, or any personal profit or advantage gained by any of the

[6] Lloyd's 1997-2001 Policy, End. 1, Clause 1.
[7] Lloyd's 1997-2001 Policy, End. 1, Clause 18.
[8] Lloyd's 1997-2001 Policy, Exclusion G, at 5.

> Directors and Officers to which they were not legally entitled *and providing any such finding is material to the cause of action so adjudicated*.[9]

The Lloyd's 1997-2001 Policy provided $20 million in coverage and, according to AT&T, it has been exhausted through the payment of defense fees and costs in the Common Stock Litigation and other litigation.

B. The National Union 1997-2001 Policy

The National Union excess policy, number 485-76-53 (the "National Union Policy"), relies for its terms on the primary Lloyd's policy that "sits" below it. The National Union Policy provides that it follows "all the terms and conditions of Policy Number QB298597 issued by Lloyd's of London (but not including any renewal or rewrite thereof unless otherwise specifically agreed in writing by the Company), except for any endorsements attached hereto."[10] The National Union Policy provides $25 million in excess coverage.

C. The Underlying Lawsuit – The "Common Stock Litigation"

Although this coverage litigation involves numerous underlying lawsuits, only one lawsuit, the "Common Stock Litigation," is pertinent to AT&T's motion for partial summary judgment. The Common Stock Litigation is a consolidation of various shareholder class action lawsuits filed against AT&T and certain of its directors and officers under sections 10(b) and 20(a) of the Securities and

[9] Lloyd's 1997-2001 Policy, End. 1, Clause 12 (emphasis added). This provision is hereinafter referred to as "the Fraud Exclusion."
[10] National Union 1997-2001 Policy No. 485-76-53 (Declaration Page), James Aff. Ex. 2.

Exchange Act of 1934 and Rule 10b-5.[11] There is no dispute that the Common Stock Litigation is a "**Securities Action Claim"** under the National Union Policy.

On September 16, 2002, the court in the Common Stock Litigation certified a class consisting of all purchasers of AT&T common stock between October 25, 1999 and May 1, 2001.[12] On June 4, 2004, Judge Brown, the judge presiding over the Common Stock Litigation, granted partial summary judgment in favor of AT&T with respect to certain claims. Judge Brown's grant of partial summary judgment in favor of AT&T dismissed claims based on the alleged failure to disclose known material facts and held that the claims remaining in the case (for the jury to determine) concerned whether specific forward-looking statements were false or misleading when made.[13] The court then ordered the previously certified class be narrowed to all purchasers of AT&T common stock between December 6, 1999 through May 1, 2001.[14] A jury trial commenced on October 5, 2004.[15] On October 25, 2004, AT&T reached an agreement with the plaintiffs to settle the Common Stock Litigation. Trial stopped immediately, and the jury was dismissed before it reached a verdict on the plaintiffs' claims.

Throughout the Common Stock Litigation, the defendants vehemently denied any wrongdoing:

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[11] *See* Consol. Am. Compl. for Violation of the Securities Exchange Act of 1934, James Aff. Ex. 5.
[12] *See* Stipulation and Agreement of Settlement ("Stipulation and Agreement"), James Aff. Ex. 6 at 3.
[13] *See In Re AT&T Corporation Litigation*, D.N.J. No. 00-5364, Brown, J. (June 4, 2004) (Mem. Op.), James Aff. Ex. 7 at 49, 61.
[14] *See* Stipulation and Agreement at 3.
[15] *See id.* at 4.

> [T]he Defendants vigorously deny and disclaim any wrongdoing or liability whatsoever, including denying any and all claims of liability or wrongdoing and all charges and allegations that have been asserted against them, but have determined to enter into this settlement on the terms and conditions set forth herein to halt the substantial expense that continues to be attendant to the litigation, as well as to eliminate uncertainty and risks from continued litigation . . . .[16]

Pursuant to the Settlement Agreement, AT&T agreed to pay $100 million into an escrow fund by May 1, 2005. This amount represents about 4% of the aggregate damages allegedly suffered by plaintiffs in the Common Stock Litigation.[17] The settlement was subject to a fairness hearing and final court approval.[18] The Notice of Settlement provides that:

> The issues on which the parties disagree include: (1) whether any of the statements made or facts allegedly omitted were false, material or otherwise actionable; (2) whether any of the statements were made with the state of mind required to impose liability; (3) the extent to which external factors, such as general market and industry conditions, influenced the trading price of AT&T common stock at various times during the Class Period; (4) the extent to which the various statements or omissions that Plaintiffs alleged were materially false or misleading influenced (if at all) the trading price of AT&T common stock at various times during the Class Period; and (5) the appropriate economic model for determining the amount by which the trading prices of

[16] *See* Stipulation and Agreement at 3.
[17] Plaintiffs' damages expert testified that the aggregate damages incurred by the plaintiff class during the class period were $2.9 billion. *See* James Aff. Ex. 7 at 33.
[18] *See* Notice of Settlement of Class Action ("Notice of Settlement"), James Aff. Ex. 8.

> AT&T common stock were allegedly artificially inflated (if at all) at any time during the Class Period.[19]

The court approved the settlement and entered a final judgment, dismissing the case with prejudice, on April 22, 2005.[20] On May 1, 2005, AT&T paid $100 million into an escrow account in settlement of the Common Stock Litigation.

There is no dispute that no court has held, and no jury has ever found, that AT&T or any of the defendants in the Common Stock Litigation engaged in any deliberate dishonest, fraudulent or criminal act or omission.

D. National Union's Denial of Coverage

Lloyd's, the primary D&O insurance carrier for the 1997-2001 period, paid out its limits under the Lloyd's 1997-2001 Policy in response to defense invoices submitted for the Common Stock Litigation and other litigation. AT&T sought and continues to seek coverage for the Common Stock Litigation settlement and additional defense fees and costs under the National Union Policy. National Union refuses to pay the defense fees and costs incurred by AT&T in connection with the Common Stock Litigation or the amount paid by AT&T in settlement of the Common Stock Litigation, claiming that the Fraud Exclusion bars coverage.[21]

[19] Notice of Settlement at 2.
[20] *See In Re AT&T Corporation Litigation*, D.N.J. No. 00-5364, Brown, J. (Apr. 22, 2005) (Mem. Op.), James Aff. Ex. 9.
[21] AT&T points out that National Union's Amended Answer contains ten affirmative defenses and nine counterclaims. Its second affirmative defense is the adjudicated fraud exclusion.

II. DISCUSSION

A. Choice of Law – Introduction

Choice of law is a threshold issue in complex litigation. At the Court's request, AT&T and the insurers provided supplemental briefing on the issue of whether New York or New Jersey law governs the interpretation of the policies at issue.[22] AT&T argues that there is no conflict between the laws of New York and New Jersey in all relevant respects and that in the absence of conflict, the Court should apply the general principles common to both states.[23] AT&T argues that if the Court determines that New York and New Jersey law are not in accord, New Jersey law should control. In opposition, the insurers argue that New York law applies and that under New York law, coverage for the Common Stock Litigation is precluded as a matter of law whereas the outcome under New Jersey law is less clear.[24] Upon thorough consideration of the extensive briefing submitted by AT&T and the insureds, the Court finds that New York law governs the construction of the policies comprising the 1997 AT&T Program.

[22] AT&T's Opening Br., D.I. 102, Resp. Br. of Natl' Union in Opp'n., D.I. 245, Opp'n by Federal Ins. Co., D.I. 246, AT&T Corp.'s Consolidated Reply, D.I. 251, Am. Stipulation and Order, D.I. 320, Opening. Br. of Pl. AT&T Corp. Regarding the Proper Choice of Law ("AT&T Choice of Law Opening Br."), D.I. 490, Insurers' Supplemental Br. on Choice of Law ("Insurers' Choice of Law Opening Br."), D.I. 497, AT&T Choice of Law Answ. Br., D.I. 517, Insurers' Choice of Law Answ. Br., D.I. 518.
[23] AT&T Choice of Law Opening Br. at 26.
[24] Insurers' Choice of Law Answ. Br. at 2.

B. The Choice of Law Provision in the ACE 4th Excess Policy

In support of their argument that New York law applies, the insurers point to a choice of law provision contained in the ACE 4th excess policy which provides that that policy "shall be construed and enforced in accordance with the internal laws of the state of New York."[25] The Twin City 5th excess policy and the Travelers 6th excess policy provide that they follow form to the ACE 4th excess policy.[26] Thus, according to the insurers, because the Twin City and Travelers policies are governed by New York law, New York law must be applied to the entire 1997 AT&T Program.[27] National Union argues that even though the ACE 4th excess policy sits *above* its policy (and thus cannot "follow form"), the National Union Policy should be governed by New York law for consistency purposes.[28]

The Court is convinced that the choice of law provision in the ACE 4th excess policy is dispositive of the choice of law issue. There can be no question that the Twin City and Travelers policies follow form to the ACE 4th excess policy. The Twin City 5th excess policy provides:

> This policy is subject to the same warranties, terms, conditions, definitions, exclusions and endorsements…as are contained in or as may be added to the policy of the Primary Insurer, together with all the warranties, terms, conditions, exclusions and limitations contained in or added by endorsement to any Underlying Excess Policy(ies).[29]

[25] Directors and Officers Liability Insurance Policy, Joint Defense ("JD") Ex. 6 at ¶IV § J.
[26] JD Ex. 60 at III § A; JD Ex. 7 at II § D, 1.
[27] Insurers' Choice of Law Answ. Br. at 4.
[28] Insurers' Choice of Law Opening Br. at 10.
[29] JD Ex. 60 at III § A. The Underlying Policies include the ACE 4th excess policy.

Similarly, the Travelers 6th excess policy provides:

> The Insured Company agrees that this Policy, except as herein stated, is subject to all terms, conditions, agreements and limitations of the Underlying Insurance in all respects as in effect of the Policy Inception Date. In the event that any excess policy identified in Item 4(b) of the Declarations contain terms, conditions, agreements and/or limitations which are not contained in the Primary Policy, such terms, conditions, agreements and limitations shall also apply to this Policy…"[30]

AT&T's argument that the Twin City and Travelers policies fail to incorporate by reference the choice of law provision contained in the ACE 4th excess policy in unavailing. Under New York law, before a document will be deemed to have been incorporated by reference into another instrument or agreement, the agreement must: (1) specifically reference and sufficiently describe the document to be incorporated, and (2) there must be a clear manifestation of intent to be bound by the terms of the incorporated instrument. The Twin City and Travelers policies comply with the New York standard for incorporation by reference.

AT&T's reliance on *In re Enron Corp. Securities, Derivative &"ERISA" Litig.*,[31] is misplaced. In that case, the follow form policies at issue provided coverage in conformance with the primary policy and "any other Underlying Insurance." The primary policy, however, contained several provisions that clearly conflicted with provisions contained in an Underlying Insurance policy. Because

[30] JD Ex. 7 at II § D, 1. Item 4(b) of the Declarations references the ACE 4th excess policy.
[31] 391 F. Supp. 2d 541 (S.D. Tex. 2005).

the follow form policies incorporated inconsistent provisions, the Court was faced with the dilemma of deciding which provision controlled. In that situation, the court held that the reference to "any other Underlying Insurance" was "totally lacking" in specificity and thus deficient under New York law.[32] The facts of this case are distinguishable because here the Court is not faced with conflicting provisions. The Lloyd's primary policy and ACE 4th excess policy, for all relevant purposes, do not contain inconsistent provisions. The ACE 4th choice of law provision provides that New York law shall govern whereas the Lloyd's primary policy is silent. This does not create an inconsistency. The Travelers policy expressly addresses the present situation and provides that in the event that an underlying policy contains terms not contained in the primary policy, then the terms of the underlying policy shall apply. The lack of specificity concerns raised in *In re Enron*[33] are not applicable in this case.

AT&T also argues that ACE's choice of law provision is part of a set of dispute resolution (ADR) provisions and that ADR provisions are not incorporated by reference like coverage provisions.[34] The Court disagrees. The arbitration provision is found in Section IV§ (I) of the ACE 4th policy under the heading "Arbitration." The choice of law provision, however, is found in Section IV§ (J) of the ACE 4th policy under the heading "Governing Law and Interpretation." The

[32] *In re Enron*, 391 F. Supp. 2d at 581.
[33] *Id.*
[34] AT&T Choice of Law Answ. Br. at 34 n. 114.

provisions are found in two distinct sections, under distinct headings, and are distinguished by their express terms. AT&T offers no reason why the Court should conflate these two provisions.[35]

AT&T next argues that if, as the insurers claim, the Twin City and Travelers policies follow form on the choice of law provision, they must also follow form on the arbitration provision contained in the ACE 4th excess policy yet neither Twin City nor Travelers have invoked this provision.[36] AT&T acknowledges that "by their actions, the Insurers at least impliedly waived, the arbitration provision – not only have the Insurers availed themselves of this Court by answering AT&T's pleadings, but National Union and Travelers have filed counterclaims in response thereto."[37] In *Russykevicz v. State Farm Mutual Automobile Ins. Co.,*[38] the Delaware Supreme Court held that:

> an insured who initiates a suit, generates discovery and responds to discovery in Superior Court prior to making written demand for arbitration upon [its] insurer clearly actively takes steps inconsistent with the right to arbitrate [and such] action affirmatively constitutes

[35] In a footnote, AT&T cites to *In re Enron* for the proposition that there exists a distinction between coverage and dispute resolution provisions. AT&T's reliance is misplaced. There, two excess policies followed form to the primary policy but contained independent ADR provisions. The Court found that the independent ADR provisions controlled. The Court did not acknowledge a distinction between coverage and ADR provisions rather it enforced the general principle that a follow form policy generally incorporates all the terms and conditions of the incorporated document except for those terms otherwise specifically provided in its own policy. *See Aetna Casualty and Surety v. Home Ins. Co.*, 882 F.Supp. 1328, 1345 (S.D.N.Y. 1995).

[36] The arbitration clause contained in the ACE 4th excess policy provides: "Any dispute arising under or relating to this policy, or the breach thereof, *shall* be finally and fully determined in Hamilton, Bermuda under the provisions of the Bermuda Arbitration Act of 1986….[e]ither party to the dispute, once a claim or demand on its part has been denied or remains unsatisfied for a period of twenty (20) calendar days by the other party, *may* notify the other party of its desire to arbitrate the matter in dispute…" To the extent that the language "shall" and "may" create some ambiguity, it does not change the outcome here.
JD Ex. 6 at ¶IV § I,

[37] AT&T Choice of Law Answ. Br. at 33 n. 109.

[38] Del. Ch., No. 13138, V.C. (June 29, 1994) (Mem. Op.).

> an intention to waive the insured's right to demand arbitration and prejudices the insurer by allowing the insured a known tactical advantage under the circumstances of this case.

As the insured, AT&T had notice of the terms of the arbitration provision in the ACE 4th excess policy and it also had knowledge that the Twin City and Travelers policies followed form to that policy.[39] To the extent that AT&T initially filed suit in this Court and failed to notify Twin City and Travelers of its desire to arbitrate as required by those policies, it is reasonable to conclude that AT&T also impliedly waived its right to pursue arbitration. Consequently, the Court finds that AT&T and the insurers impliedly waived their rights to arbitrate and thus failure to arbitrate is not fatal to the insurers' claim.

Twin City and Travelers had a justified expectation that New York law would govern the construction of their policies. This explains why the Twin City policy contains a New York Amendatory Endorsement and a New York free trade zone notice as required by New York Code.[40] AT&T cannot argue around the express choice of law provision in the ACE 4th policy and its effect on the Twin City and Travelers policies. AT&T and the insures are concededly sophisticated parties that understood the meaning and effect of including the New York choice of law provision in the ACE 4th excess policy and the ramifications it would have

[39] *See Smith-Morlock v. Harleysville Ins. Co.*, 2007 WL 316390 (Del. Ch.) (holding that in order to find that a party waived its right to arbitration, the court must find by clear and convincing evidence that the waiving party had actual or constructive notice of its right, and "subsequently, explicitly or through behavior clearly inconsistent with that right, waived the right.").

[40] Insurers' Choice of Law Answ. Br. at 13.

on the excess policies that "follow form." AT&T concedes that the law of a single state must be applied to the entire 1997 AT&T Program.[41] Thus, the Court agrees with National Union that even though the ACE 4th excess policy sits *above* its policy (and thus cannot "follow form"), the National Union Policy should be governed by New York law for consistency purposes.[42]

B. Insurance Policy Construction and Summary Judgment

The construction of an insurance policy is a matter of law for the court.[43] "Absent an ambiguity that requires an inquiry into facts extrinsic to the policy, the construction of an insurance policy is an appropriate subject for disposition on summary judgment."[44] The Court finds that the Fraud Exclusion is not ambiguous and thus the construction of the Fraud Exclusion is an appropriate subject for disposition on summary judgment.[45]

The Fraud Exclusion bars coverage for deliberate dishonest, fraudulent or criminal acts or omissions upon "such finding is material to the cause of action so *adjudicated*." This provision does not bar coverage for dishonest, fraudulent or criminal acts or omissions *unless* (1) there is a "finding" that such acts occurred, and (2) that such finding is "material" to the cause of action being adjudicated.

[41] "AT&T's insurance portfolio, while made of up of separate contracts with numerous insurers, was in reality an integrated whole and must be construed and applied consistently for it to serve its intended purpose." AT&T Answ. Br. in Opp'n to National Union Fire Insurance Co. Mot. for Summ. J., JD Ex. 95 at 21.
[42] Insurers' Choice of Law Br. at 10.
[43] *Alstrin v. St. Paul Mercury Ins. Co.,* 179 F. Supp. 2d 376, 388 (D.Del. 2002).
[44] *Id. at* 388.
[45] *Id*.

Simply stated, Judge Brown's opinion granting partial summary judgment in favor of AT&T is not a "finding" that deliberate, dishonest, fraudulent, or criminal acts/omissions occurred, nor is it an "adjudication."

Trial culminating in a verdict in the underlying lawsuit, the Common Stock Litigation, would be an "adjudication," as that term is used in the Fraud Exclusion, not the trial within a trial that National Union now seeks in this coverage dispute.[46] As the Court in *Pepsico Inc.,*[47] held:

> The exclusion for "dishonesty" attaches only after a "final judgment or other final adjudication" implicates the directors. Such a finding is no longer possible in this case. The class action claims have been dismissed with prejudice and although the S.E.C. investigation resulted in charges against Pepsico, none were asserted against any of its directors or officers. Continental cannot now put the directors and officers other than Ahern on trial to determine whether or not they were, in fact, dishonest to the point that policy will not cover them.

No fact finder considered all the evidence and rendered a "finding" or verdict in the Common Stock Litigation. Judge Brown dismissed certain claims against AT&T and determined that others should be decided by a jury. [48] He did *not* "adjudicate" the claims he did not dismiss, and the fact that the claims surviving summary judgment concerned whether specific forward looking statements were

[46] *See Pepsico, Inc. v. Continental Casualty Co.*, 640 F. Supp. 656 (S.D.N.Y. 1986) *disagreed with on other grounds by* H*Waltuch v. Conticommodity Servs., Inc.*, 88 F.3d 87, 93 n. 8 (2d Cir. 1996)H.
[47] 640 F. Supp. at 660.
[48] *See In Re AT&T Corp. Litigation*, D.N.J. No. 00-5364, Brown, J. (June 4, 2004) (Mem. Op.), James Aff. Ex. 7.

false or misleading when made in no way changes the insurers' obligations under the Fraud Exclusion.

Similarly, the settlement of the Common Stock Litigation did not "adjudicate" anything. A settlement is a settlement. The Court agrees with AT&T that "[i]t would seem obvious that there has been no adjudication or finding of deliberate, dishonest, fraudulent or criminal conduct in a case whose merits *no finder of fact has ever decided*."[49] Nor can there now be an adjudication, because the matter has settled. The "adjudication" contemplated in the policy does not, as National Union asserts, mean an adjudication within the coverage dispute. It means an adjudication in the underlying action.[50]

National Union cannot argue its way around the fact that Endorsement No. 1 replaced the "in fact" exclusion language in Exclusion G with policy language typically found in adjudicated fraud exceptions.[51] National Union's interpretation of the Fraud Exclusion would render the language added by Endorsement No. 1 meaningless and, in any event, its interpretation is belied by the plain language of the exclusion.[52] It is not a close question. The Fraud Exclusion does not entitle the insurers to a trial now on the issue of whether the defendants in the Common

[49] AT&T Cons. Reply Br. at 3 (emphasis added).
[50] *See Atl. Permanent Fed. Sav. & Loan Ass'n*, 670 F. Supp. at 172; *see also Nat'l Union Fire Ins. Co v. Cont'l Ill. Corp.*, 666 F. Supp. 1180, 1197-98 (N.D. Ill. 1987) (finding fraud exclusion "at worst" ambiguous and therefore to be construed against the insurer); *Alstrin*, 179 F. Supp. 2d at 398.
[51] *Id.*
[52] *See Chubb Ins. Co. v. Hartford Fire Ins. Co.*, 1999 WL 760206, at *5 (S.D.N.Y.); *Customized Distrib. Servs. v. Zurich Ins. Co.*, 862 A.2d 560, 567-68 (N.J. Super. Ct. App. Div. 2004).

Stock Litigation engaged in deliberate dishonest, fraudulent or criminal acts.[53] The "cause of action so adjudicated" is not the coverage dispute; it is the underlying action giving rise to the coverage dispute.

National Union argues that under New York law, when the only pending causes of action require a finding of fraud or of a knowing wrongful act, courts will apply the fraud exclusion to a settlement where there has been no actual finding of fraud even if the exclusion requires a final adjudication.[54] In *Alstrin,*[55] the Delaware District Court addressed and rejected this argument because:

> [i]f the deliberate fraud exclusion applies to securities claims, there would be little or nothing left to that coverage. Particularly, in a D&O insurance policy, where securities fraud claims are among the most common claims filed against directors and officers, the effect of such an exclusion would be particularly devastating. No insured would expect such limited coverage from a policy that purports to cover all types of securities fraud claims.[56]

There is no dispute that the National Union policy expressly provides coverage for securities claims.[57] Under the circumstances here, to hold the Fraud Exclusion applicable to such claims would effectively eviscerate the purpose of the policy.

For these reasons, the Court finds that New York law governs the 1997 AT&T Program and that National Union cannot rely on the Fraud Exclusion to

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[53] *See Nat'l Union Fire Ins. Co.*, 666 F. Supp. at 1197-98; *Atl. Permanent Fed. Sav. & Loan Ass'n Cas. Co.*, 670 F. Supp. at 171-72; *Pepsico*, 640 F. Supp. at 659.
[54] Resp. Br of National Union in Opposition to Mot. by AT&T for Partial Summ. J. at 15; citing *Tartaglia v. Home Ins. Co.*, 240 A.D. 2d 396, 398 (2nd Dep't, N.Y. App. Div. 1997).
[55] 179 F. Supp. 2d at 397-398.
[56] *Id.* at 398.
[57] James Aff. Ex. 1, End. 1, Clause 17 (Lloyd's 1997-2001 Policy).

deny coverage for the settlement and defense costs in the Common Stock Litigation.

IT IS SO ORDERED.

Jan R. Jurden, Judge