SUPREME COURT OF THE STATE OF NEW YORK
COUNTY OF NEW YORK: COMMERCIAL DIVISION PART IAS MOTION 3EFM

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XL SPECIALTY INSURANCE COMPANY, CONTINENTAL CASUALTY COMPANY, ARGONAUT INSURANCE COMPANY, FREEDOM SPECIALTY INSURANCE SUPPLEMENTAL COMPANY, QBE INSURANCE COMPANY,

Plaintiffs,

- v -

AR CAPITAL, LLC, BELLEVUE CAPITAL PARTNERS, LLC, NICHOLAS SCHORSCH, EDWARD WEIL, WILLIAM KAHANE, PETER BUDKO,

Defendants.

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INDEX NO.	650018/2019
MOTION DATE	N/A
MOTION SEQ. NO.	016

DECISION + ORDER ON MOTION

HON. JOEL M. COHEN:

The following e-filed documents, listed by NYSCEF document number (Motion 016) 261, 262, 263, 264, 265, 266, 267, 268, 269, 270, 271, 272, 273, 274, 275, 276, 277, 278, 279, 280, 281, 282, 283, 284, 285, 286, 287, 288, 289, 290, 291, 292, 293, 294, 295, 296, 297, 298, 299, 300, 301, 302, 303, 304, 305, 306, 307, 308, 309, 310, 311, 312, 313, 314, 315, 316, 317, 318, 319, 320, 321, 322, 323, 324, 325, 326, 327, 328, 329, 330, 331, 332, 333, 334, 335, 336, 337, 338, 339, 340, 341, 342, 343, 344, 345, 346, 347, 348, 349, 350, 351, 358, 359, 360, 361, 362, 363, 364, 365, 373, 374, 375, 376, 377, 378, 379, 401

were read on this motion for SUMMARY JUDGMENT.

This is an insurance coverage dispute. Plaintiffs Continental Casualty Company (CCC), Argonaut Insurance Company (Argonaut), Freedom Specialty Insurance Company (Freedom), and QBE Insurance Company (QBE) (collectively, the Insurers) seek declarations that their policies do not provide coverage for settlements and consent judgments in three underlying actions involving allegedly false and misleading Securities and Exchange Commission (SEC) filings by VEREIT, Inc. (VEREIT), a publicly-traded real estate investment trust (REIT).

The Insurers move, pursuant to CPLR 3212, for summary judgment declaring that their insurance policies *do not* cover the settlements and consent judgments in the underlying actions. The Insurers also request their costs and reasonable attorneys' fees.

Defendants/counterclaim plaintiffs AR Capital, LLC (AR Capital), Bellevue Capital Partners, LLC (Bellevue), Edward M. Weil (Weil), William M. Kahane (Kahane), Peter M. Budko (Budko), and Nicholas S. Schorsch (Schorsch) (collectively, the AR Capital parties) cross-move, pursuant to CPLR 3212, for summary judgment declaring that the policies *do* provide coverage for the settlements and consent judgments, and requiring the Insurers to tender the full limits of their policies, along with pre- and post-judgment interest.

For the reasons set forth below, the Insurers' motion is granted (other than with respect to costs and attorneys' fees), and the AR Capital parties' cross motion is denied.

BACKGROUND

The following facts are taken from the parties' submissions and from their Rule 19-a statements and are undisputed, except where otherwise noted.

I. AR Capital and AR Capital REITs

Schorsch and Kahane formed AR Capital as a Delaware limited liability company on August 10, 2007 (NYSCEF Doc No. 262, ¶¶ 11-12). The individual defendants are all members of AR Capital (*id.*, ¶ 13).[1]

AR Capital sponsored and managed a publicly traded REIT, formerly known as American Realty Capital Properties, Inc. (ARCP), now known as VEREIT (*id.*, ¶ 14). AR Capital also sponsored and managed publicly held, non-traded REITs, including American

[1] Bellevue is allegedly the parent company of AR Capital (NYSCEF Doc No. 266, amended complaint, ¶ 7).

Realty Capital Trust III, Inc. (ARCT III) and American Realty Capital Trust IV, Inc. (ARCT IV) (*id.*, ¶ 15).

ARC Properties Advisors, LLC (ARC Advisors), a wholly owned subsidiary of AR Capital, externally managed the day-to-day activities of VEREIT until January 8, 2014 (*id.*, ¶¶ 16-17).

VEREIT merged with ARCT III in 2013 and with ARCT IV in 2014 (*id.*, ¶¶ 18-19). Prior to the mergers, ARC Advisors externally managed ARCT III and ARCT IV (*id.*, ¶ 20).

II. Individual Defendants

Schorsch was the chairman of the board and chief executive officer of VEREIT from December 2010 through January 2014; was the chief executive officer and the chairman of ARCT III from October 2010 until it merged with VEREIT in February 2013; and was the chief executive officer and chairman of ARCT IV from February 2012 until its merger with VEREIT in January 2014 (*id.*, ¶ 21).

Kahane served as a director and executive officer of VEREIT from December 2010 through March 2012 and a director of VEREIT from February 2013 through June 2014; and was an executive officer of ARCT III from October 2010 until April 2012 (*id.*, ¶ 22).

Weil served as a director and officer of VEREIT from December 2010 through approximately February 2013; was an executive officer of ARCT III from October 2010 until it merged with VEREIT in February 2013; and was the chief operating officer, president, treasurer, and secretary of ARCT IV from February 2012 until it merged with VEREIT in January 2014 (*id.*, ¶ 23).

Budko served as the chief investment officer and executive vice president of VEREIT from December 2010 through January 2014; was an executive officer of ARCT III from October

2010 until it merged with VEREIT in February 2013; and was the executive vice president and chief investment officer of ARCT IV from February 2012 until it merged with VEREIT in January 2014 (*id.*, ¶ 24).

On October 29, 2014, VEREIT, then operating under the name ARCP, announced that it had discovered errors in its financial statements filed with the SEC (*id.*, ¶ 36).

III. The Underlying Actions

A. Securities Class Action

Between late 2014 and 2016, VEREIT shareholders filed putative class actions against VEREIT and the individual defendants, which were consolidated under the caption *In re American Capital Props., Inc. Litig.*, Case No. 15-mc-0004 (SD NY) (the Securities Class Action) (*id.*, ¶ 38; NYSCEF Doc No. 286). The complaint alleged that the individual defendants made false and misleading statements in violation of section 11 of the Securities Act of 1933 (the 1933 Act) and section 10 (b) of the Securities Exchange Act of 1934 (the 1934 Act) and Rule 10b-5, and asserted control person liability claims under section 15 of the 1933 Act and section 20 (a) of the 1934 Act against the individual defendants (NYSCEF Doc No. 262, ¶ 39; NYSCEF Doc No. 286).

On November 6, 2015, United States District Judge Alvin Hellerstein dismissed the control person liability claims with leave to replead (NYSCEF Doc No. 287). The plaintiffs thereafter filed a second amended complaint in which they again asserted control liability claims against the individual defendants, among other claims (NYSCEF Doc No. 288, counts IX, XI). On August 5, 2016, the court dismissed the section 15 and section 20 control person liability claims (NYSCEF Doc No. 290 at 7). On September 30, 2016, the plaintiffs filed a third amended complaint, which contained causes of action for violations of section 11 of the 1933

Act against the individual defendants and section 10 (b) of the 1934 Act against Schorsch (NYSCEF Doc No. 291, counts I-VII, IX). The third amended complaint asserted causes of action against AR Capital and ARC Advisors (but not against the individual defendants) for violation of section 15 of the 1933 Act and section 20 (a) of the 1934 Act (*id.*, counts VIII and X).

On September 30, 2019, the parties filed a stipulation of settlement, pursuant to which the defendants agreed to pay $1.025 billion "in full and final disposition of the Litigation" (NYSCEF Doc No. 262, ¶ 46; NYSCEF Doc No. 292, stipulation of settlement § 2.1).

AR Capital, ARC Advisors, Schorsch, Budko, Kahane, and Weil agreed to "contribute, or cause to be contributed" $225 million to the settlement of the Securities Class Action (NYSCEF Doc No. 262, ¶ 47; NYSCEF Doc No. 292, stipulation of settlement § 2.1). According to the stipulation of settlement, $31,972,934 of the AR Capital parties' contribution to the settlement was already deemed to be in VEREIT's custody and would be contributed to the settlement fund by VEREIT (NYSCEF Doc No. 262, ¶ 48; NYSCEF Doc No. 292, stipulation of settlement § 2.2).

B. Derivative Action

Between late 2014 and 2016, VEREIT's shareholders filed a derivative action against the individual defendants, captioned *Witchko v Schorsch*, Case No. 15-cv-06043 (SD NY) (the Derivative Action) (NYSCEF Doc No. 262, ¶ 49).

As relevant here, the amended verified complaint asserted causes of action against Schorsch, Kahane, and Weil for breaching their fiduciary duties owed to VEREIT as members of VEREIT's board of directors (*id.*, ¶ 50; NYSCEF Doc No. 293, amended verified shareholder derivative complaint, counts I, III, IV).

On October 2, 2019, the parties filed a stipulation of settlement in the Derivative Action (NYSCEF Doc No. 262, ¶ 51; NYSCEF Doc No. 294). Pursuant to the stipulation of settlement, the AR Capital Parties "agreed to contribute consideration with a value of two-hundred and twenty-five million dollars ($225,000,000) (inclusive of the value of certain operating partnership units in VEREIT Operating Partnership, L.P. [OP units], and related dividends previously surrendered by some of the AR Capital Parties as part of a settlement with the Securities and Exchange Commission, which total $31,972,934 in value) to a global settlement to settle the Class Action, as well as any and all claims in the Derivative Actions" (NYSCEF Doc No. 294, stipulation and agreement of settlement § 2.1). On April 6, 2020, the court ordered VEREIT to pay $7.5 million in plaintiffs' attorneys' fees (NYSCEF Doc No. 262, ¶ 52).

C. The SEC Action

On November 12, 2014, the SEC issued a formal Order Directing Private Investigation and Designating Officers to Take Testimony captioned *In the Matter of American Realty Capital Props., Inc.* (NY-9181) (*id.*, ¶ 53).

On July 1, 2019, the AR Capital parties, Brian Block, VEREIT, and VEREIT Operating Partnership, L.P. entered into an OP Unit Surrender and Cancellation Agreement (*id.*, ¶ 59).

On July 16, 2019, the SEC commenced the action entitled *Securities & Exchange Commn. v AR Capital, LLC*, Case No. 1:19-cv-06603 (SD NY), in the United States District Court for the Southern District of New York (the SEC Action), which alleged that AR Capital violated section 17 (a) of the 1933 Act, sections 10 (b) and 13 (b) (5) of the 1934 Act and Rules 10b-5 and 13b2-1, and that Schorsch violated sections 17 (a) (2) and (a) (3) of the 1933 Act and 1934 Act rule 13b2-1 (*id.*, ¶ 60; NYSCEF Doc No. 300). The SEC alleged that Schorsch improperly inflated incentive fee calculations in connection with VEREIT's mergers with ARCT

III and ARCT IV (NYSCEF Doc No. 300, complaint, ¶¶ 3, 23-24). The SEC Action alleged that AR Capital and Schorsch directed the creation of and/or approved misleading asset purchase and sale agreements for furniture, fixtures and equipment, which resulted in defendants receiving $7.2 million from VEREIT in unsupported charges (*id.*, ¶ 4).

Pursuant to a consent judgment, AR Capital was required to disgorge 2,922,445 OP units by surrendering those units to VEREIT for cancellation, disgorge $12,313,856 in cash, and pay a $14 million civil penalty (NYSCEF Doc No. 262, ¶ 67; NYSCEF Doc No. 301 ¶ 2).

Under a separate consent judgment, Schorsch was required, on a joint and several basis with AR Capital, to disgorge 1,542,851 OP units, and disgorge $6,898,222 in cash (NYSCEF Doc No. 262, ¶ 68; NYSCEF Doc No. 302 ¶ 2).

IV. The Insurance Policies

AR Capital obtained a "tower" of directors and officers liability insurance coverage for the policy period from October 23, 2014 to October 23, 2015 (NYSCEF Doc No. 262, ¶ 73).

Plaintiff XL Specialty Insurance Company (XL) issued a primary management liability and company reimbursement policy to AR Capital for the 2014 to 2015 policy period, containing a $10 million limit of liability per claim and in the aggregate (NYSCEF Doc No. 305, appendix, exhibit OO).

CCC issued an excess insurance policy to AR Capital for the 2014 to 2015 policy period, containing a $10 million limit of liability per claim and in the aggregate, excess to $10 million in underlying limits (NYSCEF Doc No. 306, appendix, exhibit PP).

Argonaut issued an Argo Flex-XS follow form excess insurance policy to AR Capital for the 2014 to 2015 policy period, containing a $10 million limit of liability per claim and in the

aggregate, excess to $20 million in underlying limits (NYSCEF Doc No. 307, appendix, exhibit QQ).

Freedom issued an excess insurance policy to AR Capital for the 2014 to 2015 policy period, containing a $10 million limit of liability per claim and in the aggregate, excess to $30 million in underlying limits (NYSCEF Doc No. 308, appendix, exhibit RR).

QBE issued an excess liability policy to AR Capital for the 2014 to 2014 policy period, containing a $10 million limit of liability per claim and in the aggregate, excess to $40 million in underlying limits (NYSCEF Doc No. 309, appendix, exhibit SS).

Except as otherwise provided, the policies issued by CCC, Argonaut, Freedom, and QBE "follow form" to the terms and conditions of XL's policy.

Insuring Agreement B of XL's policy provides that:

> "The Insurer shall pay on behalf of the **Company Loss** which the **Company** is required or permitted to pay as indemnification to any of the Insured Persons resulting from a Claim first made against the **Insured Persons** during the **Policy Period** or, if applicable, the Optional Extension Period, for a **Wrongful Act** or **Employment Practices Wrongful Act**"

(NYSCEF Doc No. 305, XL's policy, form DO 71 00 09 99, section I, insuring agreements [B]).

Insuring Agreement C states that:

> "The Insurer shall pay on behalf of the **Company Loss** resulting from any **Securities Claim** against the **Company** during the **Policy Period** or, if applicable, the Optional Extension Period, for a **Company Wrongful Act**"

(*id.*, section I, insuring agreements [C]).

Insured means the **Insured Persons** and the **Company** (*id.*, section II, definitions [I]). AR Capital is a Company (*id.*, declarations page). Notably, VEREIT, ARCT III, and ARCT IV are neither Companies nor Insured Persons under the Policy (*id.*).

The policy defines an Insured Person, in pertinent part, as follows:

> "(1) any past, present or future director or officer, or member of the Board of Managers, of the **Company** and those serving in a functionally equivalent role for the **Parent Company** or any **Subsidiary** operating or incorporated outside the United States;
>
> "(2) any past, present or future employee of the **Company** to the extent any **Claim** is a **Securities Claim**"

(*id.*, section II, definitions [J]).

The policy defines **Wrongful Act**, in relevant part, to include "any actual or alleged act, error, omission, misstatement, misleading statement, neglect or breach of duty by any Insured Person while acting in his or her capacity as . . . an Insured Person of the Company . . ." and "any matter asserted against an Insured Person solely by reason of his or her status as a director or officer of the Company" (*id.*, section II, definitions [S], as amended by endorsements 18, 20).

The policy defines **Securities Claim** as follows:

> "**Securities Claim** means a **Claim**, other than an administrative or regulatory investigation of a **Company**, made against any **Insured** for:
>
> (1) any actual or alleged violation of any federal, state, local regulation, statute or rule (whether statutory or common law), including but not limited to actual or alleged violations of the foregoing in connection with the purchase or sale of, or offer to purchase or sell, securities which is:
>
> (a) brought by any person or entity based upon, arising out of, directly or indirectly resulting from, in consequence of, or in any way involving the purchase or sale of, or offer to purchase or sell, securities of the **Company**; or
>
> (b) brought by a securities holder of a **Company** with respect to such security holder's interest in securities of such **Company**; or
>
> (2) brought derivatively on behalf of the **Company** by a security holder of such **Company**.
>
> "Notwithstanding the foregoing, the term '**Securities Claim**' shall include administrative or regulatory investigations of, a **Company**, but only if and only during the time that such investigation is also commenced and continuously maintained against an **Insured Person**"

(*id.*, section II, definitions [Q], as amended by endorsement 12).

The policy defines **Company Wrongful Act** to mean "any actual or alleged act, error, omission, misstatement, misleading statement or breach of duty by the Company in connection with a **Securities Claim**" (*id.*, section II, definitions [E]).

The policy defines **Loss** as follows:

> "'**Loss**' means damages, judgments, settlements, pre-judgment and post-judgment interest or other amounts (including punitive, exemplary or multiple damages, where insurable by law) and **Defense Expenses** in excess of the **Retention** that the Insured is legally obligated to pay. **Loss** will not include:
>
> (1) fines, penalties or taxes imposed by law, or
>
> (2) matters which are uninsurable under the law pursuant to which this **Policy** is construed"

(*id.*, section II, definitions [E], as amended by endorsement 10).

Exclusion (I) of the policy provides:

> "The Insurer shall not be liable to make any payment for Loss in connection with any **Claim** made against an **Insured Person**, or with respect to INSURING AGREEMENT (C), the **Company**:
>
> (I) based upon, arising out of, directly or indirectly resulting from, in consequence of, or in any way involving an **Insured Person** acting in their capacity as a [sic] **Insured Person** of any entity other than the **Company**, **Non- Profit Entity** or **Joint Venture**"

(*id.*, section III, exclusions [I]).

The policy also contains the following allocation of loss provision:

> "If both **Loss** covered by this Policy and Loss not covered by this Policy are incurred, either because a **Claim** made against the Insured contains both covered and uncovered matters, or because a Claim is made against both the Insured and others (including the **Company** for **Claims** other than **Securities Claims**) not insured under this Policy, the Insured and the Insurer will use their best efforts to determine a fair and appropriate allocation of Loss between that portion of Loss that is covered under this Policy and that portion of Loss that is not covered under

> this Policy. Additionally, the **Insured** and the Insurer agree that in determining a fair and appropriate allocation of Loss, the parties will take into account the relative legal and financial exposures of, and relative benefits obtained in connection with the defense and/or settlement of the **Claim** by, the Insured and others"

(*id.*, section V, defense, settlement and allocation of loss [D]).

V. Insurers' Denial of Coverage and Procedural History

The Insurers denied coverage for and/or reserved their rights to deny coverage under the excess policies on the grounds that (a) no Securities Claim for a Company Wrongful Act had been made against AR Capital; (b) no Claim for a Wrongful Act had been made against any Insured Person in his or her insured capacity; and/or (c) Exclusion I of the primary policy barred coverage for VEREIT Securities Matters (NYSCEF Doc No. 266, amended complaint, ¶ 36).

In the amended complaint, the Insurers assert three counts seeking declarations that their policies do not provide coverage for the settlements and consent judgments (*id.*, counts I, IV, V).

The AR Capital parties, in turn, assert counterclaims for declaratory judgments that the policies cover the settlements and consent judgments (NYSCEF Doc No. 267).

DISCUSSION

"It is well settled that 'the proponent of a summary judgment motion must make a prima facie showing of entitlement to judgment as a matter of law, tendering sufficient evidence to demonstrate the absence of any material issues of fact'" (*Pullman v Silverman*, 28 NY3d 1060, 1062 [2016], quoting *Alvarez v Prospect Hosp.*, 68 NY2d 320, 324 [1986]). "Once this showing has been made, . . . the burden shifts to the party opposing the motion for summary judgment to produce evidentiary proof in admissible form sufficient to establish the existence of material issues of fact which require a trial of the action" (*Alvarez*, 68 NY2d at 324). "[M]ere

conclusions, expressions of hope or unsubstantiated allegations or assertions are insufficient" to raise an issue of fact (*Zuckerman v City of New York*, 49 NY2d 557, 562 [1980]).

The duty to indemnify is determined "by the actual basis for the insured's liability to a third person" (*Servidone Constr. Corp. v Security Ins. Co. of Hartford*, 64 NY2d 419, 424 [1985]). An insurer's duty to indemnify "does not turn on the pleadings, but rather on whether the loss, as established by the facts, is covered by the policy" (*Atlantic Mut. Ins. Co. v Terk Tech. Corp.*, 309 AD2d 22, 28 [1st Dept 2003]). "[E]ven in cases of negotiated settlements, there can be no duty to indemnify unless there is first a covered loss" (*Servidone*, 64 NY2d at 423; *see also Stellar Mech. Servs. of N.Y., Inc. v Merchants Ins. of N.H.*, 74 AD3d 948, 953 [2d Dept 2010]; *Hotel des Artistes v General Acc. Ins. Co. of Am.*, 9 AD3d 181, 193 [1st Dept 2004], *lv dismissed* 4 NY3d 739 [2004]; *Royal Zenith Corp. v New York Mar. Mgrs.*, 192 AD3d 390, 391 [1st Dept 1993]).

Generally, the burden to establish coverage and a duty to indemnify lies with the insured (*see Consolidated Edison Co. of N.Y. v Allstate Ins. Co.*, 98 NY2d 208, 218 [2002]). The insurer has the burden of proving facts establishing that the loss falls within a policy exclusion (*see Continental Cas. Co. v Rapid-American Corp.*, 80 NY2d 640, 652 [1993]; *Prashker v United States Guar. Co.*, 1 NY2d 584, 592 [1956]).

I. Civil Litigations Settlement

At the outset, the court notes that the AR Capital parties "are only seeking coverage for the portion of the Civil Litigations Settlement attributable to the Individuals' Loss, not AR Capital's" (NYSCEF Doc No. 349, AR Capital parties' memorandum of law, at 3-4).

The Insurers argue that the individual defendants are not entitled to coverage for the settlements in the Securities Class Action and Derivative Action because they faced liability

solely for acts undertaken in their uninsured capacities as directors and officers *of VEREIT*. In addition, the Insurers contend that the AR Capital parties did not pay any amount to settle the Derivative Action and did not suffer any Loss.

The AR Capital parties counter that the Securities Class Action and the Derivative Action allege that the individual defendants, as directors and officers of AR Capital and its subsidiaries, enriched themselves at the expense of VEREIT by causing VEREIT to make improper and inflated payments to AR Capital and its subsidiaries. The AR Capital parties contend that the Securities Class Action and Derivative Action complaints contain numerous allegations that they engaged in wrongful conduct *in an AR Capital capacity*. Thus, they allege, these allegations satisfy the policy's definition of Wrongful Act. According to the AR Capital parties, the individual defendants incurred Loss in settling the Derivative Action, since they agreed to contribute $225 million to a global settlement to settle the Securities Class Action, as well as any claims in the Derivative Action.

"In determining a dispute over insurance coverage, we first look to the language of the policy" (*Consolidated Edison Co. of N.Y.,* 98 NY2d at 221). In addition, the court must "construe the policy in way that 'affords a fair meaning to all of the language employed by the parties in the contract and leaves no provision without force and effect'" (*id.* at 221-222, quoting *Hooper Assoc. v AGS Computers*, 74 NY2d 487, 493 [1989]). "As with any contract, unambiguous provisions of an insurance contract must be given their plain and ordinary meaning . . . and the interpretation of such provisions is a question of law for the court" (*White v Continental Cas. Co.*, 9 NY3d 264, 267 [2007] [citation omitted]). If the policy terms are ambiguous, the parties may submit extrinsic evidence as an aid in construction, and any ambiguity must be construed in favor of the insured and against the insurer (*Matter of Mostow v*

State Farm Ins. Cos., 88 NY2d 321, 326 [1996]; *State of New York v Home Indem. Co.*, 66 NY2d 669, 671 [1985]).

Under Insuring Agreement B, the policy covers **Loss** resulting from a "**Claim** . . . made against the **Insured Persons** . . . for a **Wrongful Act**" (NYSCEF Doc No. 305, XL's policy, form DO 71 00 09 99, insuring agreements, section I [B]). **Loss** is defined as "settlements . . . that the insured is legally obligated to pay" (*id.*, section II [M], as amended by endorsement 10). **Wrongful Act**, in turn, is defined as "any actual or alleged act, omission, misstatement, misleading statement, neglect, or breach of duty by any **Insured Person** while acting in his or her capacity as . . . an **Insured Person** of the **Company**" and "any matter asserted against an **Insured Person** solely by reason of his or her status as a director or officer of the **Company**" (*id.*, section II [S], as amended by endorsements 18, 20). There is no dispute that the individual defendants qualify as **Insured Persons** or that AR Capital is a **Company** (*id.*, section II [D], declarations page). VEREIT, however, is not.

Here, the Insurers have demonstrated prima facie that the individual defendants were not legally obligated to pay the settlements in the Securities Class Action and Derivative Action, *i.e.*, the settlements did not result from Claims for their Wrongful Acts in an AR Capital capacity.

In the Securities Class Action, the third amended complaint alleged violations of section 11 of the 1933 Act against the individual defendants (NYSCEF Doc No. 291, third amended class action complaint, counts I-VII). Section 11 of the 1933 Act provides that any signer of a registration statement, director of the issuer, or underwriter, may be held liable to purchasers of registered securities if any part of the registration statement, when such part became effective, contained an untrue statement of a material fact or omitted to state a material fact required to be stated therein or necessary to make the statements therein not misleading (15 USC § 77k [a]).

"[A] claim under Section 11 has three elements: 1) a defendant is a signer of a registration statement or a director of the issuer or an underwriter for the offering; 2) the plaintiff purchased the registered securities; and 3) any part of the registration statement for the offering contained an untrue statement of a material fact or omitted to state a material fact necessary to make the statements not misleading" (*In re Citi Group Inc. Bond Litig.*, 723 F Supp 2d 568, 587 [SD NY 2010]). "Issuers are subject to 'virtually absolute' liability under section 11, while the remaining potential defendants under sections 11 and 12 (a) (2) may be held liable for mere negligence" (*In re Morgan Stanley Info. Fund Sec. Litig.*, 592 F3d 347, 359 [2d Cir 2010]). The individual defendants signed the subject registration statements in their capacities *as directors and officers of VEREIT*, not AR Capital (NYSCEF Doc No. 262, ¶¶ 27, 30, 32; NYSCEF Doc No. 350, ¶¶ 27, 30, 32).

In addition, the third amended complaint asserted a claim for violation of section 10 (b) of the 1934 Act and Rule 10b-5 against Schorsch (NYSCEF Doc No. 291, third amended class action complaint, count IX). To recover for securities fraud in violation of section 10 (b) of the 1934 Act and rule 10b-5, the plaintiff must prove "'that in connection with the purchase or sale of securities, the defendant, acting with scienter, made a false material representation or omitted to disclose material information and that plaintiff's reliance on defendant's conduct caused [plaintiff] injury'" (*Caiola v Citibank, N.A., N.Y.*, 295 F3d 312, 321 [2d Cir 2002], quoting *In re Time Warner Inc. Sec. Litig.*, 9 F3d 259, 264 [2d Cir 1993] [internal quotation marks and citation omitted]). Schorsch signed the SEC filings in his capacity as "Chief Executive Officer of the Board of Directors (Principal Executive Officer)" of VEREIT (NYSCEF Doc No. 262, ¶¶ 25-35; NYSCEF Doc No. 350, ¶¶ 25-35).

Although the second amended complaint alleged "control person" liability under section 15 of the 1933 Act and section 20 of the 1934 Act against the individual defendants by virtue of their executive and director positions at AR Capital and ARC Advisors (NYSCEF Doc No. 288, second amended class action complaint, ¶¶ 125, 316), the court dismissed these claims at oral argument with leave to replead, and the plaintiffs advised the court that they chose not to replead those claims against the individual defendants (NYSCEF Doc No. 289 at 2). By decision and order dated August 5, 2016, Judge Hellerstein memorialized the dismissal of the section 15 and section 20 control person claims against Schorsch, Kahane, Budko, and Weil (NYSCEF Doc No. 290 at 7). The third amended complaint, which was the operative complaint at the time of the Securities Class Action settlement, only asserted section 15 and 20 control person claims against AR Capital and ARC Advisors (NYSCEF Doc No. 291, third amended complaint, ¶¶ 121, 314), not against the individual defendants. As noted above, only the individual defendants are seeking coverage for the Securities Class Action settlement.

In the Derivative Action, the individual defendants were sued for breaching their fiduciary duties *to VEREIT as members of VEREIT's board of directors*, not to AR Capital (NYSCEF Doc No. 293, amended verified shareholder derivative complaint, ¶¶ 143-148, 155-160, 161-166). The complaint alleged that the individual defendants, "because of their positions of control and authority as directors and/or officers of [VEREIT], were able to and did, directly and/or indirectly, exercise control over the wrongful acts complained of herein, as well as the contents of the various public statements issued by [VEREIT]" (*id.*, ¶ 23). Thus, the individual defendants only faced liability in their VEREIT capacities. And, the AR Capital parties only seek to recover amounts paid by the individual defendants in the Derivative Action settlement.

The AR Capital parties have failed to meet their burden to establish that the Insurers are required to indemnify them for the settlements in the Securities Class Action and Derivative Action. Additionally, the AR Capital parties have failed to raise an issue of fact as to whether the individual defendants were legally obligated to pay the settlements for their Wrongful Acts in an AR Capital capacity. In arguing that that the Insurers are obligated to indemnify them, the AR Capital parties point to the allegations of the Securities Class Action complaint and the Derivative Action complaint and contend that these allegations targeted the individual defendants in an AR Capital capacity. But the Insurers' indemnification obligation does not turn on the pleadings, but rather on the actual basis for the claims (*see Atlantic Mut. Ins. Co.*, 309 AD2d at 28). In any event, the AR Capital parties have failed to demonstrate that their potential liability was for Wrongful Acts in an AR Capital capacity.

Therefore, the Insurers are entitled to a declaration that their policies do not cover the AR Capital parties' settlements in the Securities Class Action and Derivative Action.

II. SEC Action

The Insurers also argue that the AR Capital parties are not entitled to coverage for the consent judgments entered in the SEC Action. Specifically, the Insurers contend that: (1) entity coverage is not available for the consent judgment entered against AR Capital, because the SEC Action is not a Securities Claim; (2) insured persons coverage is not triggered because the individual defendants were not legally obligated to pay any portion of the consent judgment entered against AR Capital; and (3) the disgorgement is uninsurable under the law.

The AR Capital parties assert that the SEC investigation qualifies as a Securities Claim because it was an administrative or regulatory investigation of AR Capital that was continuously maintained against one or more Insured Persons. Additionally, the AR Capital parties maintain

that, under New York law, the SEC settlement is insurable. The AR Capital parties also point out that the Insurers sold policies that cover penalties paid as part of an SEC settlement.

The policy's definition of **Loss** does not include "matters which are uninsurable under the law pursuant to which this Policy is construed" (NYSCEF Doc No. 305, XL's policy, form DO 71 00 09 99, section II [M], as amended by endorsement 10).

In *J.P. Morgan Sec., Inc. v Vigilant Ins. Co.* (166 AD3d 1, 8 [1st Dept 2018]), the First Department held, relying on the United States Supreme Court's decision in *Kokesh v Securities and Exchange Commn.* (137 SCt 1635 [2017]), that an insured's payment to the SEC did not constitute a loss under a primary and excess liability policy. The Court explained that:

> "The Supreme Court's rationale as to the nature of disgorgement in *Kokesh* applies with equal force to the issue of whether the disgorgement paid by Bear Stearns, even if representing third-party gains, was a 'Loss' within the meaning of the policy and whether public policy bars insurance companies from indemnifying insureds paying SEC disgorgement. In both instances disgorgement is a punitive sanction intended to deter. To allow a wrongdoer to pass on its loss emanating from the disgorgement payment to the insurer, thereby shielding the wrongdoer from the consequences of its deliberate malfeasance, undermines this goal "and violate[s] the fundamental principle that no one shall be permitted to take advantage of his own wrong" (*Biondi v Beekman Hill House Apt. Corp.*, 94 NY2d 659, 664 [2000] [internal quotation marks omitted]). Thus, as SEC disgorgement is a penalty, it does not fall within the definition of 'Loss' and there is no coverage"

(*id.* at 7-8).

Thus, in light of *J.P. Morgan*, the SEC disgorgement is uninsurable as a matter of law. At oral argument, the AR Capital parties conceded that the entire amount of coverage that they sought for the SEC Action fell "under the umbrella of disgorgement" (NYSCEF Doc No. 401, oral argument tr at 22). Accordingly, the AR Capital parties are not entitled to coverage for the consent judgments in the SEC Action. The court need not reach the parties' remaining arguments.

III. Capacity Exclusion

Even assuming arguendo that the AR Capital parties suffered a covered Loss, the Insurers have demonstrated that Exclusion (I) bars coverage for the settlements in their entirety.

As noted above, the capacity exclusion provides that the Insurers "shall not be liable to make any payment for **Loss** in connection with any **Claim** made against an **Insured Person**, or with respect to INSURING AGREEMENT (C), the **Company** [AR Capital]. . . based upon, arising out of, directly or indirectly resulting from, in consequence of, or in any way involving an **Insured Person** acting in their capacity as a [sic] **Insured Person** of any other entity other than the **Company** [AR Capital] . . ." (NYSCEF Doc No. 305, XL's policy, form DL 71 00 09 99, section III, exclusions [I]). **Claim** means, among other things, "a written demand for monetary or non-monetary relief" and "any civil proceeding in a court of law or equity, or arbitration" (*id.*, section II, definitions [C] [1], [2]).

The Insurers assert, in moving for summary judgment, that the individual defendants' liability in the underlying actions hinged on acts undertaken in their uninsured VEREIT capacities. The Insurers argue that the counts pleaded against the individual defendants would have failed "but for" the acts alleged against the individual defendants in their capacities as officers and directors of VEREIT. Additionally, the underlying actions "involve" the individual defendants acting in their uninsured capacities, i.e., on behalf of VEREIT, ARCT III, and ARCT IV.

The AR Capital parties do not dispute that the Civil Litigations and SEC Action involve allegations in a VEREIT capacity (NYSCEF Doc No. 349, AR Capital parties' memorandum of law at 20). However, they assert that the capacity exclusion does not bar coverage for covered portions of the settlements. The AR Capital parties contend that the words "**Loss** in connection

with" shows that only the particular **Loss** attributable to an uncovered **Claim** is excluded from coverage. In addition, the AR Capital parties maintain that this reading is consistent with the allocation of loss provision, which provides that if "**Loss** covered by this Policy and **Loss** not covered by this Policy are incurred . . . because a **Claim** made against the Insured contained both covered and uncovered matters," then the insurer and the insured "will use their best efforts to determine a fair and appropriate allocation of **Loss**" (NYSCEF Doc No. 305, XL's policy, form DL 71 00 09 99, section V, defense, settlement and allocation of loss [D]). The AR Capital parties further argue that various allegations could not exist if the individual defendants did not use their control over AR Capital and ARC Advisor to the detriment of VEREIT.

"[P]olicy exclusions are given a strict and narrow construction, with any ambiguity resolved against the insurer" (*Belt Painting Corp. v TIG Ins. Co.*, 100 NY2d 377, 383 [2003]). "However, unambiguous provisions of insurance contracts will be given their plain and ordinary meaning" (*Country-Wide Ins. Co. v Excelsior Ins. Co.*, 147 AD3d 407, 408 [1st Dept 2017] [internal quotation marks and citation omitted]). "To negate coverage by virtue of an exclusion, an insurer must establish that the exclusion is stated in clear and unambiguous language, is subject to no other reasonable interpretation, and applies to the particular case" (*Continental Cas. Co. v Rapid-Am. Corp.*, 80 NY2d at 652). Where an insured offers a "plausible" interpretation of the exclusion that would result in coverage, the insured's position must be sustained (*National Football League v Vigilant Ins. Co.*, 36 AD3d 207, 211 [1st Dept 2006]; *see also RJC Realty Holding Corp. v Republic Franklin Ins. Co.*, 2 NY3d 158, 165 [2004]).

"In the context of a policy exclusion, the phrase arising out of is unambiguous, and is interpreted broadly to mean originating from, incident to, or having connection with" (*Country-Wide Ins. Co.*, 147 AD3d at 409 [internal quotation marks and citation omitted]). "There is no

significant difference between the meaning of the phrases 'based on' and 'arising out of' in the coverage or exclusion clauses of an insurance policy" (*Mount Vernon Ins. Co. v Creative Hous*, 88 NY2d 347, 352 [1996]). The Court of Appeals has held that a "but for" test applies to determine an "arising out of" exclusion (*id.* at 350 ["(I)f no cause of action would exist but for the (excluded conduct), the claim is based on (the excluded conduct) and the exclusion applies"]).

Courts have held that the language "based upon' and 'arising out' of imply a causal relationship, [but] 'in any way involving' does not require one" (*Darwin Natl. Assur. Co. v Westport Ins. Corp.*, 2015 WL 1475887, *12, 2015 US Dist LEXIS 42550, *36 [ED NY, Mar. 31, 2015, No. 13–CV–02076, Chen, J.]; *accord Quanta Lines Ins. Co. v Investors Capital Corp.*, 2009 WL 4884096, *21, 2009 US Dist LEXIS 117689, *62 [SD NY, Dec. 17, 2009, No. 06 Civ. 4624, Leisure, J.], *affd sub nom. Quanta Specialty Lines Ins. Co. v Investors Capital Corp.*, 403 Fed Appx 530 [2d Cir 2010]). The language '"in any way involving' simply requires some kind of connection or relationship between the two" (*Darwin Natl. Assur. Co.*, 2015 WL 1475887, *13, 2015 US Dist LEXIS 42550, *36).

In this case, the capacity exclusion is clear and unambiguous. Applying a "but for" test, the exclusion applies to bar coverage for the settlements in the Securities Class Action and Derivative Action in their entirety. In the Securities Class Action, the individual defendants were sued for signing false and misleading SEC filings *as directors and officers of VEREIT* (NYSCEF Doc No. 291, third amended complaint, ¶¶ 24, 27-28, 32, 79, 84, 89, 95, 101, 106, 111, 309-310; NYSCEF Doc No. 262, ¶¶ 25-35; NYSCEF Doc No. 350, ¶¶ 25-35). In the Derivative Action, the plaintiff asserted causes of action against the individual defendants for

breach of fiduciary duty *as directors and officers of VEREIT* (NYSCEF Doc No. 293, amended verified shareholder derivative complaint, ¶¶ 14, 16-17).

Accordingly, the causes of action would have failed but for the acts against the individual defendants in their capacities as directors and officers of VEREIT (*see Law Offs. of Zachary R. Greenhill, P.C. v Liberty Ins. Underwriters, Inc.*, 147 AD3d 418, 420 [1st Dept 2017], *lv denied* 30 NY3d 904 [2017] [plaintiffs' claims fell within policy exclusion for claims arising out of attorney's capacity as officer, director, or employee of an organization other than the named insured]; *Langdale Co. v National Union Fire Ins. Co. of Pittsburgh, Pa.*, 609 Fed Appx 578, 596 [11th Cir 2015] [exclusion barred coverage for claims arising out of an act of an insured serving in any capacity other than as an executive]; *Goggin v National Union Fire Ins. Co. of Pittsburgh, Pa.*, 2018 WL 6266195, *5, 2018 Del Super LEXIS 1533, *12 [Del Super Ct 2018] [finding that capacity exclusion in directors and officers liability policy applied and eliminated insurer's coverage obligation; "'But for' Goggin and Goodwin's roles as members/managers of ECM Entities, the FAC claims would fail"]).

Moreover, it is undisputed that the underlying actions involve the individual defendants' acts as directors and officers of VEREIT. Thus, the exclusion applies because the claims in the underlying actions "in any way involve" the individual defendants' acts in their uninsured capacities for VEREIT (*see Darwin Natl. Assur. Co.*, 2015 WL 1475887, *13, 2015 US Dist LEXIS 42550, *36).

The AR Capital parties' reading of the capacity exclusion would render the language "*any* payment" "in connection with *any Claim* . . . directly or indirectly resulting from, in consequence of, or in any way involving an Insured Person acting in their capacity as a [sic] Insured Person of any other entity other than the Company [AR Capital]" meaningless.

Furthermore, the plain language of the allocation provision only requires that the parties use their best efforts to determine a fair and appropriate allocation of Loss where an insured makes a Claim "contain[ing] both covered and uncovered matters." Here, the capacity exclusion bars coverage for the settlements in the underlying actions in their entirety.

* * * *

In sum, the Insurers have demonstrated that the policies do not cover the settlements and consent judgments, and that even if the settlements were covered, they would be excluded by the capacity exclusion. Therefore, the Insurers are entitled to summary judgment declaring that their policies do not provide coverage for the settlements and consent judgments.

However, the Insurers have failed to demonstrate a basis for an award of costs or attorneys' fees. Generally, "attorneys' fees and disbursements are incidents of litigation and the prevailing party may not collect them from the loser unless an award is authorized by agreement between the parties or by statute or court rule" (*Matter of A.G. Ship Maintenance Corp. v Lezak*, 69 NY2d 1, 5 [1986]). The Insurers have pointed to no such authority or any other legal basis for such an award.

For the same reasons, the AR Capital parties' cross motion must be denied.

CONCLUSION

Accordingly, it is

ORDERED that the motion (sequence number 016) of plaintiffs Continental Casualty Company, Argonaut Insurance Company, Freedom Specialty Insurance Company, and QBE Insurance Company for summary judgment is granted to the extent of declaring that their policies do not cover the settlements and consent judgments in the underlying actions; and it is further

ORDERED that the cross motion of defendants/counterclaim plaintiffs AR Capital, LLC, Bellevue Capital Partners, LLC, Edward M. Weil, William M. Kahane, Peter M. Budko, and Nicholas S. Schorsch for summary judgment is denied; and it is further

ADJUDGED and DECLARED that the policies issued by plaintiffs Continental Casualty Company, Argonaut Insurance Company, Freedom Specialty Insurance Company, and QBE Insurance Company do not provide coverage for the settlements in the actions captioned *In re American Capital Props., Inc. Litig.*, Case No. 15-mc-0004 (SD NY) and *Witchko v Schorsch*, Case No. 15-cv-06043 (SD NY) and the consent judgments entered in the action entitled *Securities & Exchange Commn. v AR Capital, LLC*, Case No. 1:19-cv-06603 (SD NY).

The Clerk shall enter judgment accordingly.

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2/2/2021
DATE

JOEL M. COHEN, J.S.C.

CHECK ONE:	[X]	**CASE DISPOSED**		[ ]	**NON-FINAL DISPOSITION**		
	[X]	**GRANTED**	[ ] **DENIED**	[ ]	**GRANTED IN PART**	[ ]	**OTHER**
APPLICATION:	[ ]	**SETTLE ORDER**		[ ]	**SUBMIT ORDER**		
CHECK IF APPROPRIATE:	[ ]	**INCLUDES TRANSFER/REASSIGN**		[ ]	**FIDUCIARY APPOINTMENT**	[ ]	**REFERENCE**