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IN THE SUPREME COURT OF THE STATE OF DELAWARE

IN RE INFINITY Q CAPITAL MANAGEMENT, LLC	No. 334, 2022 No. 335, 2022 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 **PUBLIC VERSION**

REPLY BRIEF OF APPELLANTS INFINITY Q CAPITAL MANAGEMENT LLC, LEONARD POTTER, AND SCOTT LINDELL

Kenneth H. Frenchman, Esq.
(*pro hac vice*)
Andrew N. Bourne, Esq.
(*pro hac vice*)
COHEN ZIFFER FRENCHMAN & McKENNA LLP
1325 Avenue of the Americas
31st Floor
New York, NY 10019
Telephone: (212) 584-1890
kfrenchman@cohenziffer.com
abourne@cohenziffer.com

Jennifer C. Wasson (No. 4933)
Carla M. Jones (No. 6046)
POTTER ANDERSON & CORROON LLP
Hercules Plaza, Sixth Floor
1313 North Market Street
Wilmington, DE 19801
Telephone: (302) 984-6000
jwasson@potteranderson.com
cjones@potteranderson.com

Attorneys for Plaintiffs Below, Appellants Infinity Q Capital Management LLC, Leonard Potter, and Scott Lindell

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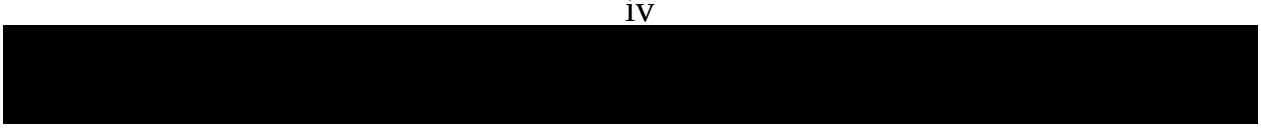

PRELIMINARY STATEMENT

If anything, the Answering Brief ("Answering Br.") filed by the Insurance Companies[1] simply reinforces the errors committed by the Superior Court in condoning the abandonment of the Insureds – particularly the innocent Insureds – by the Insurance Companies at the time when the Insureds needed the bargained-for coverage the most. The errors of the Superior Court all start from the same point – the well-settled standards governing a claim seeking advancement of defense costs from an insurance company. As explained in the Insureds' Opening Brief, under fundamental principles of Delaware law, an insurance company is required to honor its duty to advance defense costs so long as a claim is *potentially* covered by the insurance policy.

Buried at the back of the Answering Brief, the Insurance Companies admit that the numerous Noticed Matters "undeniably constitute a Claim under the Primary Policy to which the Excess Policies follow form." (Answering Br. at 55.) With the "undeniable" potential for coverage for the Noticed Matters, under Delaware law, the Superior Court should have required the Insurance Companies to advance defense costs until the Insurance Companies had satisfied their burden of showing

[1] For the Court's convenience, the terms defined in Corrected Opening Brief of Appellants Infinity Q Capital Management LLC, Leonard Potter, and Scott Lindell (the "Opening Br.") have the same meaning in this Reply Brief.

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that coverage is unambiguously and indisputably barred – a burden which they could not meet. The Superior Court did not. Instead, the Superior Court ignored this precedent regarding the advancement of defense costs.

Moreover, the Superior Court turned another well-settled principle of Delaware law on its head in failing to construe the facts in favor of the non-moving party. As set forth in the Insureds' Opening Brief, the Insurance Companies took discovery and used it to cobble together a justification for their abandonment of their Insureds with suppositions that supposedly show that the Warranty Letters were triggered. These "facts," however, were mere inferences drawn from snippets of a handful of documents, without any testimony or effort given to getting to the bottom of the factual disputes. The Superior Court took the Insurance Companies' spurious story and construed the issues of fact in their favor. The Superior Court erred by acting as the finder of fact on heavily disputed factual issues, in the context of a summary judgment motion, with only an extremely limited record and no testimony. Instead, it should have been up to a jury to balance the credibility of the Insureds' witnesses as to the application of the Warranty Letters, after being presented with a complete evidentiary record.

And if these errors were not enough, the Superior Court committed another error in abandoning principles of insurance policy construction by effectively rescinding the Excess Policies, even as to innocent insured directors. The Insurance

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Companies do not dispute, because they cannot, that there are several Insureds who had no knowledge of any of the relied upon facts prior to the issuance of the Warranty Letters. Yet, the Insurance Companies, like the Superior Court, effectively read the Representation and Severability Provision out of the policy – a provision that makes clear that innocent insureds, who, without knowledge of misrepresentations in a "warranty," are entitled to coverage. If left to stand, this decision will severely and negatively impact Delaware companies by permitting insurance companies to avoid providing coverage to innocent Delaware directors and officers.

Additionally, even if this Court were to accept the Superior Court's decision denying coverage to the Insureds, which it should not, the Superior Court further erred in refusing to enforce the Insurance Companies' duty to advance defense costs until such time that the Insurance Companies proved the Insureds were not entitled to coverage. Thus, when the Superior Court permitted the Insurance Companies to take discovery into the Insureds' "prior knowledge and information when the Warranty Letters were submitted of facts and circumstances giving rise to the Underlying Matters," the Superior Court erred in refusing to require the Insurance Companies to honor their defense obligations until such time as they could prove the Warranty Letters applied. In other words, even though the Insurance Companies concede that the Noticed Matters constitute a covered Claim under the insuring

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agreements of the Excess Policies themselves, by giving the Insurance Companies a free pass from their defense obligation until such time as the Insurance Companies could prove the applicability of an exclusion, the Superior Court abrogated long-standing principles of insurance law.

In the face of these errors committed by the Superior Court, the Insurance Companies argue that there is an alternative ground for affirmance – the "prior or pending proceedings" exclusions. The Insurance Companies seek to transform the SEC Inquiries into the requisite "investigation" or "regulatory proceeding" even though the plain language of the exclusions say otherwise. This last-ditch effort to avoid coverage is based on a misreading of the plain language of the Excess Policies.

Accordingly, nothing presented by the Insurance Companies saves the Superior Court's erroneous decision. The Insureds therefore respectfully submit that this Court reverse the Superior Court's judgment and direct the Insurance Companies to honor the duty to advance defense costs until the Insurance Companies prove the applicability of any exclusion.

[redacted]

ARGUMENT

I. THE SUPERIOR COURT ERRED BY FAILING TO APPLY THE PLAIN LANGUAGE OF THE WARRANTY LETTERS AND RESOLVING ISSUES OF FACT IN THE INSURANCE COMPANIES' FAVOR

A. The Plain Language Of The Warranty Letters Requires A Subjective, Not Objective, Analysis

The Insurance Companies' first attempt to rescue the errors in the Superior Court's decision is to argue that the Superior Court's application of "a mixed subjective/objective test" is correct. (Answering Br. 28-31.) According to the Insurance Companies, this test considers "the insured's [subjective] knowledge of the relevant facts and [requires] an objective determination of whether a reasonable person in the insured's position should have expected such facts to be the basis of a claim." (Answering Br. 30 (brackets in original) (quoting *B Five Studio LLP v. Great Am. Ins. Co.*, 414 F. Supp. 3d 336, 340 (E.D.N.Y. 2019).) This is not what the Warranty Letters say (A01285) and the words "objective" and "reasonable person" appear nowhere.

Instead, the Insurance Companies' cited cases contain prior knowledge exclusions that specifically include language adding an objective element to the respective Warranty Letter. (Answering Br. at 29-31.) Many of these cases were addressed in the Insureds' Opening Brief (Opening Br. at 28-29) and the new cases the Insurance Companies cite are no more helpful to them. For example, the

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Insurance Companies cite to *Sycamore Partners Management LP v. Endurance American Insurance Co.*, 2021 WL 4130631, at *24 (Del. Super. Sept. 10, 2021), in which the warranty letter at issue applied if there was "actual knowledge" of an act that "reasonably could be expected to create a Claim under the Policies."

The best retort the Insurance Companies offer is that the court in *XL Specialty Insurance Co. v. Agoglia*, 2009 WL 10656292, at *3-4 (S.D.N.Y. Mar. 2, 2009), lumped one policy's language that specifically provided that a warranty letter applied when the insured "had reason to suppose" a claim into another's language that did not. That is hardly binding on this Court, which requires, as the Insurance Companies admit, insurance policy construction to "not destroy or twist' the words of a clear and unambiguous contract. (Answering Br. at 28 (quoting *In re Solera Ins. Coverage Appeals*, 240 A.3d 1121, 1131 (Del. 2020).) In any event, the *Agoglia* court specifically found the objective standard within the "reason to suppose" language, and not within the "might afford valid grounds for a claim." *Agoglia*, 2009 WL 10656292, at *7. Here, the phrase "may give rise to a claim" in the Warranty Letters is equivalent to the latter phrase in *Agoglia*, which was not the basis to impose an objective standard of analysis in the Prior Knowledge Exclusion. The objective standard language on which *Agoglia* turns is entirely absent from the Excess Policies at issue here.

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Additionally, the Insurance Companies later cite to *Koransky, Bouwer & Porakcky, P.C. v. Bar Plan Mutual Insurance Co.*, 2012 WL 443957, at *16 (N.D. Ind. Feb. 8, 2012), where the Court applied only an objective standard, not based on the policy language, but rather based on long-standing Indiana law on alleged material misrepresentations in an insurance application: "The answer to a question on an application is held to the standard of 'whether a reasonable professional in the insured's position might expect a claim or suit to result.'" *Id*. at *12-13 ("The only issue is whether Koransky was aware of the circumstances creating a basis to anticipate a claim."). That is not Delaware law and the Insurance Companies attempt to have this Court impose the same standard into the Warranty Letters without any such precedent is wholly improper. Likewise, the Superior Court's analysis wrongly read an objective standard that is otherwise not present into the plain language of the Excess Policies.

Accordingly, unlike the cases relied upon by the Insurance Companies, the Warranty Letters make no reference to any objective standard and are directed only to subjective "knowledge." Thus, to have granted summary judgment in the Insurance Companies' favor, the Superior Court should have required the Insurance Companies to prove that someone at Infinity Q had knowledge of facts that may give rise to a claim and that those facts were known prior to August 20, 2020. The Superior Court erred in concluding that the Insurance Companies met that burden.

[redacted]

B. The Insurance Companies, Like The Superior Court, Rely On Hindsight And Supposition In Contravention Of Summary Judgment Standards

As set forth in the Insureds' Opening Brief, not only did the Superior Court err when it concluded that the Warranty Letters applied, it also erred when it violated basic principles of Delaware law in reaching that conclusion. The Insurance Companies merely echo the Superior Court's reasoning and do nothing to save the Superior Court's decision.

The Insurance Companies do not challenge that Delaware law has long required the Superior Court to view the record in the light most favorable to the non-moving party, the Insureds, *see Pavik v. George & Lynch, Inc.*, 183 A.3d 1258, 1265 (Del. 2018), or 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). Nonetheless, the Insurance Companies construe the pre-warranty letter facts in the same manner as the Superior Court for its solitary conclusion: the Insureds purportedly "knew the SEC Division of Enforcement had an ongoing inquiry into Infinity Q's valuation of fund assets when the Warranty Letters were signed." (Answering Br at 32.)

However, as set forth in the Insureds' Opening Brief (Opening Br. at 32-37), under the proper framework, this conclusion, by relying on inferences from a handful of documents, construed the facts in the light most favorable to the movant and, as such, the Superior Court's decision must be reversed. Indeed, while the Insureds walk through the very same facts cited by the Insurance Companies, and construe them in accordance with Delaware's summary judgment standard, the Insurance Companies construe them to their own benefit with no regard for any standard. In other words, the Insurance Companies can only conclude that the Insureds "knew the SEC Division of Enforcement had an ongoing inquiry," by construing disputed facts showing the opposite. (Opening Br. at 35.) While the Insureds have never disputed that Mr. Lindell and Mr. Velissaris knew of the SEC Inquiries, this does not *ipso facto* suggest knowledge of facts and circumstances that may give rise to a claim. In fact, as previously explained, 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.

Moreover, as explained in the Insureds' Opening Brief, even if the SEC Inquiries were ongoing, that is not enough – the Insurance Companies must also show that Infinity Q had knowledge that the SEC Inquiries may give rise to a claim. (*Id.*) The Insurance Companies, like the Superior Court, point to nothing at that time that would suggest such knowledge and thus a breach of the Warranty Letters.

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Indeed, the facts outside of the inquiry letters presented by the Insurance Companies do not change the analysis, particularly when construed in favor of the Insureds as the Superior Court was required to do. These facts – [redacted] – do not show that anyone at Infinity Q had specific knowledge of any facts that may give rise to a claim that may fall within the scope of the Excess Policies. Nor do these facts show knowledge of facts and circumstances of a potential claim. Instead, they show the reasonable contemporaneous reaction of a company facing a government inquiry.

The Superior Court also failed to consider the fact that [redacted]. The Superior Court ignored all of the facts suggesting that Mr. Velissaris exercised the discretion that he was afforded, such that as of August 20, 2020, Infinity Q did not know that it could face a claim simply because of his actions.

[2] The Insurance Companies allude to Mr. Velissaris's guilty plea and Mr. Lindell's resolution of an SEC action, both of which took place after the Superior Court's decision. (Answering Br. at 24-25.) These events, while are wholly outside the record, do not alter the analysis that the Insurance Companies failed to prove the requisite knowledge at the time the Warranty Letters were signed.

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Indeed, the Superior Court never heard from a single witness and, instead, construed every bit of information contained in the paper record against the Insureds.

C. Even Under A Mixed Subjective/Objective Analysis There Was No Reasonable Basis To Expect A Claim

Given the lack of evidence showing Infinity Q's actual knowledge that a claim may result from the facts underlying the Noticed Matters, the Insurance Companies' argument depends on their rewriting an "objective" standard into the Warranty Letters and the evidence they claim a hypothetical reasonable person could have strung together to believe that a claim against Infinity Q may be made. Considering the Warranty Letters narrowly and the evidence in favor of the Insureds, as this Court must, it is clear that the Superior Court erred.

The SEC Inquiries themselves do not permit such a conclusion because they state that the [redacted] A00638. This stands in sharp contrast to the SEC's formal Order Directing Private Investigation, issued well after the August 2020 Warranty Letter, which states that the SEC [redacted] there were possible violations of securities law. A00583. Therefore, the SEC "inquiry" documents alone do not support the conclusion that someone at Infinity Q knew, or even should have known, of facts

[redacted]

that may lead to a claim. Again, the Superior Court did not consider any testimony and instead made credibility determinations without the benefit of hearing from any witnesses.

In short, only when viewing all the facts with the benefit of hindsight, and construing all the facts against the Insureds on summary judgment, could anyone begin to conclude 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.'"

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II. THE SUPERIOR COURT ERRED IN REFUSING TO APPLY THE SEVERABILITY PROVISION THAT EXPRESSLY APPLIES TO "WARRANTIES"

Although the words "this Warranty Letter is non-severable" appear nowhere in the Warranty Letters, the Insurance Companies contend that the exclusion concerning prior knowledge in the Warranty Letters is not subject to the Representations and Severability Provision incorporated into the Excess Policies. (Answering Br. at 49.) The Insurance Companies' argument is wrong for a number of reasons.

A. The Plain Language Of The Representations And Severability Provision Applies To Misrepresentations Made In A Warranty

The Insurance Companies (like the Superior Court) read out the Representations and Severability Provision from the Excess Policies. This reading violates Delaware law. *See, e.g.*, *RSUI Indem. Co. v. Murdock*, 248 A.3d 887, 905 (Del. 2021) (stating "[i]nsurance contracts, like all contracts, 'are construed as a whole, to give effect to the intentions of the parties.' Proper interpretation of an insurance contract will not render any provision 'illusory or meaningless.'" (citations omitted)). As set forth in the Insureds' Opening Brief, 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. Specifically, the

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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 key here is that **Application** is specifically defined to include 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 as to these other individuals.

Like the Superior Court, the Insurance Companies contend that the Representations and Severability Provision "applies only to one exclusion set forth in the Primary Policy's Subsection XII.(B)." (Answering Br. at 51.) That is not what the Representations and Severability Provision says. It applies if there is an inaccurate statement in a "warranty" and there is a **Claim** arising from (or attributable to) any "inaccuracies," then there is no coverage for the **Insured Person** who knew of such inaccuracies (or to the **Insured Entity**). A00233-34. Here, the

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Insurance Companies do not challenge that the **Claim** arises from an alleged misrepresentation in a warranty and therefore "knowledge" may be imputed only to certain individuals. More fundamentally, Subsection XII.(B) is how the Warranty Letters are 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**. A00225 ("The Application [which includes warranty] is deemed attached to, incorporated into and made part of this Policy.").

As a result, the Insurance Companies' assertion that the "Insureds do not argue that anything in the language of the Prior Knowledge Exclusion itself makes it severable because they cannot," Answering Br. at 50, is a red herring. Reading the Excess Policies as a whole, *see Murdock*, 248 A.3d at 905, the Warranty Letters are incorporated into the Excess Policies by the Representation and Severability Provision. Therefore there is no ambiguity: the Excess Policies' Representation and Severability Provision applies to Warranty Letters.

[redacted]

B. The Insurance Companies' Precedent Did Not Involve Policies That Expressly Apply The Representation And Severability Provision To A Warranty Like The Excess Policies Here

The Insurance Companies couple their misreading of the Representation and Severability Provision with reliance on inapplicable case law. (Answering Br. at 50.) None of the cases cited by the Insurance Companies involved a Representation and Severability Provision that explicitly applied to a "warranty" like the Representation and Severability Provision here. (Answering Br. at 50 (citing *Rivelli v. Twin City Fire Ins. Co.*, 2008 WL 5054568 (D. Colo. Nov. 21, 2008); *Murphy v. Allied World Assur. Co.*, 370 F. App'x 193, 194 (2d Cir. 2010); *Delaware Ins. Guar. Ass'n v. Valley Forge Ins. Co.*, 1992 WL 147998 (Del. Super. June 9, 1992)).) The closest the Insurance Companies come to finding support for their position is *Ironshore Indemnity Inc. v. Kay*, 2022 WL 4329790 (D. Nev. Sept. 16, 2022), in which the district court refused to apply a severability provision to a warranty letter where the severability provision applied to "applications." However, in that case, unlike here, "applications" was not explicitly defined to include a warranty.

In short, none of the Insurance Companies' cases involved a court interpreting whether a severability provision applied to a warranty letter where the plain language of the severability provision covered misrepresentations made in a warranty.

C. The Insurance Companies' Attempt To Avoid Delaware's Long Standing Public Policy Of Protecting Delaware Directors And Officers Should Be Rejected

The Insurance Companies make no effort to hide from the fact that their reading of the Representation and Severability Provision, like the Superior Court's holding, will have a profound effect on Delaware's directors and officers. In fact, the Insurance Companies do not argue otherwise. Instead, the Insurance Companies retort that there is no Delaware public policy requiring an insurer to issue D&O insurance or "prohibiting an insurer newly added to the risk from limiting its coverage based on the unambiguous terms of a warranty letter." (Answering Br. at 53-54.) The Insurance Companies' argument is a non-sequitur because, while nothing in Delaware public policy would prohibit an insurance company from limiting coverage, the Insurance Companies failed to do so here.

The Insurance Companies do not challenge the well-settled principle of Delaware law that exclusions – like the Warranty Letters – must be stated clearly and conspicuously in the Excess Policies. *See Murdock*, 248 A.3d at 906. The Insurance Companies claim that the evidence shows that the parties intended for the Warranty Letters to apply. (Answering Br. at 52-53.) But the Insurance Companies fail to point to a single document showing that the parties intended the Warranty Letters to override the Representation and Severability Provision. If the Insurance Companies intended to do more than "incorporate" the Warranty Letters into the

Excess Policies, they had an obligation to do so clearly and explicitly. The Insurance Companies did not.

This bright-line rule becomes even more meaningful when considered in the context of non-rescindable insurance policies like we have here, A00234, and the Delaware public policy intended to protect directors and officers from personal liability when acting in their corporate capacity. Without making it abundantly clear that innocent insureds were giving up their bargained-for coverage, the Warranty Letters cannot be said to override the plain language of the Representation and Severability Provision. 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 and/or directors of Infinity Q.

[redacted]

III. THE INSURANCE COMPANIES MISS THE POINT ABOUT THE SUPERIOR COURT'S ERROR CONCERNING DISCOVERY

The Insurance Companies misstate a question presented by this Appeal, Question No. 2, by attempting to reframe it as an appeal from the Superior Court's decision to allow the Insurance Companies to take discovery under Rule 56(f). (Answering Br. at 43.) The Insureds do not appeal the Superior Court's exercise of its discretion to permit discovery; rather, the Insureds contend that the Superior Court erred when it permitted the Insurance Companies to escape any and all obligations during the time period in which the Insurance Companies admittedly could not prove the application of any exclusion. For months, the Insureds were left without the fundamental promise the Insurance Companies made to the Insureds (a Delaware limited liability company and its directors and officers) that the Insureds would be protected from the costs of defending against allegations of wrongdoing. Indeed, [redacted] in defense costs and the Superior Court should have found that the Insureds are entitled to their promised-for defense until such time as the Insurance Companies could meet their burden with respect to the exclusion. Thus, contrary to the Insurance Companies' position, this appeal is not about whether the Superior Court properly permitted the Insurance Companies to take discovery.

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In attempting to reframe the issue, the Insurance Companies' position conflicts with Delaware law, as well as the law from around the country. The Insurance Companies argue that the "Superior Court used its discretion to elevate substance over litigation tactics that seek to (mis)use the court's own procedures as a means to secure an early victory in deliberate substantive darkness." (Answering Br. at 46.) The Insurance Companies' argument misunderstands the nature of its defense obligations and ignores that courts will not permit insurance companies to avoid a defense obligation in the face of unproven allegations.

For example, in *Hoechst Celanese Corp. v. National Union Fire Ins. Co. of Pittsburgh, Pa.*, 1994 WL 721618, at *1 (Del. Super. Apr. 8, 1994), the Superior Court found that the policyholder was entitled to early partial summary judgment on the duty to defend even though the insurance company, National Union, contended that there was no duty to defend because of alleged misrepresentations in procuring the policy. Relying on several cases that found the same, *id.* at *3-4, the Superior Court found that "an insurer must prove that the insured acted in a fraudulent manner while obtaining an insurance policy in order to negate its duty to defend." *Id.* at *4. The Superior Court continued that a "mere allegation of fraud is not sufficient to preclude summary judgment in favor of the insured" on the duty to defend, "until [the insurance company] is able to substantiate and obtain a factual decision unless

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or upon its allegations that [the insured] committed fraud in procuring these insurance policies." *Id.*

This holding is in perfect accord with the cases cited by the Insureds in their Opening Brief: *Expedia, Inc. v. Steadfast Ins. Co.*, 329 P.3d 59 (Wash. 2014) and *Haskel v. Superior Court*, 39 Cal. Rptr. 2d 520 (Cal. Ct. App. 1995). The Insurance Companies contend that those cases concern stays of discovery in coverage actions, (Answering Br. at 46), but that contention is wrong. While those cases ordered the lower courts to stay discovery, both *Expedia* and *Haskel* required a defense until such time that the possibility of coverage was eliminated. *See Expedia*, 329 P.3d at 66 (noting "[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); *Haskel*, 39 Cal. Rptr. 2d at 527-28 (holding that the insurer may not "delay an adjudication of their defense obligation until they develop sufficient evidence to retroactively justify their refusal to provide that defense.").

While the Insureds contend that the Superior Court erred in finding that the Insurance Companies met their burden of proof at all, there is no dispute that the Insurance Companies failed to meet their burden until, at the very least, August 2022. The Superior Court therefore should be directed to order the Insurance Companies to advance to the Insureds the costs of their defense until that time, as

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discussed above, or such time that the Insurance Companies are able to prove the applicability of the Warranty Letters or any other exclusion in the Excess Polices.

IV. THE INSURANCE COMPANIES' LAST DITCH EFFORT TO ENFORCE THE "PRIOR OR PENDING PROCEEDINGS" EXCLUSIONS SHOULD BE REJECTED

The Insurance Companies' argument that the Superior Court's decision should be affirmed on the alternate ground of the "Prior or Pending Litigation Exclusion," should be rejected. (Answering Br. at 55-58.) The Insurance Companies admit that "[t]he Noticed matters undeniably constitute a Claim under the Primary Policy to which the Excess Policies follow form." (Answering Br. at 55). Nonetheless, in a last-ditch effort to avoid their obligations under the Policies they sold to Infinity Q, the Insurance Companies claim that the Prior or Pending Litigation Exclusions in the Excess Policies bar coverage here. In their Answering Brief, the Insurance Companies tellingly define each of the exclusions in the Excess Policies as the "Prior or Pending Proceeding Exclusion," (Answering Br. at 55), but notably, the exclusions are actually titled the "Prior or Pending **Litigation** Exclusion." *See e.g.*, A00353. Similarly, the Insurance Companies transform the SEC's "inquiry" into an "investigation" or "regulatory proceeding" even though the SEC declined to characterize it as such.

Delaware law holds that "[e]xclusionary clauses . . . are 'accorded a strict and narrow construction.'" *Med. Depot, Inc. v. RSUI Indem. Co.*, 2016 WL 5539879, at *7 (Del. Super. Sept. 29, 2016) (citation omitted). Courts "will give effect to

exclusionary language where it is found to be 'specific,' 'clear,' 'plain,' 'conspicuous' and 'not contrary to public policy.'" *Id.*

The Insurance Companies contend that each of the Excess Policies contain some form of a "prior or pending litigation" exclusion. (Answering Br. at 56). The specific term "inquiry" is not found in any of their Policies. Instead, the Insurance Companies contend that the inquiry falls under the definition of an "informal investigation," solely "for purposes of the Arch" policy exclusion, but, for the purpose of the Travelers and AXIS Excess Policies" exclusions, inquiry means a "regulatory proceeding." (Answering Br. at 56-57). The plain language of the Prior or Pending Litigation Exclusions do not include the term "inquiry," which is fatal to the Insurance Companies' motion.

Courts considering this issue have found that an "inquiry" does not mean an "informal investigation." *See Patriarch Partners, LLC v. Axis Ins. Co.*, 758 Fed. Appx. 14, 16 (2d Cir. 2018) (noting that the SEC first sent Patriarch Partners a letter notifying the company that the SEC was conducting an "informal inquiry" and later, according to the court, the "SEC again contacted Patriarch" and "described the SEC proceeding as an 'informal investigation,' as opposed to the earlier 'inquiry'").

Additionally, under its plain meaning, an "inquiry" does not mean a "regulatory proceeding." *See* Black's Law Dictionary 1324 ("Proceeding," defined as a lawsuit or official business conducted by a court or other official tribunal); *see*

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also Merriam-Webster's Online Dictionary, available at https://www.merriam-webster.com/dictionary/proceeding ("proceeding" defined as a "legal action"). Similarly, other courts have held that "regulatory proceeding against" does not include an investigation, let alone an inquiry. *See Off. Depot, Inc. v. Nat'l Union Fire Ins. Co. of Pittsburgh, Pa.*, 734 F. Supp. 2d 1304, 1320 (S.D. Fla. 2010) ("Under its plain meaning and ordinary sense, the phrase 'administrative or regulatory proceeding against,' in this specific context, does not include the SEC's informal or formal investigation of Office Depot"), *aff'd*, 453 F. App'x 871 (11th Cir. 2011). Thus, an "inquiry" – where there are not even allegations of wrongdoing – does not qualify as a proceeding against an Insured.

Indeed, the Insurance Companies' arguments conflict within their Answering Brief. For example, the Insurance Companies claim that the SEC Inquiries are a "regulatory proceeding." (Answering Br. at 57). At the same time, the Insurance Companies argue in the same section that "the SEC inquiry was an 'informal investigation' for the purpose of the Arch" policy. *Id.* The Insurance Companies' interpretation therefore changes the meaning of the term "inquiry" based on varying, undefined policy terms. In addition, the terminology used by the SEC suggests that the inquiry does not qualify as an investigation or regulatory proceeding because the

[redacted]

SEC differentiates between them. Even here, Infinity Q's interactions began with an "inquiry," A00636-52, which later led to an "investigation."[3] A00583.

Assuming *arguendo* that the Insurance Companies' interpretation has any merit, a reasonable insured would not expect that an inquiry, which does not rise to the level of a Claim because it is not "a formal regulatory proceeding commenced by the filing of a notice of charges, order of investigation, or similar document," would trigger an exclusion for prior or pending litigations. *Med. Depot*, 2016 WL 5549879, at *7. In other words, an inquiry that does not constitute a Claim under the Excess Policies (and, as such, would not be covered under the prior year's insurance program), cannot later be construed as a prior proceeding that triggers the Prior or Pending Litigation Exclusion, as it would render the insured's coverage a nullity under the subsequent year's insurance program.

Next, the Insurance Companies equate Infinity Q's Form 1661 obligations to "any demand" and rely on inapposite case law. (Answering Br. at 57.) The May 2020 Inquiry and the June 2020 Inquiry included only the Form 1661, which applies to all "investment advisers" and did not refer to any alleged substantive violations of law apart from non-compliance with the SEC's request. A00654-57. As a result,

[3] *See* U.S. Securities and Exchange Commission, *How Investigations Work*, available at https://www.sec.gov/enforce/how-investigations-work.html (noting that after an investigation, the SEC "can authorize the staff to file a case in federal court or bring an administrative action.").

the Insurance Companies' position is wrong for two reasons. First, "demand," being used in an exclusionary provision must be "accorded a strict and narrow construction." *Med. Depot, Inc.*, 2016 WL 5539879, at *7.

Second, even under the definition adopted by the *Weaver* Court, cited by the Insurance Companies, the SEC's inquiries do not constitute a "demand." In *Weaver*, the Court focused on the request for "non-monetary relief" in finding that the letter constituted a "demand." *Weaver v. Axis Surplus Ins. Co.*, 2014 WL 5500667, at *9 (E.D.N.Y. Oct. 30, 2014) ("A request to cease all offers and sales of business opportunity, which threatens court-ordered relief should the requested relief not be granted, is a demand…"). Indeed, the Court focused on the necessary element of "demand," which is missing here, stating that "the 2007 Maryland AG Letter did not 'simply request information and materials to determine whether Multivend [was] in compliance with the Act' **but it also demanded non-monetary relief that was equitable in nature because it requested that Multivend 'immediately cease all offers and sales of the Vendstar business opportunity to Maryland residents**.'" *Id.* (internal citation omitted) (emphasis added) (brackets in original). Those circumstances are simply not present here; the SEC's inquiries made no "demands" that Infinity Q cease any of its business activities.

[redacted]

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. Alternatively, the Insureds respectfully request that this Court reverse the Superior Court's judgment and find that the Warranty Letters are severable such that the innocent directors and officers are entitled to the coverage for which Infinity Q paid substantial premiums.

POTTER ANDERSON & CORROON LLP

Kenneth H. Frenchman, Esq.
(*pro hac vice*)
Andrew N. Bourne, Esq.
(*pro hac vice*)
COHEN ZIFFER FRENCHMAN
& McKENNA LLP
1325 Avenue of the Americas
31st Floor
New York, NY 10019
Telephone: (212) 584-1890
kfrenchman@cohenziffer.com
abourne@cohenziffer.com

By: */s/ Jennifer C. Wasson*
Jennifer C. Wasson (No. 4933)
Carla M. Jones (No. 6046)
POTTER ANDERSON
& CORROON LLP
Hercules Plaza, Sixth Floor
1313 North Market Street
Wilmington, DE 19801
Telephone: (302) 984-6000
jwasson@potteranderson.com
cjones@potteranderson.com

Attorneys for Plaintiffs Below, Appellants Infinity Q Capital Management LLC, Leonard Potter, and Scott Lindell

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