EFiled: Aug 29 2013 10:34AM EDT
Filing ID 53948579
Case Number 209,2013

IN THE SUPREME COURT OF THE STATE OF DELAWARE

DR. HENRY T. NICHOLAS, III, *et al.*,	)	
	)	No. 209, 2013
Plaintiffs Below/Appellants,	)	
v.	)	Court Below – Superior Court of the State of Delaware, in and for New Castle County Case No. N12C-07-311 JRJ CCLD
	)	
NATIONAL UNION FIRE INSURANCE COMPANY OF PITTSBURGH, PA, *et al.*,	)	
	)	
Defendants Below/Appellees.	)	

APPELLEE TWIN CITY FIRE INSURANCE COMPANY'S SUPPLEMENTAL ANSWERING BRIEF

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Dated: August 29, 2013

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NATURE OF PROCEEDINGS

This action was filed by Plaintiffs-Appellants Dr. Henry T. Nicholas, III, William J. Ruehle, and Dr. Henry Samueli (collectively, "Appellants"), in Superior Court in and for New Castle County alleging that Twin City and the other Appellees engaged in tortious bad faith and tortious interference with contract. Appellants, three of Broadcom's current or former top executives, were defendants in a federal lawsuit filed in California that alleged they and others had unlawfully "backdated" stock options. The other defendants and derivative plaintiffs entered into a Stipulation and Agreement of Partial Settlement (the "Stipulation" or "Partial Settlement"), that "fully incorporated" an "Insurance Agreement" that provided almost all of its funding. Appellees are insurance companies who were parties to the Insurance Agreement.

Although Appellants objected to the "Stipulation," the settlement was approved by the United States District Court for the Central District of California in 2010. Appellants appealed, but then, following their own settlement, they dismissed the appeal and agreed in a second, court-approved "Plaintiffs' Settlement" not to pursue coverage under the insurers' policies and "not to make any claims seeking to invalidate or void the Insurance Agreement or any provision therein."

In response to the action filed in Superior Court, Appellees brought a motion to dismiss on several grounds, maintaining that: the Complaint violated Appellants' court-approved covenant not to "make any claims seeking to invalidate or void the Insurance Agreement or any provision therein," the Complaint was an improper collateral attack on the California federal court's 2010 order approving the Partial Settlement Stipulation, which "fully incorporated" the Insurance Agreement; Appellants' agreement not to pursue any claim to coverage precluded them from stating a cause of action for bad faith; and, Appellants did not state a claim for "tortious interference" because insurers on a common insurance tower are not "strangers" to the insurance contracts with which they allegedly interfered.

Appellee Twin City joined in the motion to dismiss of the other Appellees but also filed a separate motion moving to dismiss the first cause of action. Twin City asserted that Appellants could not prove bad faith under California law because no harm was proximately caused by Twin City. Twin City had exhausted its entire $10 million limit of liability under the Twin City Policy before Plaintiffs' Settlement, the Partial Settlement and Insurance Agreement. Twin City also argued that it had no obligation to preserve its limits of liability for the Appellants' Settlement, and was in fact required to pay the defense costs when they became due.

Judge Jan R. Jurden granted the motion to dismiss in a Decision and Order dated March 19, 2013. Judge Jurden ruled that because Appellants' claims were based on the premise that the Insurance Agreement was unlawful (and could not lawfully be performed by the insurers), Appellants had violated their court-sanctioned agreement not to "make any claims seeking to invalidate or void the Insurance Agreement or any provision therein." Judge Jurden did not address the other grounds supporting the motion to dismiss, including those raised in Twin City's separate motion.

Appellants filed a Notice of Appeal on April 18, 2013, in the Superior Court, which notice was transferred to this Court on May 22, 2013.

SUMMARY OF ARGUMENT

1. Denied. Twin City joins with the other Appellees in their Answering Brief, Points I and II.

2. Denied. There are multiple alternative grounds for upholding the Superior Court's dismissal as to all Appellees. Additionally, as to Twin City, Appellants' Complaint does not sufficiently plead allegations of a prima facie claim for tortious bad faith and therefore the first cause of action cannot survive a motion to dismiss. A necessary element of a tortious bad faith cause of action is the existence of harm suffered as a proximate result of a party's actions. Appellants cannot adequately allege any harm that was proximately caused by Twin City's participation in the Partial Settlement and Insurance Agreement, because (1) Twin City paid out its entire $10 million limit of liability prior to the Partial Settlement and Insurance Agreement; and (2) Twin City had no obligation to preserve its limit of liability for a theoretical future payment by Appellants (i.e., their subsequent Settlement).

STATEMENT OF FACTS

Twin City incorporates by reference and adopts the Statement of Facts set forth in the Answering Brief filed on its behalf and on behalf of Appellees Federal Insurance Company, XL Specialty Insurance Company, National Union Fire Insurance Company of Pittsburgh, Pa., and Arch Insurance Company (collectively, the "Insurers").

Additionally, in addition to the facts referenced in that brief, Twin City notes that Twin City and the other Insurers funded the Partial Settlement with a payment of $118 million, inclusive of the $43.3 million that certain of the insurers previously advanced to Broadcom for defense expenses (Under Side-B of the Broadcom Insurance Program). A.28-29; *see also*, Compl. ¶ 46. On August 20, 2009, the Insurers, Broadcom, and certain of the individual defendants in the Derivative Action entered into a Settlement Agreement and Mutual Release that detailed the terms and conditions of the Insurers' agreement to fund the Partial Settlement. Compl. ¶ 54; *see also*, A.50-63. The Insurance Agreement was made part of the record submitted for court approval. A.17-48. The $43.3 million in defense expenses that certain insurers advanced prior to the Partial Settlement and Insurance Agreement completely exhausted the first two layers of insurance, including all of Twin City's $10 million limit of liability under its policy (the "Twin City Policy"), and partially exhausted certain other layers. A. 54. The

Insurers' contribution to the Partial Settlement was conditioned on the resolution of insurance coverage disputes with Broadcom. A.29. Also, pursuant to the Insurance Agreement, Broadcom made a $2.265 million refund payment to Twin City. A. 55.

In exchange for the Insurers' contribution to the Partial Settlement, Broadcom agreed to indemnify the Insurers for monetary amounts up to the full $210 million of the insurance limits on the Broadcom D&O Program, other than for loss which could be allocated solely to bad faith claims by a non-settling insured. Compl. ¶ 57; A. 58-59.

ARGUMENT

I. APPELLANTS CANNOT ESTABLISH THE NECESSARY HARM FOR TORTIOUS BAD-FAITH

A. Question Presented

Can Appellants establish the requisite harm for tortious bad-faith where Twin City had exhausted its entire $10 million limit of liability under the Twin City Policy and Appellants had no rights or interests remaining in the Twin City Policy by that time?

B. Scope of Review

This Court may affirm an order below based upon a rationale other than those which were set forth by the trial court so long as it was fairly presented to that court. *Cent. Laborers Pension Fund v. News Corp.*, 45 A.3d 139, 141 (Del. 2012); *Standard Distrib. Co. v. Nally,* 630 A.2d 640, 647 (Del. 1993).[1]

C. Merits of Argument

1. Appellants Were Not Harmed by Twin City's Participation in the Partial Settlement and Insurance Agreement.

Appellants' First Cause of Action is based upon the contention that by participating in the Partial Settlement and Insurance Agreement, Twin City somehow prevented Appellants from accessing insurance coverage. Compl. ¶94. That position, however, is meritless because there were no Twin City benefits available. Regardless of whether Twin City participated in the Partial Settlement

[1] In the event that this case is remanded to Superior Court and this Court declines to reach the issues raised by Twin City in its motion, Twin City requests that it be given the opportunity to have its motion to dismiss ruled upon by the Superior Court. *See Unitrin, Inc. v. American General Corp.*, 651 A. 2d 1361 (Del. 1995).

and Insurance Agreement, Appellants did not have any remaining rights or interests in the Twin City Policy at that time. Twin City already had paid out its full $10 million limit of liability through payments made in reimbursement of incurred defense costs – including defense costs paid on behalf of Appellants. A. 54. These payments were made prior to the Partial Settlement and Insurance Agreement. Therefore, Twin City did not cause Appellants any harm and the trial court had this basis upon which it could have relied in dismissing the First Cause of Action as to Twin City.

a. Receipt of the Full Benefit of Twin City's Policy is Fatal to Appellants' Bad Faith Claim.

In its motion to dismiss, Twin City noted that under California law, in order for a plaintiff to properly plead a tortious bad faith cause of action arising from an insurance agreement, the plaintiff must allege the existence of plaintiff's insurance under an insurance policy issued by a defendant, the plaintiff's entitlement to benefits covered by the policy, that defendant failed to deal fairly and in good faith by unreasonably withholding payment of a claim, and that defendant's failure to deal fairly and in good faith caused plaintiff to suffer harm. *See Cal. Jury Instr. Civ. 12.92*; *see also, Love v. Fire Ins. Exch.*, 221 Cal. App.3d 1136, 1151 (Cal. Ct. App. 4th Dist. 1990); *Progressive West Ins. Co. v. Superior Court,* 37 Cal. Rptr. 3d 434, 446-47 (Cal. Ct. App. 3d Dist. 2005).

Of course, the tort claim must describe a cognizable harm that resulted from the purported breach. As the Ninth Circuit explained in *Berg v. First State Ins. Co*, 915 F.2d 460, 465 (9th Cir. 1990), "Under California law, 'uncertainty as to the fact of damage, rather than its amount... negatives the existence of a cause of action.' *Walker v. Pacific Indem. Co.,* 183 Cal. App. 2d 513, 517, 6 Cal. Rptr. 924, 926 (1960). 'Uncertainty as to the fact of damage, that is, as to the ... existence... of the damage, is fatal.' *Allen v. Gardner*, 126 Cal. App.2d 335, 340, 272 P.2d 99, 102 (1954)." The existence of actual harm is such a necessary element that courts have rejected even prospective harm, stating "[i]t is clear that the mere possibility, or even probability, that an event causing damages will result from a wrongful act does not render the act actionable." *Doser v. Middlesex Mutual Ins. Co.*, 101 Cal. App.3d 883 (Cal. App. 1980). The need for a cognizable harm to properly plead a claim for tortious bad-faith also has been extended to specifically include insurance agreements. *See Wolkowitz v. Redland Ins. Co.*, 112 Cal. App.4th 154, 162 (Cal. App. 2003); *Safeco Ins. Co. v. Superior Court of Contra Costa County*, 71 Cal. App. 4th 782 (1999) (where an insurer declines to settle, but then obtains judgment below settlement or obtains a complete defense verdict, the insured has no cause to complain because of the lack of harm).

Where a party successfully establishes harm, the party who breached the duty of good faith is liable for all of an injured party's damages **proximately**

caused by the purported breach. (emphasis added). *Wolkowitz*, *supra*. The Supreme Court of California wrote that "[o]ne of the concepts included in the term proximate cause is cause in fact, also referred to as actual causes." The Court continued that there are two widely recognized tests for establishing cause in fact: the 'but for' or 'sine qua non' rule, which "asks whether the injury would not have occurred but for the defendant's conduct." The second test "asks whether the defendant's conduct was a substantial factor in bringing about the injury." *Mitchell v. Gonzales*, 54 Cal.3d 1041, 819 P.2d 872 (1991)(discussing the proximate cause jury instruction containing, "but-for" test of cause in fact, in California negligence actions).

The entire premise of Appellants' First Cause of Action is that by participating in the Partial Settlement and Insurance Agreement, Twin City somehow prevented Appellants from accessing available insurance coverage. Compl. ¶94. However, regardless of whether Twin City participated in the Partial Settlement and Insurance Agreement, Appellants did not have any remaining rights or interests in the Twin City Policy at that time. Prior to the Partial Settlement and Insurance Agreement, Twin City had already paid out its full $10 million limit of liability through payments made in reimbursement of incurred defense costs – including defense costs paid on behalf of Appellants. A. 54. Accordingly, Twin City's participation in the Partial Settlement and Insurance Agreement did not

prevent Appellants from receiving any further funds from Twin City, and did not cause Appellants any harm.

Faced with the irrefutable logic of Twin City's argument in its motion to dismiss, Appellants responded that Twin City's policy limit is irrelevant to their assertion of harm, and conceded that they received the full benefit of Twin City's $10 million limit of liability. Instead, Appellants advanced below a new argument, maintaining that after Twin City provided the full benefit of its $10 million limit of liability to Appellants and their fellow insureds, Twin City damaged Appellants by depriving them of access to the remaining policy limits of the *other* Insurer Defendants. This allegation was equally meritless, because tortious bad faith must be based on (1) the benefits of the particular policy being withheld; *and* (2) the reason for withholding the benefits must be unreasonable or without proper cause. Since Appellants did not plead the first prong they therefore could not plead the second prong either.

Repurposing the same damages alleged in Appellants' tortious interference claim is not sufficient to sustain their bad faith claim. Whether or not there is any merit to the claim that Twin City prevented Appellants from accessing the other Insurer Defendants' remaining policy limits (and there is none) the simple fact is that Plaintiffs have conceded that Twin City paid its full $10 million limit of liability before the Partial Settlement and Insurance Agreement. Accordingly,

Appellants do not – and indeed, cannot – plead that Twin City withheld any benefits of its policy.

It is well-established that to sustain "tort liability against an insurer for breach of the covenant [of good faith and fair dealing], a plaintiff must show: (1) benefits due under the policy were withheld; and (2) the reason for withholding the benefits must have been unreasonable or without proper cause." *U.S. National Association v. PHL Variable Insurance Co.*, 2012 WL 1525012 (C.D. Cal. April 26, 2012), *quoting Love v. Fire Ins. Exch.,* 221 Cal. App.3d 1136, 1151 (1990). See Exhibit A. Further, "the essence of the tort of the implied covenant of good faith and fair dealing is focused on the prompt payment of benefits due under the insurance policy, there is no cause of action for breach of the covenant of good faith and fair dealing when no benefits are due." *Progressive West Ins. Co. v. Yolo Cnty. Superior Court,* 135 Cal. App. 4th 263, 279 (2005).

With respect to Appellants' claim, none of the few limited circumstances that would support an insured's claim for tortious bad faith and extra-contractual damages after the payment of full benefits due under the policy exists. For example, in *Love v. Fire Ins. Exch.,* the court noted that "[b]ecause peace of mind and security are the principal benefits for the insured, the courts have imposed special obligations, consonant with these special purposes, seeking to encourage insurers promptly to process and pay claims." 221 Cal. App.3d at 1148.

Moreover, "[t]o avoid or discourage conduct which would thus frustrate realization of the contract's principal benefit (i.e., peace of mind), special and heightened implied duties of good faith are imposed on insurers and made enforceable in tort." *Id.* These "implied duties of good faith" include that an insurer "must investigate claims thoroughly; it may not deny coverage based on either unduly restrictive policy interpretations or standards known to be improper; it may not unreasonably delay in processing or paying claims." *Progressive West Ins. Co.,* 135 Cal. App. 4th at 277.

Where an insurer paid the full benefits of a policy, but did so only after failing to thoroughly investigate a claim or after unreasonably delaying payment of the claim, the insured could theoretically maintain a tortious bad faith claim. Such claims necessarily are premised, however, on the fact that the insured was denied access to the benefit of the policy, even if for a limited amount of time.[2] But there is no such allegation here. Appellants could not adequately plead the harm necessary to sustain tortious bad faith because they promptly received the benefit of the full $10 million limit of Twin City's limit of liability and no further benefits are due. To the extent that Appellants are alleging that Twin City caused them harm after providing the full benefits due under its policy, such allegations are

[2] Twin City is not aware of, and Appellants did not cite to, any case law in any jurisdiction that stands for the proposition that an insurer that paid the full limits of its liability in a timely manner can be liable for bad faith.

insufficient to plead a claim for bad faith. Accordingly, the court below had ample basis upon which it could base a dismissal of the tortious bad faith claim.

b. Twin City's Policy Limits Were Exhausted Prior to the Partial Settlement and Could Not Be Replenished.

Again, in response to Twin City's compelling motion to dismiss, Appellants sought to plead the requisite harm by claiming a right to the $2.265 million refund payment that Broadcom made to Twin City under the Insurance Agreement. App. 330.[3]

But, as Twin City explained in its Motion to Dismiss, Appellants cannot argue, on one hand, that they were harmed by Twin City's participation in the Partial Settlement and Insurance Agreement, and then simultaneously seek the refund payment made solely in connection with the complained of Partial Settlement and Insurance Agreement. This logic is consistent with Appellants' statement in their opposition to Twin City's motion that "insureds can pursue bad faith claims as long as they could have been entitled to coverage in absence of the offending parties' acts [entering into the Partial Settlement and Insurance Agreement]." Plaintiffs' Opp. Brief at pg. 3. If Twin City did not participate in

[3] Appellants' characterization below of that payment as a "kickback" is both offensive and, quite simply, legally and factually wrong. Contrary to Appellants' assertion, the refund Twin City received as consideration for agreeing to resolve coverage issues was paid by Broadcom, and not by the other Defendant Insurers. A. 55, ¶¶C and E. The Insurance Agreement recited that "the Insurers [had] raised numerous defenses to coverage of" the Broadcom matters (including rescission), "and dispute whether their respective Policies, or any of them, cover or are otherwise responsible for any and all claims for payment and/or reimbursement of such claimed loss in connection with those matters...." A. 53.

the "offending parties' acts" [entering into the Partial Settlement and Insurance Agreement], Appellants would be in the same position as they are today: with no remaining insurance coverage available to them under the Twin City Policy. As detailed in the Insurance Agreement, Twin City paid its full $10 million limit of liability before the Partial Settlement and Insurance Agreement. Therefore, even in the absence of Twin City's alleged "offending acts," Appellants would not have been entitled to coverage under the Twin City Policy. Even if the Court were to consider the $2.265 million refund payment, the Complaint still fails to plead harm for purposes of their bad faith claim. The simple fact is that Appellants have no rights or interests in the $2.265 million refund payment. Appellants' position would have the ludicrous result of effectively increasing a $10 million limit of liability to a $12.265 million limit of liability.

In their response to Twin City's motion, Appellants offered case law that was, in fact, inapposite. Neither *Reliance Ins. Co. v. Nat'l Union Fire Ins. Co of Pittsburgh, Pa.*, 691 N.Y.S.2d 458 (N.Y. App. Div. 1999)(two companies had issued concurrent policies, one a professional liability policy and the other a commercial general liability policy, to the same policyholder) nor *Flintkote Co. v. General Accident Assurance Co. of Canada*, 2008 WL 2477420 (N.D. Cal. June 18, 2008)(insurer improperly refused to advance defense costs and allowed the insured's other insurer to advance funds to cover the underlying matters) were

analogous to the facts here. See Exhibit B. In those cases, the crux of the courts' decisions was that an insured should not be deprived of the benefit of the full policy it bargained for in a situation where one insurer pays policy funds another insurer should have properly paid. Those cases do not require an insurer to provide a benefit to its insured that is greater than the full limit of liability. The rationale underlying the decisions is simply to ensure that the insured receives the full benefit of its available insurance. *Reliance Ins. Co.* and *Flintkote Co.* have no relevance to the exhaustion of Twin City's policy because Twin City already had provided Appellants with the full benefit of its $10 million policy.

Appellants received the full benefit of the $10 million limit of liability under the insurance contract with Twin City. The subsequent refund Broadcom paid to Twin City in an agreement separate and apart from Twin City's contract to provide insurance does not serve to replenish Twin City's policy. Accordingly, Appellants failed to plead any allegations that establish the harm necessary to sustain a tortious bad faith claim, and on this basis alone the first cause of action against Twin City cannot be sustained.

CONCLUSION

The judgment of the Superior Court should be affirmed.

Respectfully submitted.

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