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**IN THE SUPREME COURT OF THE STATE OF DELAWARE**

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| IN RE INFINITY Q CAPITAL MANAGEMENT, LLC | : | No. 334, 2022<br>No. 335, 2022<br>No. 339, 2022 |
| | : | CASE BELOW: |
| | : | SUPERIOR COURT OF THE STATE OF DELAWARE IN AND FOR NEW CASTLE COUNTY |
| | : | C.A. No. N21C-07-158 EMD CCLD |

# CORRECTED OPENING BRIEF OF APPELLANTS INFINITY Q CAPITAL MANAGEMENT LLC, LEONARD POTTER AND SCOTT LINDELL

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## NATURE OF THE PROCEEDINGS

This insurance coverage dispute concerns an insurance company's obligation to advance the costs incurred by a Delaware limited liability company and its directors and officers in defending against allegations of wrongdoing. Delaware courts have long recognized the fundamental importance of advancing defense costs to Delaware companies and their directors and officers, such as Plaintiffs Below, Appellants, Infinity Q Capital Management LLC ("Infinity Q"), Leonard Potter ("Mr. Potter") and Scott Lindell ("Mr. Lindell") (collectively, "the Insureds") under insurance policies such as the ones sold by the Insurance Companies.[1] So fundamental is this promise that Delaware law requires an insurance company to honor its duty to advance defense costs so long as a claim is even potentially covered by an insurance policy. That obligation extends unless and until the insurance company proves that there is no possible basis for coverage.

The Insureds here were entitled to such advancement. In February 2021, Infinity Q learned that its Chief Investment Officer, Plaintiff-Intervenor Below, Appellant James Velissaris ("Mr. Velissaris"), was accused of adjusting certain parameters within the pricing models of a third-party valuation service that affected

[1] The term "Insurance Companies" refers to Defendants Below, Appellees, Travelers Casualty and Surety Company ("Travelers"), Axis Insurance Company ("Axis"), and Arch Insurance Company ("Arch").

the reported valuation of complex derivatives in Infinity Q's portfolios. As soon as the Insureds disclosed this information, an onslaught of litigations and investigations – the "Noticed Matters"[2] – beset the Insureds.

The Insureds immediately provided notice of the Noticed Matters to their primary insurance company, Federal Insurance Company ("Federal"), as well as to the Insurance Companies, whose policies sit in excess of the Federal Policy. Federal agreed to advance defense costs for the Insureds' defense of the Noticed Matters and exhausted its limits of liability with payments made toward that defense. However, the Insurance Companies, which follow form to the Federal Policy, refused to commit to the advancement of defense costs for the Noticed Matters upon exhaustion

[2] The term "Noticed Matters" refers to: (a) an investigation by the Securities and Exchange Commission ("SEC"), styled *In the Matter of Infinity Q Capital Management, LLC*, No. NY-10234 (SEC Order of Sept. 15, 2020) (the "SEC Investigation"); (b) the actions styled *Yang v. Trust for Advised Portfolios, et al.*, No. 1:21-cv-01047 (E.D.N.Y.); *Hunter v. Infinity Q Diversified Alpha Fund, et al.*, Index. No. 651295/2021 (N.Y. Sup. Ct.); *Rosenstein v. Trust for Advised Portfolios, et al.*, Index No. 651302/2021 (N.Y. Sup. Ct.); *Sokolow v. Trust for Advised Portfolios, et al.*, No. 1:21-cv-2317 (E.D.N.Y.); *Oak Financial Group, Inc. v. Infinity Q Diversified Alpha Fund, et al.*, Civ. Action No. 1:21-cv-03249 (E.D.N.Y.); *Schiavi + Co., et al. v. Trust for Advised Portfolios, et al.*, No. 1:22-cv-00896 (S.D.N.Y.) (collectively, the "Underlying Actions"); (c) an investigation by United States Attorney's Office for the Southern District of New York (the "SDNY Investigation"); (d) a criminal action captioned *United States v. Velissaris*, No 1:22-cr-00105-DLC (S.D.N.Y); (e) an action filed by the SEC, captioned *SEC v. Velissaris*, No. 1:22-cv-01346 (S.D.N.Y.); and (f) an action filed by the CFTC captioned *CFTC v. Velissaris*, No. 1:22-cv-01347 (S.D.N.Y.).



[redacted]

of the applicable underlying limits of liability based upon "Warranty Letters" signed by Infinity Q on August 20, 2020.

The Warranty Letters for each of the Insurance Companies are uniform and warrant that "[n]o person or entity for whom this insurance is intended has any knowledge or information of any act, error, omission, fact or circumstance that may give rise to a claim under the proposed insurance." A00333. The Warranty Letters further provide that "any claim for, based upon, arising from, or in any way related to any act, error, omission, fact or circumstance of which any such person or entity has any knowledge or information shall be excluded from coverage under the proposed insurance." *Id*.

When the Insurance Companies first refused to commit to contribute to the defense of the Noticed Matters upon exhaustion of the underlying limits, the Insurance Companies contended that they needed discovery into the Insureds' "prior knowledge and information when the Warranty Letters were submitted of facts and circumstances giving rise to the Underlying Matters…" This is not how the duty to advance defense costs works under Delaware law. Indeed, the Insurance Companies' initial stance – that there existed only the possibility that the Insureds had the requisite prior knowledge – functioned as a concession that there is at least a potential for coverage and thus a duty to advance defense costs with respect to the Noticed Matters.



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Without a commitment to advance defense costs, the Insureds commenced this Action and immediately moved for summary judgment in the Superior Court. Turning the long-standing Delaware standard relating to the duty to advance defense costs on its head, the Superior Court delayed resolution of the Insureds' motion so the Insurance Companies could explore factual issues relating to the Insureds' knowledge of the SEC Inquiries. The Superior Court hollowed out the established duty to advance defense costs under Delaware law when it held that the Insurance Companies can sidestep their obligation and instead develop a one-sided factual record to avoid coverage through exclusionary language. Black-letter law, as well as case law across the country, holds that advancement is required until the insurance company satisfies its burden to establish that coverage is unambiguously barred.

After permitting the Insurance Companies to develop a record to attempt to meet their burden they otherwise could not meet, the Superior Court then turned into a finder of fact on heavily disputed issues and erroneously ruled on a scant record that the Warranty Letters applied as a matter of law, granting summary judgment in favor of the Insurance Companies. *See* August 15, 2022 Opinion, attached as Exhibit A. The Superior Court seized upon the fact that the SEC sent an inquiry letter to Infinity Q in May 2020 and followed up with another inquiry letter in June 2020 (the "SEC Inquiries") to erroneously conclude that the Warranty Letters were triggered, because Infinity Q knew the SEC Inquiries were "ongoing." The Insurance

Companies, however, never even contended that the mere fact of the SEC Inquiries was sufficient to trigger the Warranty Letters; if that were the case, the Insurance Companies would have had no need for discovery in the first place.

The Superior Court compounded its error by finding the requisite knowledge based on a limited number of documents which the Superior Court concluded showed that Infinity Q knew that the SEC Inquiries may give rise to a claim. However, none of the cherry-picked facts – that Infinity Q consulted with counsel in responding to the inquiries or that Infinity Q tried to stay abreast of the who, what, and why of the SEC Inquiries – alter the absence of knowledge that a claim may be coming. This is particularly true because Mr. Velissaris, Infinity Q's Chief Investment Officer, had significant discretion in determining the valuation of the investments and, notwithstanding his indictment (which occurred many months after the Warranty Letters), Mr. Velissaris's counsel still contended that he "managed investments at Infinity Q with the highest integrity in accordance with all applicable principles." In fact, Mr. Velissaris has pleaded not guilty and appears to be mounting an aggressive defense to the government's charges based upon the legal fees he has incurred to date (which fees have been borne by the investors in the hedge fund Mr. Velissaris managed).

At bottom, the Insureds do not dispute that prior to August 20, 2020, the SEC sent Infinity Q an "inquiry" that touched upon a wide range of topics, including



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valuation of the assets managed by Infinity Q. However, Mr. Velissaris had the responsibility to value the investments, and a fair and accurate valuation often requires flexibility and judgment given the complex nature of the securities. While there may have been an "inquiry," SEC inquiries of registered investment advisers are common and do not equate to a finding that wrongdoing has occurred or knowledge that a claim may arise. The SEC "inquiry" here cannot, in and of itself, show that any individuals at Infinity Q knew, or even should have known, that a claim may arise. An SEC inquiry is not an investigation, an enforcement action, or a Wells letter. Further, even if the SEC had doubts about the valuations of the portfolio – which is something that was never expressed in the SEC Inquiries – the valuation of the complex derivatives in the portfolio was not an exact science but rather subject to the exercise of significant judgment by the party doing the valuation. And, in the case of the portfolio managed by Infinity Q, there was significant discretion in determining the valuation of the investments. Even if a finder of fact were able to conclude based on the limited documentary evidence that the Warranty Letters were violated, to make such a determination on summary judgment, without hearing from a single witness regarding their subjective knowledge, and taking an issue such as this away from the jury, is a clear error as a matter of law.



[redacted]

Perhaps most importantly, the Superior Court committed further error by robbing innocent insured directors – who indisputably had no knowledge prior to the Warranty Letters of any of the facts the Superior Court raised -- of the insurance coverage that every officer and director relies upon before joining a company or board of directors. Indeed, while misrepresentations in the policy application – which are explicitly defined to include any warranty – can be a basis to exclude coverage, the Excess Policies, which incorporate the terms of the Primary Policy, make clear that insureds without any knowledge of the misrepresentations do not lose that coverage (the "Representations and Severability Provision"). The Superior Court's ruling that the Warranty Letters effectively override the Representations and Severability Provision incorporated into the Excess Policies is not only a misapplication of the clear policy language, but a ruling that could have a far-reaching detrimental effect on Delaware companies, because it signals to putative executives that the insurance coverage that they rely upon when joining can be snatched from them despite their complete innocence. The Representations and Severability Provision functions precisely to prevent the Insurance Companies from denying coverage to an individual insured, such as Plaintiff-Appellant Mr. Potter, who indisputably had no knowledge of matters that might give rise to a claim.

The Superior Court erred in finding the Insurance Companies met their burden of proving the applicability of the Warranty Letters, as well as with respect to its

refusal to apply the Representations and Severability Provision. Accordingly, this Court should reverse and enter summary judgment directing the Insurance Companies to advance the Insureds the defense costs incurred in defense of the Noticed Matters.



[redacted]

## SUMMARY OF ARGUMENT

1. The Superior Court erred in resolving in the Insurance Companies' favor disputed issues of fact regarding the Insureds' knowledge at the time Infinity Q signed the Warranty Letters. The Insurance Companies failed to meet their heavy burden of proving the applicability of the Warranty Letters. To apply, the Warranty Letters required the Insurance Companies to prove that Infinity Q had knowledge or information of any act, error, omission, fact or circumstance that may give rise to a claim under the Excess Policies. Under the plain language of the Warranty Letters, it is not enough that a reasonable person might believe a claim may be forthcoming. Rather, the Warranty Letters required actual, subjective knowledge. While the Insureds do not dispute receiving the SEC Inquiries prior to signing the Warranty Letters, that fact is not enough for the Superior Court to find, on a limited documentary record, that someone at Infinity Q had knowledge of a fact or circumstance which may give rise to a claim. In particular, because the SEC was investigating the valuation of certain investments, and Infinity Q's Chief Investment Officer had significant discretion in valuing those investments, the limited documentary evidence did not permit the Superior Court to resolve, as a matter of undisputed fact, that someone at Infinity Q had the requisite knowledge. Indeed, at the time the Warranty Letters were signed, there had been no allegation of wrongdoing and the SEC Inquiries themselves specifically stated that the SEC was

not making any allegation of wrongdoing. In order to reach the conclusion that the subject matter of the SEC Inquiries, or an inquiry itself, may be a basis for a claim, the Superior Court presumed guilt. Without that presumption, the fact of an inquiry is completely inconclusive and the Superior Court erred when it inferred that a claim was possible.

2. The Insurance Companies did not dispute that the Noticed Matters potentially triggered their Excess Policies. Nonetheless, the Superior Court's judgment permitted the Insurance Companies to escape their contemporaneous advancement obligation even before the Insurance Companies were able to prove that there was no basis for coverage under the Excess Policies. Delaware law requires an insurance company to honor its duty to advance defense costs once triggered, which ends only when the insurance company proves that there is no basis for coverage. Here, the Insurance Companies could not meet their burden without discovery. Accordingly, this Court should reverse the Superior Court's judgment and direct the Superior Court to enter an order enforcing the Insurance Companies' duty to advance defense costs at least until the time in which the Insurance Companies are able to prove that there was no basis for coverage.

3. The Superior Court erred in finding that the Representations and Severability Provision in the Excess Policies was inapplicable. The plain language of the Severability Provision contemplates that coverage would be afforded to



innocent directors or officers should there be a breach of a warranty. This is because the Representations and Severability Provision provides that while a misrepresentation in a warranty can be a basis to exclude coverage, those without knowledge of the misrepresentations do not lose coverage. The Superior Court erred in holding that an innocent insured director lost the protection of the Representations and Severability Provision that expressly applied to misstatements made in a warranty.



[redacted]

## STATEMENT OF FACTS

### A. The Insurance Policies At Issue

#### 1. The Federal Primary Policy

In exchange for a significant premium, non-party Federal issued an "Asset Management Protector by Chubb" insurance policy, Policy No. 8251-9651, (the "Federal Primary Policy"), providing $5 million in coverage in excess of a $500,000 retention, for the policy period August 20, 2020 to August 20, 2021. A00212-319. The Federal Primary Policy contains multiple coverage parts potentially applicable to the facts of the Noticed Matters: (a) Directors & Officers Liability Coverage; (b) Professional Liability Coverage, Fund Adviser Liability Coverage; (c) Investment Company Coverage; and (d) Private Fund Coverage. *Id.* Two provisions in the Federal Primary Policy are germane to this dispute.

First, the Federal Primary Policy provides that Federal must advance defense costs on a current basis. A00230-31; A00280. Second, the Federal Primary Policy sets out the contours of the Representations and Severability Provision. The Representations and Severability Provision incorporated into the Excess Policies is clear that, if an "**Application** contains any material misrepresentations, untruthful information or inaccurate statements made with the actual intent to deceive or which materially affect the acceptance of the risk or the hazard assumed by the Company," A00274, "and there is a **Claim** made based upon, arising from, or attributable to,

any such misrepresentations, untruths or inaccuracies, no coverage shall be afforded under this Policy for such **Claim** as to any **Insured Person** who knew of such misrepresentations, untruths or inaccuracies, or to any **Insured Entity** to which such statements are imputed." A00233-34. The Representations and Severability Provision then provides that knowledge will only be imputed, in certain circumstances, to the Insured Entity (Infinity Q), but not other innocent, individual insureds. *Id.*

Importantly, the Representations and Severability Provision, which in part governs representations made prior to the issuance of the policies, applies to a "warranty" because the policy defines **Application** as including any "warranty." A00225. In fact, it is the only provision in any of the policies that can provide a basis to exclude coverage based on an extrinsic document such as a warranty. Thus, even if there were a misstatement contained in a "warranty" (which there is not), knowledge of such misstatement may not be imputed to other individuals, such as Mr. Potter, and the Insurance Companies would still be required to advance costs to these other individuals.

### 2. The Insurance Companies' Excess Policies and the Warranty Letters

Each of the Insurance Companies issued excess executive and organization liability insurance policies (the "Excess Policies") covering the Insureds that follow



[redacted]

form, in relevant part, to the Federal Primary Policy. These Excess Policies are comprised of: (a) a SelectOne+ Excess Policy, Policy No. 107306224, issued by Travelers (the "Travelers Policy") that provides $5 million in coverage in excess of the $5 million in coverage provided by the Federal Primary Policy; (b) an Excess Insurance Policy No. 1010302 0817 issued by AXIS (the "AXIS Policy") that provides $5 million in coverage in excess of the underlying $10 million in coverage; and (c) an Arch Essential Excess Policy, Policy No. IAX1000020-00, (the "Arch Policy") (together with the Travelers Policy and the AXIS Policy, the "Excess Policies"), that provides $5 million in coverage in excess of the underlying $15 million in coverage. A00320-331; A00334-45; A00346-57. In addition, on August 20, 2020, Mr. Lindell, Infinity Q's Chief Compliance Officer at the time, signed Warranty Letters, which read:

> No person or entity for whom this insurance is intended has any knowledge or information of any act, error, omission, fact or circumstance that may give rise to a claim under the proposed insurance.
>
> It is agreed that any claim for, based upon, arising from, or in any way related to any act, error, omission, fact or circumstance of which any such person or entity has any knowledge or information shall be excluded from coverage under the proposed insurance.
>
> It is also agreed that Arch Insurance Group Inc. and its insurance company subsidiaries are relying upon the above representation and that this letter shall be deemed incorporated into any insurance policy issued for the proposed insurance.



[redacted]

*See, e.g.*, A00333.

None of the Excess Policies refer to the Warranty Letters. However, the Warranty Letters are deemed part of the Excess Policies through the Warranty Letters themselves and the Federal Primary Policy's definition of Application, to which the Excess Policies follow form. A00225 ("The Application [which includes warranty] is deemed attached to, incorporated into and made part of this Policy.").

### B. The Investment Strategy Employed By Infinity Q

The coverage dispute arises out of a common core of facts. Established in 2014, Infinity Q managed capital using a variety of strategies, including complex derivative strategies. A00549. Infinity Q is an investment advisor for two funds: Infinity Q Diversified Alpha Fund ("IQDAF"), and (2) Infinity Q Volatility Alpha Fund ("IQDVF"). *Id.* IQDAF is a mutual fund. A00550. While Infinity Q is the investment advisor, IQDAF is issued by Intervenor Below, Appellant Trust for Advised Portfolios ("TAP"). *Id.* TAP provides transfer agent services, fund administration services (including compliance, financial reporting, board of directors), fund accounting services, and custody services. *Id.*

[redacted] A01550. One of these strategies consisted of Bilateral Over The Counter ("OTC") Positions, which were valued using



[redacted]

Bloomberg's Evaluated Pricing services ("BVAL"). A00550. In certain instances, Infinity Q's Chief Investment Officer had the right and responsibility to value these positions to arrive at the Fund's valuation. A00479. In fact, the IQDAF prospectus states that "where market quotations are not readily available *[i.e., for swaps that were valued using certain pricing models]*, fair value shall be determined by the Fund's Adviser." *Id.* In other words, in the context of valuing the Bilateral OTC Positions, Infinity Q was not only permitted to arrive at a valuation, but it was also required to do so, and it had significant discretion about how it did so. *Id.* An inquiry by the SEC into how Infinity Q valued these securities does not in and of itself mean that Infinity Q had any reason to believe it may be subject to a claim later.

### C. <u>In May 2020, Infinity Q Received A SEC Inquiry</u>

By letter dated May 13, 2020, the SEC sent Infinity Q the first of the SEC Inquiries (the "May 2020 Inquiry"). A00635-43. The May 2020 Inquiry sought information on a variety of topics and stated that the [redacted] and that [redacted] *Id.* The Insurance Companies did not argue that the mere fact that Infinity Q received the May 2020 Inquiry triggered the Warranty Letter. Rather, the Insurance Companies and the Superior Court focused on Infinity Q's reaction to the May 2020



[redacted]

Inquiry Letter. None of the facts developed, however, can be interpreted as demonstrating knowledge that a claim may be made against Infinity Q.

The facts relied upon by the Insurance Companies and cited by the Superior Court include: (a) Upon receipt of the May 2020 Inquiry, Mr. Lindell exclaimed "WTF?"; (b) Infinity Q contacted its fund counsel at Dechert, which included, among others, a former co-chief of the SEC Division of Enforcement's Asset Management Unit; and (c) Mr. Velissaris circulated a SEC press release. Ex. A at 25-26. The record facts also show, however, that by the next day, any nervousness at Infinity Q subsided. [redacted] A01112. Shortly thereafter, Mr. Lindell wrote in a Bloomberg chat to Mr. Velissaris: [redacted] A01611. Such a reaction, particularly in conjunction with reaching out to counsel, reflects Mr. Lindell's (and Infinity Q's) inexperience in receiving an informal inquiry, not awareness of facts that may give rise to a claim.

Over the next two weeks, Infinity Q, along with its outside compliance firm, Alaric Compliance, compiled information to respond to the May 2020 Inquiry. On May 29, 2020, Infinity Q responded to the May 2020 Inquiry. A01596-603. In that



[redacted]

response, Infinity Q made clear that it did not believe that it would be subject to a claim, as it responded that it had [redacted] to the request relating to concerns raised about valuation of the assets held by IQDAF.[3] A01596.

On June 23, 2022, the SEC sent Infinity Q the second inquiry of the SEC Inquiries (the "June 2020 Inquiry"). A01157-64. Like the May 2020 Inquiry, the June 2020 Inquiry says that the [redacted] and that [redacted] A01159. As with the May 2020 Inquiry, Infinity Q promptly responded and answered all questions in connection with the June 2020 Inquiry. A01605. For the rest of Summer 2020, Infinity Q had no contact with the SEC.

The Superior Court concluded that Infinity Q did not believe the SEC inquiry was over after it provided responses to the June 2020 Inquiry, Ex. A at 29, notwithstanding that Mr. Lindell expressed his hope, however [redacted] it was, that [redacted] the SEC again after submitting Infinity Q's response to the SEC. A01166. Nonetheless, the Superior Court cited, and the Insurance Companies focused on, three documents regarding a Trust Board Meeting in August 2020 to

[3] While the Government alleges that Mr. Velissaris obstructed the SEC's inquiry in Infinity Q's response to the SEC, A01314-15, those are unproven allegations.



[redacted]

reach the conclusion that Infinity Q understood the SEC inquiry may result in a claim. Ex. A at 26.

First, the Superior Court cited an internal TAP document that "Infinity Q has *resolved* the firm's valuation issues and overall, decreased compliance risks, which were observed at the 2019 site visit." Ex. A at 26; A01175 (emphasis added). Far from establishing knowledge of facts or circumstances that may give rise to a claim, this observation shows that Infinity Q had no reason to believe that it would be subject to a claim in the future, *having resolved the previously observed valuation issues.*

Second, the Superior Court emphasized that at a Trust Board meeting, it was reported that, after noting Infinity Q's response to the June 2020 Inquiry, "there have been no subsequent communications between the SEC and Infinity Q and that the inquiry is ongoing." Ex. A at 26; A01185. Mr. Jensen reported the inquiry was "ongoing" because neither he, nor anyone at Infinity Q, could say what the SEC was doing, as the SEC did not provide status updates. But this communication does not mean that there was knowledge of potential circumstances that may give rise to a claim – it just meant that Infinity Q had not heard from the SEC. The Superior Court inferred a meaning that is not reflected in the record, and there was no testimony taken at the trial court level from which any conclusion could be drawn.



[redacted]

Third, the Superior Court alluded to informal communications between Mr. Lindell and Mr. Velissaris, presumably about their desire to avoid involving the Trust's auditor in the discussions about the SEC Inquiries. Ex. A at 26; A01227; A01229. These conversations do not demonstrate knowledge of anything other than a desire to move on from the SEC Inquiries. Indeed, Infinity Q, having kept the Trust advised on the responses, would have no need to hide anything from the Trust's accountants. Again, there is no testimony on this point in the record, let alone testimony supporting the Superior Court's inferences.

### D. The SEC Formally Investigates Infinity Q

Despite believing that it put the SEC Inquiries behind them, in the fall of 2020, after the Excess Policies were issued, Infinity Q learned that the SEC would be commencing the SEC Investigation. A00550. In November 2020, the SEC issued a subpoena to Infinity Q as part of the SEC Investigation. *Id.* On February 19, 2021, Infinity Q informed IQDAF that at such time it was unable to conclude that the values it had previously determined for the Bilateral OTC Positions were reflective of their fair value. A00551. Infinity Q then informed IQDAF that it would not be able to calculate a fair value for any of the Bilateral OTC Positions in sufficient time to calculate an accurate net asset value ("NAV") for at least several days. *Id.* That same day, Infinity Q informed the SEC that IQDAF was uncertain when it would be able to calculate a NAV that would enable it to satisfy requests for redemptions of



[redacted]

IQDAF's shares and requested an order from the SEC to suspend redemptions and to stop calculating the NAV. *Id.* On February 22, 2021, the SEC issued an order permitting IQDAF to suspend redemptions and postpone the date of redemption payments beyond seven days. *Id.*

Following this disclosure, the Insureds, along with others, were named as defendants in the Underlying Actions. A00358-456; A00508-534. The Underlying Actions alleged various violations of federal securities laws based on IQDAF's disclosures concerning the adjustment of the parameters of the pricing models of complex derivatives in Infinity Q's portfolios. *Id.*

Around the same time the Underlying Actions were filed, Infinity Q also learned of the SDNY Investigation. A00551. In February 2022, the United States Government filed criminal charges against Mr. Velissaris, and the SEC and CFTC commenced civil actions against him. A01348-413; A01414-53.

### E. Federal Agrees To Advance Defense Costs, But The Insurance Companies Fail To Acknowledge Their Obligation To Do So

The Insureds gave prompt notice of the Noticed Matters to the Insurance Companies (the "Claim") beginning in February 2021, when Infinity Q provided notice of the SEC Investigation to the Insurers. A00551. Additionally, Infinity Q provided the Insurers notice of each of the Underlying Actions. A00458-70.



[redacted]

In May 2021, Federal agreed to advance defense costs incurred by Insureds in connection with the Noticed Matters. A00535-47. Yet even though the Travelers Policy follows form to the Federal Primary Policy, Travelers reserved its rights to deny coverage, including "under the warranty letter it received from Infinity Q in connection with its procurement of the" Travelers Policy. A00471-75. Travelers reserved "all of its rights under the Warranty Letter's prior knowledge exclusion" because Travelers alleged that Infinity Q's Chief Investment Officer had knowledge "of an act, error, omission, fact or circumstance that may give rise to a claim under the proposed insurance." *Id.*

Infinity Q promptly responded to Travelers, advising that Infinity Q "strongly disagree[ed] the Warranty Letter's prior knowledge exclusion applies or even potentially applies for several reasons." A00476-80. Infinity Q outlined multiple reasons why Travelers's invocation of the Warranty Letter was misplaced, including: (1) the fact that the parameters of the pricing model were adjusted does not demonstrate that anyone had "knowledge or information of any act, error, omission, fact or circumstance that may give rise to a claim under the proposed insurance," particularly because the Chief Investment Officer had the ability to determine valuations based upon a discretionary valuation process; and (2) the Warranty Letter's prior knowledge exclusion was inapplicable because it remained unproven that anyone at Infinity Q had any of the requisite knowledge. *Id.*



In June 2021, Travelers responded to Infinity Q's letter and maintained its position that the Warranty Letter is part of the Travelers Policy and applied to the Claim, A00494-99, to which Infinity Q responded in July 2021. A00500-04. Despite timely notice and complying with all information requests, neither AXIS nor Arch acknowledged their obligations to Infinity Q for the Noticed Matters. A00551.

### F. The Procedural History of this Action

In July 2021, the Insureds commenced this Action. A00057-77. After the Insurance Companies filed their answers and affirmative defenses, the Insureds filed their motion for partial summary judgment that the Insurance Companies must advance the Insureds the costs of defending against the Noticed Matters. A00183-84. In response, the Insurance Companies contended that further discovery was necessary to determine whether the Insureds had knowledge of circumstances that may give rise to a claim. In November 2021, the Superior Court heard argument and stayed Infinity Q's motion pending limited document discovery into the SEC Inquiry. A00893.

After discovery, the Insurance Companies filed a motion for summary judgment and the Insureds renewed their motion for partial summary judgment. A00008-16. By order dated August 15, 2022, the Superior Court denied the

Insureds' motion for partial summary judgment and granted the Insurance Companies' motion for summary judgment. *See* Ex. A.

Relying on Delaware law, the Superior Court found that the prior knowledge exclusion in the Warranty Letters barred coverage. *Id*. at 35. According to the Superior Court, "the facts relating to the SEC Inquiry are stark and lead to the conclusion that Infinity Q (and its executives) had knowledge of any act, fact or circumstance that may give rise to a claim under the policies that would be issued by the Insurers." *Id.* at 24. Beyond the mere receipt of the Inquiry, the Superior Court emphasized that: (a) Infinity Q brought in outside counsel; and (b) purportedly noted that the SEC inquiry is "ongoing." *Id.* Specifically, the Superior Court concluded that "the undisputed facts demonstrate that Mr. Lindell and Velissaris knew that there were two SEC Inquiries and that the SEC matter was ongoing as of the time the Excess Policies were purchased." *Id.* at 29. Without elaboration, the Superior Court further reasoned that correspondence between Infinity Q and others "further demonstrate knowledge of a circumstance which may give rise to a claim." *Id.* In light of its ruling, the Superior Court declined to rule on the application of the "Prior or Pending Litigation" exclusion in the Excess Policies. *Id*. at 34-35.

Additionally, the Superior Court rejected the Insureds' argument about the applicability of the Representations and Severability Provision. In one line that has far reaching ramifications that will affect all Delaware domiciled corporations, the



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Superior Court eliminated coverage for all innocent director and officer insureds, finding that "the severability provision in the Primary Policy is expressly applicable to Subsection XII.(B)." *Id.* at 34. On September 14, 2022, the Superior Court entered a final judgment order. *See* Final Judgment Order, attached as Exhibit B. On September 15, 2022, the Insureds timely filed their notice of appeal.



[redacted]

## ARGUMENT

## I. THE SUPERIOR COURT ERRED WHEN IT HELD THAT THE WARRANTY LETTER APPLIED

### A. Question Presented

Whether the Superior Court erred when it resolved disputed issues of fact and held that the Warranty Letter applied because the Insureds possessed knowledge of circumstances that may give rise to a claim under the Excess Policies. A01564-77.

### B. Scope of Review and Legal Standards

The meaning and application of insurance policy language is a question of law, reviewed *de novo*. *See ConAgra Foods, Inc. v. Lexington Ins. Co.*, 21 A.3d 62, 72 (Del. 2011). This Court reviews a motion for summary judgment *de novo* "to determine whether, viewing the facts in the light most favorable to the nonmoving party, the moving party has demonstrated that there are no material issues of fact in dispute and that the moving party is entitled to judgment as a matter of law." *Pavik v. George & Lynch, Inc.*, 183 A.3d 1258, 1265 (Del. 2018) (citation omitted).

Additionally, insurance contract interpretation is purely a question of law. *See CNH Am., LLC v. Am. Cas. Co. of Reading, Pa.*, 2014 WL 626030, at *4 (Del. Super. Ct. Jan. 6, 2014). "Where the contract language is clear and unambiguous, the parties' intent is ascertained by giving the language its ordinary and usual meaning." *AT&T Corp. v. Faraday Capital Ltd.*, 918 A.2d 1104, 1108 (Del. 2007). Where there is ambiguity, however, "the doctrine of *contra proferentem* requires that the

language of an insurance policy be construed most strongly against the insurance company that drafted it. It is 'the obligation of the insurer to state clearly the terms of the policy.'" *O'Brien v. Progressive N. Ins.*, 785 A.2d 281, 288 (Del. 2001).

Insurance contracts should be interpreted as providing broad coverage to align with the insured's reasonable expectations. *RSUI Indem. Co. v. Murdock*, 248 A.3d 887, 906 (Del. 2021). Courts will interpret exclusionary clauses with "a strict and narrow construction ... [and] give effect to such exclusionary language [only] where it is found to be 'specific,' 'clear,' 'plain,' 'conspicuous,' and 'not contrary to public policy.'" *Id.* The burden "falls on the insurer to prove the elements of a policy exclusion." *E.I. DuPont de Nemours & Co. v. Admiral Ins. Co.*, 711 A.2d 45, 53 (Del. Super. Ct. 1995). "[A]n exclusionary clause in an insurance contract is construed strictly to give the interpretation most beneficial to the insured." *Sun-Times Media Grp., Inc. v. Royal & Sunalliance Ins. Co. of Can.*, 2007 WL 1811265, at *11 (Del. Super. Ct. June 20, 2007). Warranty letters that form the basis of a coverage exclusion are also construed strictly and narrowly. *Sycamore Partners Mgmt., L.P. v. Endurance Am. Ins. Co.*, 2021 WL 4130631, at *23 (Del. Super. Ct. Sept. 10, 2021).



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## C. Merits of the Argument

### 1. The Warranty Letters Require Subjective Knowledge, Not Whether A Reasonable Person Would Have Known A Claim Would Be Forthcoming

The Warranty Letters required a subjective analysis of Infinity Q's actual knowledge of circumstances that may give rise to a claim, which is distinctly different from whether a reasonable person would have known that a claim would be forthcoming. This absence of objective language in the Warranty Letters is important. A slew of cases cited by the Insurance Companies in the Superior Court utilized objective language in the warranties, permitting the court to apply a warranty if a reasonable person would have expected a claim given what had transpired.

For example, in *B Five Studio LLP v. Great American Insurance Co.*, 414 F. Supp. 3d 336, 340 (E.D.N.Y. 2019), the warranty provided that "prior to the inception date of the first Policy issued by the Company, and continuously renewed, no Principal Insured had a basis to believe that any such Wrongful Act . . . *might reasonably be expected* to be the basis of a Claim." *See also XL Specialty Ins. Co. v. Agogli*, 2009 WL 10656292, at *3-4 (S.D.N.Y. Mar. 2, 2009) (multiple policies containing prior knowledge exclusions that include "reasonable person" or "reason to suppose" language); *Patriarch Partners, LLC v. Axis Ins. Co.*, 758 F. App'x 14, 19 (2d Cir. 2018) (warranty letter stating "The undersigned, on behalf of Patriarch and all of its directors and officers, hereby represents that as of the date of this



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letter neither the undersigned nor any other director or officer of Patriarch is aware of any facts or circumstances that *would reasonably be expected* to result in a Claim under the Captioned Policy" (emphasis added)); *CPA Mut. Ins. Co. of Am. Risk Retention Grp. v. Weiss & Co.*, 915 N.Y.S.2d 57, 57 (App. Div. 2011) (noting prior knowledge exclusion barred coverage for any interrelated acts, "which, before the effective date of the policy, defendants 'believed *or had a basis to believe might* result in a "Claim,'" applied here." (emphasis added)). The absence of a "reasonable standard" in the Warranty Letters therefore required the Insurance Companies to prove that someone at Infinity Q had knowledge of circumstances that may lead to a claim.

In its decision, the Superior Court cited to two decisions it found instructive. Ex. A at 29 n.188. Those cases stand for the proposition that an insurance company needs exacting evidence of knowledge needed to invoke a warranty letter – evidence that is not present here.[4] For example, the policyholder in *Patriarch Partners*, 758 F. App'x at 22, in which the warranty letter imposed a reasonable person standard, was faced with mountains of evidence of a potential claim. In *Patriarch Partners,* the court concluded that the insured's sole officer had breached the warranty because

[4] Ex. A at 29 n.188 (citing *Patriarch Partners*, 758 F. App'x at 22 and *Rivelli v. Twin City Fire Ins. Co.*, 2008 WL 5054568 (D. Colo. Nov. 21, 2008), *aff'd*, 359 F. App'x 1 (10th Cir. 2009)).



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before the policy was issued in August 2011: (a) the SEC issued a letter stating the SEC was conducting an informal inquiry into the company; (b) the company retained counsel and complied with the requests; (c) the SEC sent another letter stating the SEC was proceeding with an informal investigation; (d) counsel for the company learned that the SEC issued an Order of Investigation; (e) the SEC interviewed former executives, who asked for legal expenses; and (f) counsel for the company met with the SEC, who referred to the meeting as a "proffer," and the company then sent out a retention policy reminder directing employees to retain communications and documents. *Id.* at 16-18.

Here, although Infinity Q received the SEC Inquiries and consulted with counsel to respond, prior to signing the Warranty Letters: (a) the SEC did not state it was proceeding with an informal investigation; (b) Infinity Q did not retain counsel to communicate with the SEC and therefore counsel did not learn that the SEC issued an order of investigation; (c) the SEC did not interview Infinity Q executives; and (d) Infinity Q did not meet with the SEC or make any sort of proffer. *Patriarch Partners* is instructive – as it shows that knowledge can be inferred only from material, established facts, not suppositions of Infinity Q's actions after responding to the SEC Inquiries and not hearing from the SEC.

*Rivelli* does not change that analysis. In *Rivelli*, the court found that allegations contained in an amended complaint filed by the SEC showed that the



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insureds knew of wrongful activities at the company that could give rise to a claim. 2008 WL 5054568, at *6. In affirming the district court's decision, the Tenth Circuit referred to the allegations found by the district court to demonstrate the requisite "subjective knowledge." *Rivelli v. Twin City Fire Ins. Co.*, 359 F. App'x 1, 5 (10th Cir. 2009). Those allegations included an acknowledgement by one of the insureds' counsel that one of the insureds knew the nature of the transactions and timing of the revenue recognition scheme, but that he did not appreciate the wrongful nature of the practices. *See Rivelli*, 2008 WL 5054568, at *6-8. The district court rejected that argument, finding that it ignored "basic information that a CEO and CFO of a publicly traded company must know. Anyone holding those positions could not fail to appreciate the potential for liability created by" those transactions. *Id.* at *9. This is a far cry from Infinity Q, where Mr. Velissaris had the right and responsibility to value these positions in certain instances to arrive at the Fund's valuation and has publicly stated (and continues to maintain) that he did so in good faith.

In other words, a warranty letter is enforced only when, unlike here, the evidence of prior knowledge is overwhelming and indisputable. Thus, as discussed below, the Insurance Companies failed to prove that someone at Infinity Q had knowledge of the facts that may give rise to a claim and that those facts were known prior to August 20, 2020. Accordingly, the Superior Court erred in granting the



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Insurance Companies' motion, particularly when it was tasked with viewing the facts in a light most favorable to the Insureds.

### 2. The Superior Court Erred In Concluding That The Warranty Letters Applied

In just one paragraph, the Superior Court concluded that the Warranty Letters applied. In reaching its conclusion, the Superior Court violated basic principles of Delaware law. Delaware law has long required the Superior Court to view the record in a light most favorable to the non-moving party, the Insureds. *See Pavik*, 183 A.3d at 1265. Moreover, this Court has made clear that summary judgment should be denied not only when the record indicates material facts in dispute, but when "it seems desirable to inquire more thoroughly into the facts in order to clarify the application of law to the circumstances." *Pathmark Stores, Inc. v 3821 Assocs., L.P.*, 663 A.2d 1189, 1191 (Del. 1995) (citations omitted).

Thus, when the Superior Court concluded that "undisputed facts demonstrate that Mr. Lindell and Mr. Velissaris knew that there were two SEC Inquiries and that the SEC matter was ongoing as of the time the Excess Policies were purchased[,]" Ex. A at 29; *see also* Ex. A at 24, the Superior Court improperly resolved an issue of fact by construing ambiguous evidence. Additionally, when the Superior Court found that "[c]orrespondence between Mr. Lindell, Mr. Velissaris, the Board of Directors, and Dechert further demonstrate knowledge of a circumstance which may



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give rise to a claim[,]" *id.*, the Superior Court failed to view that evidence in a light most favorable to the Insureds and should have held that a more thorough factual inquiry was warranted.

### a. The Fact of the SEC Inquiries Does Not Give Rise To Knowledge of a Potential Claim

The Superior Court's determination that an "ongoing" SEC Inquiry established knowledge of the potential for a claim is wrong for several reasons. While the Insureds have never disputed that Mr. Lindell and Mr. Velissaris knew of the SEC Inquiries, this does not *ipso facto* mean knowledge of facts and circumstances that may give rise to a claim. In fact, even the Insurance Companies have at least tacitly acknowledged that this fact alone is not sufficient to trigger the Warranty Letters, as they asked for discovery even after they were aware of the SEC Inquiries.

In reaching its conclusion, the Superior Court ignored several facts that dispute the notion that an SEC Inquiry should have led the Insureds to believe there may be a claim. For example, the Superior Court overlooked that: (a) the SEC informed Infinity Q that the [redacted] and that [redacted] and (b) that Infinity Q



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responded that it had no documents relating to [redacted] about valuations. A00635-43; A00644-52.

Moreover, the Superior Court overlooked the fact that, given the discretion Mr. Velissaris had in valuation of the portfolio, Infinity Q would not expect a claim merely because Mr. Velissaris exercised the discretion that he was not only afforded, but required to exercise. The Fund's prospectus is quite clear that "where market quotations are not readily available *[i.e., for swaps that were valued using certain pricing models]*, fair value shall be determined by the Fund's Adviser." A00479. Thus, Infinity Q "had the right and responsibility to adjust parameters in the pricing model to arrive at the Fund's valuation." *Id.* Speaking publicly about this issue, Mr. Velissaris's counsel stated that the "interactive pricing tool is designed to be used interactively by users to make reasonable estimates of asset valuations, and any inquiry will determine James used these tools and others when determining appropriate valuations as part of his efforts to act in the best interests of investors." *Id.* (quoting Gunjan Banerji, *Behind the Mysterious Demise of a $1.7 Billion Mutual Fund*, Wall Street Journal (Apr. 20, 2021)). In that same article, Mr. Velissaris's counsel also stated that "two of the misvaluations described by the Journal were 'clerical errors' that had been remedied and that Mr. Velissaris made efforts 'to act in the best interests of investors.'" *Id.* And even after the indictment, Mr. Velissaris continued to maintain that he "managed investments at Infinity Q with the highest



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integrity in accordance with all applicable principles." Gunjan Banerji, *Infinity Q Investment Adviser Faces Securities Fraud Charges*, The Wall Street Journal (Feb. 17, 2022).

Nor does the evidence support the finding that the Insureds knew the SEC Inquiries were ongoing. In fact, aside from a stray comment by someone outside of Infinity Q, the evidence shows the opposite. After responding to the June 2020 Inquiry, Mr. Lindell wrote that the submission was complete and guessed it was [redacted] A01166.

Nonetheless, even if the SEC Inquiries were ongoing, and Infinity Q was aware of that fact, this does not mean that Infinity Q had "knowledge or information of any act, error, omission, fact or circumstance that may give rise to a claim under the proposed insurance" at the time Infinity Q purchased the Excess Policies. Only with the benefit of hindsight could it even be argued that these facts could be construed to show that, as of August 20, 2020, anyone "had 'knowledge or information of any act, error, omission, fact or circumstance that may give rise to a claim under the proposed insurance.'" But that does not mean Infinity Q breached the Warranty Letters at the time they were signed.



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### b. The Superior Court Erred By Not Viewing The Correspondence Submitted By The Insurance Companies In A Light Most Favorable To The Insureds

Second, the Superior Court erred by taking out-of-context communications "between Mr. Lindell, Mr. Velissaris, the Board of Directors, and Dechert" to find "further demonstrate[d] knowledge of a circumstance which may give rise to a claim." Ex. A at 29. As noted above, Delaware law prohibited the Superior Court from construing these out-of-context statements – none of which admit knowledge of circumstances on the part of anyone at Infinity Q – against Infinity Q.

Puzzlingly, the Superior Court did not explain on what communications it relied. What is clear is that the Superior Court did not construe any facts in favor of the Insureds and based its determination on inferences from the limited documentary evidence without hearing from a single witness. Thus, to the extent that the Superior Court relied on the fact that Mr. Lindell exclaimed "WTF?" to the first SEC Inquiry, it erred; the Superior Court could not find that this statement demonstrated, as a matter of law, any factual knowledge of the potential for a claim. Instead, as the Insureds proffered, Mr. Lindell's reaction may simply signal his confusion as to why the SEC would even inquire into Infinity Q. Similarly, the fact that Mr. Velissaris and Mr. Lindell contacted counsel and investigated the SEC's interest in Infinity Q does not show that anyone at Infinity Q had specific knowledge of any facts that

may give rise to a claim within the scope of the Excess Policies. Instead, they show a reasonable contemporaneous reaction of a company that believed it did nothing wrong facing a government inquiry.

In addition to construing every fact in favor of the Insurance Companies, as noted above, the Superior Court ignored the key fact that Mr. Velissaris's actions in valuing the portfolio were expressly contemplated by the mutual fund's prospectus, and afforded him significant discretion in doing so. Thus, the fact that the SEC inquired into valuation practices at Infinity Q did not mean that anyone had "knowledge or information of any act, error, omission, fact or circumstance that may give rise to a claim under the proposed insurance."

These facts, ignored by the Superior Court, contradict any finding that someone at Infinity Q was aware of an act, error, omission, fact, or circumstance that may give rise to a claim. Accordingly, the Superior Court committed clear error when it resolved these disputed issues of fact as to the supposed subjective knowledge of Mr. Lindell and Mr. Velissaris, particularly because Mr. Velissaris had the express authority and responsibility to use whatever tools he deemed appropriate to value the investments fairly and accurately in client portfolios.



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## II. THE INSURANCE COMPANIES' NEED TO TAKE DISCOVERY TO PROVE THE APPLICABILITY OF THE WARRANTY LETTERS CONFIRMED THEIR OBLIGATION TO ADVANCE DEFENSE COSTS

### A. Question Presented

Whether the Superior Court erred in permitting the Insurance Companies to escape their contemporaneous advancement obligations even when they were unable to satisfy their burden to prove the applicability of the Warranty Letters without discovery. A00824-27.

### B. Scope of Review and Legal Standards

The Scope of Review and Legal Standards are outlined in Section I(B), *supra*. Whether an insurance company has a duty to advance defense costs is examined in the same manner as determining whether an insurance company has a duty to defend. *See IDT Corp. v. U.S. Specialty Ins. Co.*, 2019 WL 413692, *10 (Del. Super. Ct. Jan. 31, 2019) (citation omitted). Like the duty to defend, Delaware courts construe the duty to advance defense expenses "'broadly in favor of the policyholder,'" "which arise[s] whenever the underlying complaint alleges facts that fall within the scope of coverage." *Legion Partners Asset Mgmt., LLC v. Underwriters at Lloyd's London*, 2020 WL 5757341, at *6 (Del. Super. Ct. Sept. 25, 2020) (citation omitted). Once a policy meets that burden of proving that the underlying complaint alleges facts that fall within the scope of coverage, "the burden shifts to the [insurers] to prove that

the event is excluded under the policy." *Id.* at *7 (citation omitted). An insurance company must advance defense costs if there exists any potential for coverage under the Excess Policies. *See Continental Cas. Co. v. Alexis I. duPont School Dist.*, 317 A.2d 101, 105 (Del. 1974) (finding a defense is owed even "where there exists some doubt as to whether the complaint against the insured alleges a risk insured against, that doubt should be resolved in favor of the insured").

### C. Merits of the Argument

#### 1. The Insurance Companies Conceded That They Could Not Meet Their Burden Of Proof To Avoid Their Duty To Advance Defense Costs

Initially, in the Superior Court, the Insurance Companies did not dispute that the Noticed Matters potentially triggered the Excess Policies, which means that the Insurance Companies bore the burden of proving that a given claim is somehow excluded. Instead of denying coverage outright, the Insurance Companies contended that they needed discovery to prove the applicability of the Warranty Letters. The Insurance Companies thus effectively admitted that the SEC Inquiries were insufficient by themselves to show a breach of the Warranty Letter. Under the relevant legal standard governing the duty to advance, this concession meant that the Insurance Companies should have been advancing defense costs, notwithstanding their purported need for additional information, until the Insurance Companies proved as a matter of undisputed fact and law that the Warranty Letters applied. But



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the Superior Court allowed the Insurance Companies to escape their duty to advance defense costs altogether and fish for more discovery to ultimately exclude the Insureds' claim nearly a year after the Insureds first sought to compel the Insurance Companies to advance defense costs. This is contrary to the purpose of the advancement provision since the Insurance Companies' could not meet their burden of proof.

Importantly, courts from around the country have held that the purpose of the policy for providing a contemporaneous defense is to fund the defense without awaiting discovery. For example, in *Expedia, Inc. v. Steadfast Ins. Co.*, 329 P.3d 59 (2014),[5] the Supreme Court of Washington reversed and remanded the trial court's order denying Expedia's motion for summary judgment on the duty to defend until discovery was complete. The insurer in *Expedia* made the same arguments as the Insurance Companies made below and claimed that discovery was necessary to determine its defense obligation to Expedia. Like the Superior Court, the trial court initially agreed. However, the Washington Supreme Court found the insurers'

[5] Washington law is the same as Delaware law in determining a defense obligation. *See Expedia*, 329 P.3d at 64-65 ("'The duty to defend arises when a complaint against the insured, construed liberally, alleges facts which could, if proven, impose liability upon the insured within the policy's coverage.'" Furthermore, exclusionary clauses in the insurance contract "'are to be most strictly construed against the insurer.'" (citations omitted)).



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arguments for discovery (to produce extrinsic evidence to disclaim its duty to defend the insured) unpersuasive and held, "[i]f a showing of potential coverage was made and the insurers did not produce undisputed evidence that conclusively eliminated any possibility of coverage," the insured's motion for summary judgment should be granted. *Id*. at 66. The *Expedia* Court vacated the trial court's order and remanded the case, instructing the trial court to determine the insurers' duty to defend their insured and to stay discovery in the coverage action until it can determine the impact of such discovery on the underlying litigations. *Id.* at 67.

A similar result was reached by the California Court of Appeals in *Haskel v. Superior Court*, 39 Cal. Rptr. 2d 520, 527-28 (1995). In *Haskel*, the court held that an insurer may not "delay an adjudication of their defense obligation until they develop sufficient evidence to retroactively justify their refusal to provide that defense." The *Haskel* court reasoned that such a delay was contrary to the bedrock defense principles underlying insurance and that the immediate imposition of a defense is "necessary to provide an insured the full benefits due under the policy." *Id.* at 521.

Here, Delaware law is in accord. *See HLTH Corp. v. Axis Reinsurance Co*, 2010 WL 60128, at *3 (Del. Super. Ct. Jan. 7, 2010) (noting the well-settled Delaware public policy that "the duty to advance defense costs is particularly important in a directors and officers insurance case because it provides the directors



and officers with immediate access to insurance funds, 'which is necessary to maintain a successful defense'"). By relying on incomplete discovery in opposing the Insureds' renewed motion, the Insurance Companies effectively acknowledged that they were unable to prove that there was no potential for coverage under the Excess Policies. The Excess Policies and the law required the Insurance Companies to contemporaneously advance defense costs until they could meet their burden to prove that a Claim is not covered, which the Superior Court ignored.

In fact, the Superior Court's judgment shows the untenable situation faced by the Insureds. At the time, and continuing to this day, there is an active investigation that delves into some of the Insureds' actions. By permitting the Insurance Companies to avoid their defense obligation while they developed their own record, the Superior Court forced the Insureds "to fight a two-front war, litigating not only with the [Government and the underlying plaintiffs], but also expending precious resources fighting an insurer over coverage questions – this effectively undercuts one of the primary reasons for purchasing liability insurance." *Travelers Property Cas. Co. of Am. v. N.Y. Radiation Therapy Mgmt. Servs.*, 2009 WL 2850691, at *2 (S.D.N.Y. 2009) (quoting *Haskel*, 39 Cal. Rptr. 2d at 529).

As the Insurance Companies could not meet their burden, the Superior Court should have found that the Insureds are entitled to their promised-for defense until they could meet their burden. Accordingly, the Superior Court's judgment should



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be reversed and the case should be remanded. The Superior Court should be directed to enter judgment in favor of the Insureds and order that the Insurance Companies advance the Insureds the costs of their defense until such time that the Insurance Companies prove the applicability of the Warranty Letters or any other exclusion in the Excess Polices.



## III. EVEN IF THE WARRANTY LETTERS APPLY, THE REPRESENTATIONS AND SEVERABILITY PROVISION INCORPORATED INTO THE EXCESS POLICIES PREVENTS THE INSURANCE COMPANIES FROM DENYING COVERAGE FOR INNOCENT INSUREDS

### A. Question Presented

Whether the Superior Court erred in concluding that the Representations and Severability Provision did not apply to the Warranty Letters. A01579-82.

### B. Standard of Review and Legal Standards

The meaning and application of insurance policy language is a question of law, reviewed *de novo*. *See ConAgra Foods*, 21 A.3d at 72.

In interpreting exclusionary clauses, Delaware law requires exclusionary clauses be "accorded a strict and narrow construction[,]" and must be "'specific,' 'clear,' 'plain,' 'conspicuous,' and '*not contrary to public policy.*'" *Murdock*, 248 A.3d at 906 (emphasis added).

### C. Argument

#### 1. The Representations and Severability Provision Applies To Misrepresentations Made In A Warranty

The Representations and Severability Provision incorporated in the Excess Policies is clear that individuals without knowledge of a misrepresentation in a "warranty" do not lose coverage for claims otherwise implicated by the misrepresentation. In holding that the Representations and Severability Provision has no application here, the Superior Court erred. Specifically, the Representations



and Severability Provision says that if an "**Application** contains any material misrepresentations, untruthful information or inaccurate statements made with the actual intent to deceive or which materially affect the acceptance of the risk or the hazard assumed by the Company," A00274, "and there is a **Claim** made based upon, arising from, or attributable to, any such misrepresentations, untruths or inaccuracies, no coverage shall be afforded under this Policy for such **Claim** as to any **Insured Person** who knew of such misrepresentations, untruths or inaccuracies, or to any **Insured Entity** to which such statements are imputed." A00233-34. The policy defines **Application** as including any "warranty." A00225. Thus, under the provision incorporated into the Excess Policies, for any misstatement contained in a "warranty," knowledge of such misstatement may not be imputed to other individuals and the Insurance Companies would still be required to advance costs to these other individuals.

In reaching its determination, the Superior Court found that the Representations and Severability Provision is only "expressly applicable to Subsection XII.(B)." Ex. A at 34. That is exactly the point; Subsection XII.(B) is how a warranty gets incorporated into the Excess Policies. Subsection XII.(B) does not prevent the Representations and Severability Provisions from applying here, it is the incorporating language. The Warranty Letters are deemed part of the Excess Policies through the Excess Policies' incorporation of the definition of **Application**.



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A00225 ("The Application [which includes warranty] is deemed attached to, incorporated into and made part of this Policy.").

The Representations and Severability Provision applies to any **Claim** based upon or arising from any misrepresentation in a warranty (as part of the definition of **Application**). Here, the **Claim** arises from an alleged misrepresentation in a warranty, which means under the plain language of the Severability Provision, only certain individuals and the company may be imputed with knowledge. Any insured reading the Excess Policies would understand that misstatements made in a warranty would not bar coverage for those innocent individuals who made no such misstatements. *See Murdock*, 248 A.3d at 906 ("Insurance contracts should be interpreted as providing broad coverage to align with the insured's reasonable expectations.").

The Superior Court further erred in failing to properly apply the Representations and Severability Provision. In its decision, the Superior Court acknowledged that, even if the Representations and Severability Provision applied, it imputes knowledge by a "Chief Compliance Officer . . . unto the "Insured Entity and any of its Subsidiaries." Ex. A at 34. The Superior Court missed the fact that this means that knowledge is <u>not</u> imputed to innocent insureds, like Mr. Potter and others. Mr. Potter served on the board of Infinity Q and indisputably did not learn of the SEC inquiry until the fall of 2020, after the execution of the Warranty Letters.



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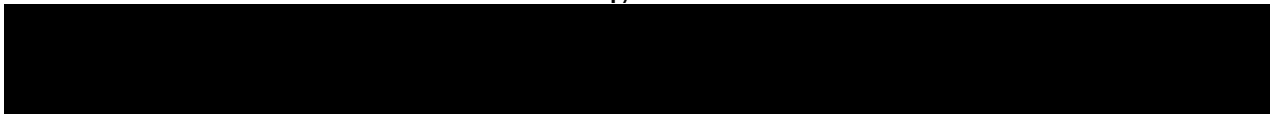
A00550. Under the plain language of the Representations and Severability Provision, the knowledge resulting from the misstatement in the Warranty Letters cannot be imputed to him. Moreover, subsection (d) of the Representations and Severability Provision states that the Insurance Companies "shall not be entitled under any circumstances to rescind" the policies. A00234. Yet, that is what the Superior Court did – it permitted the Insurance Companies to effectively rescind coverage as to Mr. Potter, even though the Excess Policies say that knowledge will not be imputed to him.

### 2. The Superior Court's Refusal To Apply The Representations and Severability Provision Will Have Significant Consequences For Delaware Directors and Officers

The Superior Court's narrow construction of the Representations and Severability Provision denies Delaware corporate entities, and their deep bench of directors and officers, Delaware's strong public policy in favor of protecting innocent directors and officers. If left in place, the Superior Court's judgment will discourage qualified individuals to serve as directors and officers of Delaware companies for fear of personal liability, in light of the Superior Court's misconstruction of a Representations and Severability Provision. As one commentator noted, the Superior Court's decision "leaves board members without protections they thought they had." A01842.





Indeed, this Court has long confirmed that Delaware's public policy "to 'promote the desirable end that corporate officials will resist what they consider' unjustified suits and claims, 'secure in the knowledge that their reasonable expenses will be borne by the corporation they have served if they are vindicated.'" *Hibbert v. Hollywood Park, Inc.*, 457 A.2d 339, 343-44 (Del. 1983) (citation omitted). In *Hibbert*, this Court continued that purpose behind Delaware's public policy "to encourage capable [persons] to serve as corporate directors, secure in the knowledge that expenses incurred by them in upholding their honesty and integrity as directors will be borne by the corporation they serve." *Id.* (internal citation omitted). The Superior Court's interpretation of the Representations and Severability Provision vitiates the protections encouraged by this Court and the Delaware legislature, with a lasting impact on the ability of Delaware companies to recruit and retain capable directors and officers.

Insurance, like the Excess Insurance at issue here, helps support Delaware's goal of limiting the exposure of Delaware's directors and officers. *See* E. Norman Veasey, Jesse A. C. Finkelstein, C. Stephen Bigler, *Delaware Supports Directors with A Three-Legged Stool of Limited Liability, Indemnification, and Insurance*, 42 Bus. Law. 399, 417 (1987) ("The final 'leg' of support afforded directors under the Delaware statutory scheme is the corporation's purchase of liability insurance on the directors' behalf."); s*ee also id.* at 419 ("insurance plays an important role in



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situations where indemnification is legally permissible but otherwise unavailable because the corporation is either unable or unwilling to indemnify"). Thus, Delaware courts have also long recognized the importance of an insurance company's obligation to advance defense costs to a Delaware corporation's directors and officers. *See HLTH Corp.*, 2010 WL 60128, at *3 (noting the well-settled Delaware public policy that "the duty to advance defense costs is particularly important in a directors and officers insurance case because it provides the directors and officers with immediate access to insurance funds, 'which is necessary to maintain a successful defense'").

With Delaware's lodestar policy of protecting innocent directors and officers to promote the service of qualified individuals on boards of Delaware companies, the Superior Court's error becomes plain to see. The Insurance Companies failed to state clearly and conspicuously in their policies that the Warranty Letter applied notwithstanding the Representations and Severability Provision. *See Murdock*, 248 A.3d at 906. As such, they cannot avoid their defense obligation to an innocent insured, such as Mr. Potter.

In fact, none of the Excess Policies mention a Warranty Letter (or the prior knowledge exclusions contained in the Warranty Letters) as being part of the Excess Policies. The Insurance Companies could have issued Excess Policies providing that the Warranty Letters apply notwithstanding any severability provision. But they did



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not. As one court noted in a similar context: "Silence does not provide the insured with the notice needed that the excess carrier is not following the form of the severability clause, and, therefore, silence cannot supply a specific term to the contrary." *In re HealthSouth Corp.*, 308 F. Supp. 2d 1253, 1282 (N.D. Ala. 2004).

Accordingly, the Representations and Severability Provision must be enforced to provide *innocent insureds* their bargained-for coverage. That result accounts for Delaware's strong public policy to protect directors and officers from personal liability, coupled with Delaware law requiring courts to interpret insurance policies providing coverage for directors and officers broadly while enforcing the reasonable expectations of the insured. Therefore, the Superior Court's determination that the Representations and Severability Provision does not apply must be reversed, and the Insurance Companies must advance the costs to those innocent insureds facing substantial legal bills through no fault of their own other than their status as executives or directors of Infinity Q.



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## CONCLUSION

The Insureds respectfully request that this Court reverse the Superior Court's judgment in its entirety and direct that judgment be entered on the Insureds' motion for partial summary judgment on advancement for the Noticed Matters.

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