SUPREME COURT OF THE STATE OF NEW YORK
COUNTY OF NEW YORK: COMMERCIAL PART 48
----------x

UNITED STATES FIRE INSURANCE COMPANY,

Plaintiff,

-against-

NINE THIRTY FEF INVESTMENTS, LLC, and NINE THIRTY VC INVESTMENTS, LLC,

Defendants.

----------x

**Index No.: 603284/09**

**DECISION AND JUDGMENT AFTER NONJURY TRIAL**

**JEFFREY K. OING, J.:**

**Nonjury Trial**

I presided over the trial of this action on April 17-20, 24-26, 2012. Over that period of time, nine individuals testified and trial counsel moved into evidence a substantial number of documents. Counsel submitted post-trial briefs on June 11, 2012.

**Factual Background**

Defendants, Nine Thirty FEF Investments, LLC ("FEF") and Nine Thirty VC Investments, LLC ("VC") (FEF and VC collectively referred to as the "insureds"), are private limited liability companies formed for investment purposes for their owners, which are charitable organizations and families. Nine Thirty Capital Management, LLC ("Nine Thirty Capital") provides FEF and VC with investment advice as well as recommendations for employing investment managers and advisors. During the relevant period of time, Stuart J. Rabin ("Rabin") was Nine Thirty Capital's Chief Executive Officer, and J. Robert Small ("Small") was its Chief

Financial Officer. Rabin and Small were also CEO and CFO of the Jacobson Family Investment ("JFI"), respectively.

In order to understand how the parties began their insurance relationship, and the evolution of the insurance coverage herein, a brief historical review is in order. In 2001, JFI through its insurance broker, Frank Crystal & Company ("Frank Crystal"), obtained from Vigilant Insurance Company ("Vigilant") a Financial Institution Bond (the "Vigilant bond"), which included an Outside Investment Advisor coverage endorsement. While the Vigilant bond contained a broker exclusion, an endorsement to the bond specifically provided that the broker exclusion did not apply to the Outside Investment Advisor coverage. In 2002, Vigilant issued a renewal bond to JFI on the same terms. In 2003, Vigilant discontinued providing Outside Investment Advisor coverage to JFI. JFI then obtained replacement coverage from National Union Insurance Company ("National Union") in 2003. National Union's bond contained the same Outside Investment Advisor coverage, and the broker exclusion, Exclusion (x) (the "National Union bond"). National Union eventually ceased providing Outside Investment Advisor coverage to JFI affiliates managed by Nine Thirty Capital, such as Nine Thirty LLC Investments ("Nine Thirty LLC"). Thereafter, Nine Thirty LLC obtained insurance coverage from Quanta Indemnity Company

("Quanta Indemnity") similar to the coverage JFI had with National Union (the "Quanta bond").

Defendant FEF sought and obtained from Quanta Indemnity a Financial Institution Bond modeled after the Quanta bond (the "FEF Quanta bond"). The FEF Quanta bond provided Outside Investment Advisor coverage, evidenced by Rider #9. Thereafter, FEF sought and obtained insurance coverage from plaintiff, United States Fire Insurance Company ("U.S. Fire"), based on the FEF Quanta bond. U.S. Fire issued FEF a Financial Institution Bond (the "FEF U.S. Fire bond"), which was in effect during the relevant period of time.

Defendant VC separately sought and obtained from U.S. Fire the same Financial Institution Bond issued to FEF (the "VC U.S. Fire bond"). It too was in effect during the relevant period of time.

Both the FEF U.S. Fire bond and the VC U.S. Fire bond contain the following language in the "EXCLUSIONS" section:

> Section 2. This bond does not cover:
>
> (x) loss resulting directly or indirectly from any dishonest or fraudulent act or acts committed by any non-Employee who is a securities, commodities, money, mortgage, real estate, loan, insurance, property management, investment banking broker, agent or other representative of the same general character.

(Exclusion (x), Pl. Trial Ex. 15).

Both also contain "Rider 9", the "OUTSIDE INVESTMENT ADVISOR RIDER", which provides, in relevant part:

> 1. The following Insuring Agreement will be added to the policy:
>
> **Outside Investment Advisor**
>
> Loss resulting directly from the dishonest acts of any Outside Investment Advisor, named in the Schedule below, solely for their duties as an Outside Investment Advisor, on behalf of the Insured, such loss limited to the Insured's investment interest, committed alone or in collusion with others, except with a director or trustee of the Insured who is not an Employee, provided however the Insured shall first establish that the loss was directly caused by dishonest acts of any Outside Investment Advisor which results in improper personal financial gain to such Outside Investment Advisor and which acts were committed with the intent to cause the Insured to sustain such loss.
>
> The following Outside Investment Advisors shall be added as follows:
>
> * * *
>
> Bernard L. Madoff Investment Securities
>
> * * *
>
> 2. By adding to Section 1. Definitions, the following:
>
> (t) Outside Investment Advisor means any firm, corporation or individual named in the Schedule for the Insuring Agreement, Outside Investment Advisor, and an employee, officer or partner of such Outside Investment Advisor.

(Id.).

**The Bernie Madoff Debacle**

The insureds' decision to enter into a business relationship with Bernard L. Madoff ("Madoff") and his firm, Bernard L. Madoff

Investment Securities LLC ("Madoff Securities") was rather straightforward. Rabin testified that JFI family members and the Madoff family had a social relationship. Some time in 1997 or early 1998, Rabin testified at trial that a suggestion was made to him to have the insureds' assets placed with Madoff and Madoff Securities because he had a reputation of being very credible and successful. Madoff's investment strategy was to utilize a "split-strike conversion strategy" to make investment decisions. In that regard, the arrangement was for Madoff to implement his strategy by having Madoff Securities execute the trades he dictated. The fee for providing this investment advice would be included in the 4-cent brokerage commission Madoff Securities would charge on each trade. The JFI entities invested with Madoff and his company. Later, FEF and VC, at Rabin's recommendation, opened investment accounts with Madoff Securities. Over the next several years, the investments performed well, until December 11, 2008, when the United States Securities and Exchange Commission filed a complaint against Madoff and Madoff Securities in the United States District Court for the Southern District of New York charging them with perpetrating a multi-billion dollar Ponzi scheme in violation of the federal securities laws. In March 2009, the federal government commenced criminal proceedings against Madoff, and

charged him with eleven felony counts arising out of his Ponzi scheme. On March 12, 2009, Madoff pleaded guilty to all charges.

**Denial of Claims**

On or about June 9, 2009, the insureds submitted claims to U.S. Fire under both bonds seeking coverage for their losses related to the Madoff debacle. Approximately four months later, in a letter, dated October 28, 2009, U.S. Fire, through its counsel, denied coverage. The letter provided, in relevant part:

> Based upon the information U.S. Fire is aware of, it appears clear that Madoff Securities was acting as a broker in its dealings with FEF and VC. As a result, there can be no coverage under the Outside Investment Rider. Similarly, Exclusion (x) of the Bond excludes coverage for any losses incurred by the Insureds.

(the "disclaimer letter", Trial Ex. O).

**Declaratory Judgment Action**

This action arises out of U.S. Fire's denial of the insureds' claims pursuant to the two financial institution bonds issued by U.S. Fire to FEF and VC. FEF and VC's claims are based on losses both allegedly sustained, respectively, at the hands of Madoff and Madoff Securities in the course of their perpetration and operation of their infamous Ponzi scheme. FEF's claimed losses total $9,257,811.71; VC's claimed losses total $5,561,493.01.

**Summary Judgment Motions**

U.S. Fire and the insureds moved for summary judgment. In a decision and order, entered June 22, 2011, Supreme Court (Justice

Richard B. Lowe, III) denied their motions. In that regard, as is relevant to this trial, Justice Lowe found that "Rider 9 defines Outside Investment Advisor as any firm, corporation, or individual named in the Schedule of Rider 9 and an employee, officer, or partner of such Outside Investment Advisor", that "Madoff Securities is listed as an Outside Investment Advisor in the Schedule", and that "[t]here is no dispute that Bernard Madoff is included under the definition of Outside Investment Advisor". As to whether FEF's and VC's losses arising out of Madoff's dishonest acts are covered pursuant to the bonds, Justice Lowe held:

> The language of Rider 9 has a definite and precise meaning, and thus, is unambiguous. In its clear and plain language, Rider 9 limits coverage to losses as a result of dishonest acts as an Outside Investment Advisor. As stated above, Rider 9 defines an "Outside Investment Advisor" as any firm, corporation, or individual named in the Schedule, including an employee, officer, or partner of such firm, corporation, or individual, and Madoff Securities is clearly listed as one of the 25 Outside Investment Advisors in the Schedule. Rider 9 does not, as U.S. Fire asserts, require that those entities listed must only be investment advisors; rather, the Rider limits the losses covered to those occurring out of the duties of an Outside Investment Advisor. If losses were suffered as a result of dishonest acts committed by Madoff in his duty as an Outside Investment Advisor, those losses are covered.

While Rider 9 is itself clear and unambiguous, Justice Lowe found the existence of an ambiguity when Rider 9 is read in conjunction with Exclusion (x). Specifically, Justice Lowe held that "[w]hile this exclusion provides that losses as a result of any

dishonest act committed by securities brokers are not covered, its meaning is unclear when read with Rider 9". In that regard, Justice Lowe found:

> Madoff is clearly included as an Outside Investment Advisor on Rider 9; however, he was admittedly a registered securities broker. Although Exclusion (x) does not cover losses as a result of dishonest acts by a securities broker, it is not clear, when read with Rider 9, whether losses from dishonest acts by Madoff, acting as an Outside Investment Advisor. The issue is whether these losses, if any, are precluded by Exclusion (x) because Madoff is also a registered securities broker. This ambiguity presents a question of fact which cannot be resolved on these motions for summary judgment.

**Preliminary Issues**

U.S. Fire urges me to revisit Justice Lowe's decision by taking the position that it is an interlocutory order, and that I have discretion to modify it. I decline to do so. To begin, Justice Lowe's decision is law of the case. Further, the proper procedural vehicle for that review would have been for U.S. Fire to move for reargument (CPLR 2221). It did not. U.S. Fire's other option was to appeal Justice Lowe's decision and order, which it did, and that appeal is still pending (CPLR 5512). Indeed, were I to conduct such an unwarranted review and reconsideration, I would be engaging in an impermissible appellate review of an order of a Justice of coordinate jurisdiction. The cases cited and relied upon by U.S. Fire to support its application are factually distinguishable given that those cases involved a subsequent reconsideration by the same

Justice or Appellate Court that rendered the original decision and order -- not a different Justice, as in this case.

Next, the issue of whether Exclusion (x) can apply to Rider 9 has been previously determined by Justice Lowe. His decision and order is clear -- Rider 9 provides coverage with respect to the claims. Justice Lowe's finding that the remaining issue is "whether these losses, if any, are precluded by Exclusion (x) because Madoff is also a registered securities broker", indicates that Exclusion (x) is to be considered when determining Rider 9 coverage, and that whether it is triggered to exclude coverage is to be determined at trial. Given this analysis, the insureds' reliance on the doctrine of efficient proximate cause is misplaced because there is no competing proximate causes for the claimed losses.

**Findings of Fact**
**Conclusions of Law**

Indisputedly, during the relevant time period with respect to the controversy herein, Madoff and Madoff Securities were registered securities brokers. U.S. Fire takes the position that this fact alone is sufficient to trigger Exclusion (x). The critical question then is whether that fact satisfies the conditions set forth in Exclusion (x) so as to exclude coverage under Rider 9.

As noted, supra, Exclusion (x) excludes coverage for:

> loss resulting directly or indirectly from any dishonest or fraudulent act or acts committed by any non-Employee who is a securities, commodities, money, mortgage, real estate, loan, insurance, property management, investment banking broker, agent or other representative of the same general character.

U.S. Fire urges me to accept its interpretation that Exclusion (x) simply means that a mere showing that Madoff and Madoff Securities were registered securities brokers during the relevant period is sufficient to trigger the exclusionary language set forth in Exclusion (x). In that regard, U.S. Fire relies on the testimony of its employees: Eric Tibak, assistant vice president of the Management Protection Claims Unit, Juan Trillo, claims specialist, and Paul Kush, chief claims officer and senior vice president of claims. They took the position that the only interpretation of the provision that U.S. Fire ever had was that Exclusion (x) was triggered due to the sole fact that Madoff and Madoff Securities were registered securities brokers (Trial Tr. at pp. 442, 452-453, 456-457, 564, 608, 617, 661, 699). Although such testimony clearly demonstrates their single-mindedness and self-assuredness with respect to the interpretation of Exclusion (x), such testimony is remarkable when considered with the claims file and their other testimony, which indicates that their confidence was not so resolute.

To begin, the claims file had no commentary or reference to Exclusion (x). Trillo gave the following explanation for such absence:

Q Exclusion X nowhere appears in the claims file that has been produced to us in this case up through July 2009? Correct?

A That's correct.

Q Is it your testimony that you are actively discussing Exclusion X throughout this entire period but you just didn't make any notation?

A Our notes are usually daily activities of us looking into the file working on the file. If you look at it there's really no discussion of any coverage except for the initial thoughts when claim first came in those are our initial review but we were discussing at the time but my claim notes would have been more showing we are working on the file, that we were contacting the people needed contacting, we received document when the claim requested it. Its more of an every day record to show if the file gets audited or for whatever reason the claim manager is working through the file, the file is not getting neglected.

A lot of time there is no coverage wording in this at all until you make a final determination, maybe you put that letter in and the claims decision at the end.

Q Well, there is nothing else in the claims file that you produced that relates to any analysis by you or Mr. Tibak or Mr. Kush about this claim? There is no more it seems like there was nothing recorded at the present time about Exclusion X and anything that you or Mr. Tibak or Mr. Kush kept related to this? Is that fair?

A That's fair.

Q So there is no written record that we have been given that would confirm that what you're telling us was the view of Exclusion X was in fact the view held by U.S. Fire? Isn't that true?

A It wouldn't be in these claims notes because these claims notes are just to show daily activity of the person handling a file, make sure they are not

neglecting their duties by not looking to the file. As you can see they are written in periodic either when information is sent or there is a 28 day reporting, 60 day reporting that sort of thing. Most of what we are dealing with were discussions and we weren't going to make a determination until we received the full proof of loss and there is nothing written in here to suggest we were talking coverage at all.

Q As far as I can see from what you produced in this case with your former employer there is not one piece of paper that's written by anyone in U.S. Fire that makes any reference to Exclusion X not once in ten months before the claim is denied. Can you point me to any that you know of?

A Again these are daily --

Q I'm not asking --

MR. KEELEY: Mr. Novak, please let him finish.

MR. NOVAK: He is not being responsive.

MR. KEELEY: He's got to let him finish.

(Trial Tr. at pp. 569-571). I find Trillo to be evasive and his explanation to be circular when questioned on the absence of references to Exclusion (x) in the claims file (Trial Tr. at p. 571).

Nonetheless, the absence of any commentary in the claims file regarding Exclusion (x) is ostensibly understandable when I consider the testimony of Kush, the senior claims person that both Tibak and Trillo consulted, that U.S. Fire did not have the expertise to handle these claims:

Q Were you more involved in the FEF and VC claims than you would be with a normal claim?

A Yes, I was.

Q Why is that?

A We had recently, only several years prior to that claim being reported, had begun a program of financial institution bond underwriting, and we really did not have any expertise within the claims operation to handle those claims immediately, so I took it upon myself to really just completely delve into those claims as they were reported, to gain an understanding of the coverages, to gain an understanding of the approach to investigation, the analysis of claims, and actually was very much involved in the couple of dozen of claims of that type that had been reported to us during that time.

* * *

Q You recall Eric Tibak and Juan Trillo were claims adjustors under you?

A Yes.

Q They have testified that this was either their first claim or one of their first bond claims. Can you explain to the court why that would be the case?

A Yes. Actually we -- initially the bond claims had been handled at the front line by an adjuster in our property claims department, and I was uncomfortable as I started to see especially some of the more significant and complex financial institution bond claims coming in the door, I thought that that group was not -- didn't have the capacity to handle those claims. At the time, Eric and Juan were handling some pretty sophisticated D&O claims, and I had been talking to them about the fact that I thought these claims were better suited for them to handle.

So prior to the -- this particular claim coming in the door, I had actually given them a handful of cases that I had been directly involved in, and just asked them to read them and become acquainted with those claims so they could understand how

those claims were handled, how the coverages applied.

And so that was all right around this time. So when this claim came in, I thought it was most appropriate that I assign it to them because that's where I wanted those claims to be handled over the long term.

(Trial Tr. at pp. 651-653).

In that same vein, Tibak's testimony was as follows:

Q This was your first fidelity claim? Correct?

A That is correct.

Q So you were learning as you went along on this?

A To some point, yeah.

* * *

Q Mr. Tibak, have you ever had any experience trying to interpret Exclusion X when it was issued in a policy with Rider 9 or something like Rider 9?

A Prior to this claim?

Q Right.

A No.

Q Have you had any past experience where you had to interpret Exclusion X in a factual scenario that is at all similar to this one here?

A No.

Q When you give your interpretation of Exclusion X its just basically your personal view on reading it? Is that it, simple as that?

A That's part of it, sure.

(Trial Tr. at pp. 521-523).

Tibak also gave the following testimony:

Q Now was the Madoff claim or the Madoff claims were they the first time that you ever had seen a claim under these financial institution bonds Form 14?

A I believe so.

Q So you came to it as a blank slate except for what Mr. Kush had taught you? Is that right?

A Yes.

* * *

Q And isn't it true that you wanted Mr. Kush's input as to exactly where you were and where you should go and how to investigate and evaluate this claim?

A Yes.

Q And isn't it true that what you were doing was all really based on what you were directed to be doing by Mr. Kush?

A Not completely.

Q Was it all based on what you were being told by Mr. Kush?

A Not completely.

Q How was it different?

* * *

A The main thrust of Juan's activity and my oversight was trying to flush out as much information from our policyholders as we could. We felt the only way to do that under the circumstances was to push for a face to face meeting with them as soon as we could. So during this time frame we were not very successful in getting our policyholders to meet with us and so Juan's activity was really geared around when can we have this meeting, when can we have this meeting. That didn't require a lot of input from Mr. Kush for those first couple months. We would talk to him about what we may have read in the press but essentially Mr. Kush's interest to us at

> the time was do we have a meeting set up, when can we go out and learn what this is about.

(Trial Tr. at pp. 442, 452-453).

Trillo testified that he too did not have experience with these kinds of claims:

> Q Would you turn to Exclusion X please at page seven. What is your understanding of what this exclusion excludes from coverage?
>
> A It excludes from coverage any acts from non-employees including security, mortgage -- securities, commodities, mortgage/real estate loan, insurance brokers, management, investment banking, agents, representatives, that sort of thing, so non-employees.
>
> Q All right. Had you dealt with this exclusion prior to this claim coming in?
>
> A No. Again, this was our first fidelity bond claim.

(Trial Tr. at p. 607).

The inference that I draw from the above testimony is that the reason the claims file did not have any reference to Exclusion (x) is because of Tibak's, Trillo's and Kush's uncertainty with respect to the policy coverage and exclusion provisions. Thus, I find their unified position concerning Exclusion (x) to be questionable.

Another basis for me to doubt their unified interpretation is their singular reliance on the proof of loss. All three testified that the key, critical factor in interpreting Exclusion (x) as it applied to Rider 9 was the insureds' proof of loss

(Trial Tr. at pp. 485, 506, 525, 553, 555, 574-576, 657, 692).

As to the purpose of the proof of loss, Tibak testified as follows:

> Q I would like to focus you on a specific point if we can stick with this one point. How did you think in February, 2009, it could conceivably be possible to get around Exclusion X if all that was required to trigger it was a showing that Madoff Securities was a registered securities broker dealer? How on earth could they possibly get around that? Tell us.
>
> A That's a good question. I had that question myself. Because at the time everything we had learned suggested that Madoff was a broker. The policy gave our insured 120 or 180 days, I'm not clear on that, to submit the proof of loss. I think it would be careless or reckless of any carrier to deny coverage at least until our policyholder submitted their proof of loss. That's their right. It wasn't my -- it wasn't up to me to assume or project the claim that might be coming in.
>
> So, sure, was it a long shot, maybe, yeah. Were we being cautious, we definitely were, but was it possible that they would submit something that would establish that Madoff was an employee and perhaps voiding Exclusion X.
>
> Q Mr. Tibak, I'm not asking you to give us your opinion as to whether you were required to wait before taking an official coverage position. I just want you to explain to the Judge how you think it was conceivable in theory for them, the insureds, to defeat Exclusion X if you believed that all they are required to go online, show he was a registered securities broker, which in fact no one was disputing as you know, so just explain to the Judge -- forget about when you should deny or not. Tell the Judge how anybody could possibly get around that interpretation, that interpretation of why it applied.

A There would be two ways somebody could get around it conceivably. One would be if they established that Madoff was not a non-employee or perhaps was an employee which would void Exclusion X in my mind. The second would be if he for some reason wasn't a broker.

Now as Mr. Novak has stated it seemed pretty clearly on that he was a broker but those were the two possible avenues that we discussed internally that we considered I guess this is potential to get around this and until the proof of loss comes in and we have the actual claim it would be premature for us to actually disclaim coverage based on what we are reading in the New York Post or what we picked up along the way.

Q How could Mr. Madoff undo the fact that he was registered with the government as a securities broker? Are you saying that he could show he wasn't registered?

A No, I'm simply telling you the two possible ways --

Q I'm asking you how that could be possible, sir.

A I'm not sure.

Q You can't tell us how that could conceivably be possible. Either he was registered or not. There is no dispute as to that?

A I don't dispute that.

(Trial Tr. at pp. 507-509).

Contrary to Tibak's, Trillo's and Kush's testimony, the proof of loss is not a "roadmap" for the coverage investigation concerning the applicability of Exclusion (x) (Trillo Trial Tr. at p. 610). First, a careful review of the proof of loss prepared by the insureds demonstrates that it makes no mention of Madoff and Madoff Securities as a securities brokers. That

simple fact is only mentioned in the federal criminal information, annexed to the proof of loss, and is stated merely in a descriptive context. Essentially, the proof of loss is a roadmap to nowhere.

Second, by June of 2009, the documentation clearly demonstrated that Madoff was not an employee, and that he was a registered securities broker, thus purportedly triggering Exclusion (x) under U.S. Fire's interpretation. Yet, Kush explained that the reason why U.S. Fire took four months to issue the disclaimer letter was because they were waiting for additional information (Trial Tr. at pp. 691-692). Tibak and Trillo's trial testimony is not to the contrary. That explanation, however, is not credible in light of Trillo's testimony that this information was financial in nature (Trial Tr. at p. 613 ["At that time I think there were still outstanding documentation, I think there were banking records; there were several things that we still didn't receive. But I think at that point it was as good as we were going to get."]). As Trillo stated:

> There was also a huge discussion on -- or we had a discussion on the banking information at the time. We had no -- I believe, if I recall, the proof of loss was again narrative. It was the amounts of -- amount claimed. I think we were asking for banking information, specifically banking transactions between FEF and Bernard Madoff, and it was that sort of information. It was mostly the financials. I think we received a narrative, and their calculation of what their actual damages was or what their damages were

> based on their last broker filing. But at that time I think we were asking for the banking information, which I'm not even sure that we received or not.

(Trial Tr. at p. 629).

Moreover, Trillo further testified that "[p]robably by June, we could have probably made a determination maybe, maybe sometime in June or July" (Trial Tr. at p. 630). Such conflicting testimony compels me to find that the information had more to do with determining the outside parameters for the sustained losses, and less to do with resolving Exclusion (x). The totality of such testimony compels me to draw the inference that the four month delay was the consequence of Tibak's, Trillo's and Kush's uncertainty that Exclusion (x) required merely that Madoff was a securities broker. Indeed, Trillo was very candid about their "confidence" in interpreting Exclusion (x):

> Q You testified that you weren't sure exactly what it meant. Is it that you were not sure what it meant or you just weren't confident that you were reading it correctly?
>
> A What I would have used was "confident." It was more of a confidence issue.
>
> Again, this was my first claim, and it happens to be tied in with Bernard Madoff and everything that was going on in 2008, so it was more of an issue of, you know, we weren't confident to make that call at that time. And I think there was something expressed by myself, and I can guarantee Eric and Paul weren't -- again, we weren't sure because this was new to us, especially new to me.

(Trial Tr. at pp. 632-633).

The straw that breaks the proverbial camel's back is U.S. Fire's own October 28, 2009 disclaimer letter. In setting forth its position concerning the interplay between Rider 9 and Exclusion (x), U.S. Fire advised the insureds, in relevant part, the following:

> Based upon the information U.S. Fire is aware of, it appears clear that Madoff Securities was acting as a broker in its dealings with FEF and VC. As a result, there can be no coverage under the Outside Investment Rider. Similarly, Exclusion (x) of the Bond excludes coverage for any losses incurred by the Insureds.

(Trial Ex. O [emphasis added]). Both Tibak and Trillo testified that they reviewed and approved the disclaimer letter together with the original complaint accompanying the disclaimer letter before U.S. Fire's counsel delivered them to the insureds.

During trial, I noted a problem with this disclaimer letter as written (Trial Tr. at pp. 497-501). Specifically, the disclaimer letter clearly indicates that coverage under Rider 9 is not available because Madoff Securities was "acting as a broker." I then noted that by using the term "similarly", without any other qualification, Exclusion (x) excluded coverage for that same reason, namely, that Exclusion (x) excluded coverage because Madoff and Madoff Securities were "acting" as brokers, and not merely due to the fact that they were registered securities brokers (Id.).

Responding to this obvious dilemma, U.S. Fire's counsel urged me to focus on the original complaint accompanying the

disclaimer letter because that pleading "made it very clear what we were saying" (Trial Tr. at p. 498). In that regard, the original complaint alleges that "FEF's and VC's losses resulted directly or indirectly from dishonest and fraudulent acts committed by Madoff and Madoff Securities, non-Employees who are securities brokers", and that "[a]s a result, Exclusion (x) excludes coverage for FEF and VC's claimed losses" (Dx E, Original Complaint, ¶ 41). Counsel essentially argued that I should use the complaint to amplify and supplement the disclaimer letter. I made no ruling at the time. I now find that argument unavailing.

As noted during colloquy with counsel, a complaint is nothing more than a pleading setting forth various allegations that need to be proved. As such, a pleading is generally amplified and supplemented by evidence, either documentary or otherwise -- not, as counsel suggests, the other way around. Tellingly, U.S. Fire puts forth no argument with respect to the disclaimer letter in its post-trial brief. Apparently, it is abandoning its earlier position.

Nonetheless, an opportunity was given to U.S. Fire to provide an explanation at trial. Tibak gave the following testimony:

> Q And I want to read it. It says based upon the information U.S. Fire is aware of it appears clear that Madoff Securities was acting as a broker in its dealings with FEF and VC. As a result there

can be no coverage under the Outside Advisor Rider. Similarly excludes for any loss incurred by the insureds.

Mr. Novak is arguing on behalf of Defendants that my last sentence there means that in order for Exclusion X to apply Mr. Madoff actually had to be acting as a broker. Was that how you read that?

A No.

Q Was that your position?

A That was never our position.

Q If my sentence there conveys that to the reader then I made a mistake and was not as clear as I could have been in conveying your decision? Is that accurate?

A That's accurate.

Q Any question in your mind?

A None.

(Trial Tr. at pp. 519-520).

Trillo testified as follows:

Q And the next sentence says: "Similarly, Exclusion X of the bond excludes coverage for any losses incurred by the insureds." Can you tell the court what your understanding of that sentence is?

A The whole paragraph?

Q Just that last sentence.

A The last sentence is that there cannot be coverage because - of Exclusion X because Bernard Madoff was a broker-dealer.

Q Did you intend to convey to the insured by that statement that there is no coverage under X because Madoff was acting as a broker?

A No. It was because he was a broker-dealer.

Q Is there any doubt in your mind that that was your position and US Fire's position?

A There is no doubt, no.

THE COURT: What was the last sentence?

THE WITNESS: The last thing I said was no coverage because he was a broker-dealer.

Q You weren't saying there was no coverage because he was acting as a broker but merely because he was a broker?

A Correct.

(Trial Tr. at pp. 619-620).

Lastly, Kush gave the following testimony:

Q Turn to Exhibit O for me please, the October 28th letter. Look at page three for me under the heading Coverage Issues. Do you see where I quote from Rider 9? Turn to the next page, page four, where I quote further from Rider 9 and then Exclusion X. I want to read you the next paragraph. It says: "Based upon the information US Fire is aware of, it appears clear that Madoff Securities was acting as a broker in its dealings with FEF and VC. As a result, there can be no coverage under the outside investment advisor rider. Similarly, Exclusion X of the bond excludes coverage for any losses incurred by the insureds.

What was your understanding of this paragraph of my letter, denial letter? What did you intend for me to be explaining to the insureds?

A Well, that there was there was no coverage under the outside investment advisor rider. And just as there was no coverage under that rider, there was no coverage because Exclusion X clearly applied to the loss.

(Trial Tr. at pp. 670-671).

To begin, I find counsel's characterization that the phrase "acting as a broker" coupled with the term "similarly" in the disclaimer letter was merely a "mistake" to be nonsensical, particularly given U.S. Fire's very substantial exposure with regard to these claims. If, in fact, counsel prepared this disclaimer letter contemporaneously with the original complaint, as he asserts, then as I noted at trial, "it would have been simple as a matter of fact to say take exactly the same sentence that you have in the complaint ... and just stick it in here ... then we would have been avoiding all this problem at this juncture but for the fact that its not there gives me or at least gives Mr. Novack the opportunity the doors open the jar as to what exactly what Exclusion X means" (Trial Tr. at p. 500).

In any event, as their testimony, supra, indicates, Tibak and Trillo both testified that they reviewed and approved the disclaimer letter and the original complaint. Tibak testified that U.S. Fire's position for Exclusion (x) was never that Madoff and Madoff Securities had to be "acting" as securities brokers, but that they merely had to be securities brokers. Trillo testified that the disputed sentence was intended to convey to the insured that there was no coverage under Exclusion (x) because Madoff was a securities broker. Indeed, Trillo explained that he thought "being" a securities broker was the same as

"acting" as one (Trial Tr. at pp. 627-628). Kush's testimony virtually mirrors Tibak's and Trillo's.

Such a single-minded view of the meaning of Exclusion (x) is simply incredible when considered in light of the following statements from Trillo:

Q Is it correct then you weren't sure how to read Exclusion X, whether it was "is a broker" triggers it or "acting as a broker" triggers it as of January, 2009?

A That early on, again, it was my first claim, it was the first time I saw the exclusion, so was I familiar with that? I mean, it was the first time I saw it, so could I definitely say I knew right there and then? I can't say that.

Q You would agree with me that the language is not crystal clear and that's why you couldn't know right there and then; true?

A I wouldn't say that. I would say at that time I was not familiar with it. My background was in D & O, directors and officers, in employment. And again, this policy is very unique to what I was accustomed to on a regular basis for years. So my issue was more of, you know, am I seeing this in the correct context of a crime claim. So it was more of my experience --

Q Irrespective of why you didn't know what Exclusion X meant at the time, isn't it correct that you did not know for sure one way or another how it should be interpreted?

A At that time probably I did not know.

* * *

Q So when you met with Mr. Tibak -- and Mr. Tibak was your immediate supervisor?

A He was.

Q Mr. Kush was head of claims?

A Correct.

Q When the two of you met, I take it you talked about X?

A We did.

Q Did you discuss with them what you thought it meant, as well as your concerns about whether you were actually reading it correctly?

A I probably did, yes.

Q Probably?

A I did.

Q Do you remember how long that discussion took place?

A No, but I know it was in Paul's office. I do recall it was Paul's office. And I think Paul was more sure of what it meant because he was more familiar with the form.

Q Did you kick it around for 10, 15 minutes?

A At least.

Q And when you left that meeting were you more confident in your reading of X?

A I was because there was consensus of what it meant.

* * *

Q So after you came out of that meeting with Mr. Kush and Mr. Tibak, what was your conclusion about what X meant?

A That it wasn't covering a broker-dealer.

(Trial Tr. at p. 625, 633-635).

Such a glaring and unmistakable difference between the language setting forth U.S. Fire's position in the disclaimer letter and the original complaint should have been obvious. To simply explain that "being" and "acting" were the same is simply not credible (Trial Tr. at p. 628). The following fact is clear -- U.S. Fire charged these individuals with the responsibility of investigating and reviewing the claims over the course of approximately ten months in which they purportedly gathered information and documentation to formulate a determination. The substantial exposure of these claims to U.S. Fire was very real. Indeed, Tibak testified that "[t]his wasn't a $10,000 claim" and that "[t]his one was pretty big and we wanted to make sure we got it right" (Trial Tr. at p. 510). To now claim that the disputed sentence says something else is disingenuous. Were I to accept this explanation, I would essentially be ignoring clear and plain English (Trial Tr. at p. 500).

Accordingly, based on the foregoing, I find that two interpretations for Exclusion (x) were considered, namely, (1) that Exclusion (x) requires a showing that Madoff and Madoff Securities were merely registered securities brokers, or (2) that Madoff and Madoff Securities were "acting" as brokers. Given that two interpretations were considered, the issue that must be resolved is which one controls.

An insurer desiring to exclude any risk must do so in clear and unmistakable terms and a vague exclusion should not be permitted to exclude coverage (Sincoff v Liberty Mut. Fire Ins. Co., 11 NY2d 386, 391 [1962]). In that regard, the exclusionary terms are to be accorded a strict and narrow construction, and are not to be extended by interpretation or implication. Any policy exclusion must be strictly construed against the insurer, and an insurer may negate coverage only if the exclusion is stated in clear and unmistakable language demonstrating that it applies in the particular case and is subject to no other reasonable interpretation (Cone v Nationwide Mut. Fire Ins. Co., 75 NY2d 747, 749 [1989]). In other words, when the issue is the appropriate construction or interpretation of the terms of an exclusionary clause, the insurer must establish that its construction or interpretation of the clause is the only proper construction (Nussbaum Diamonds, LLC v Hanover Ins. Co., 64 AD3d 488, 491 [1st Dept 2009]). The burden of satisfying this test is on the insurer (Continental Cas. Co. v Rapid-American Corp., 80 NY2d 640, 654 [1993]). If the insurer fails to submit extrinsic evidence that resolves the ambiguity in its favor, the proper interpretation is a matter of law and the ambiguity is resolved against the drafter of the contract, the insurer (Kenavan v Empire Blue Cross & Blue Shield, 248 AD2d 42, 47 [1st Dept 1998]).

With these legal principles as guideposts to resolving this issue, I make the following findings. I find that U.S. Fire failed to establish by credible testimonial or documentary evidence that its construction and interpretation of Exclusion (x) is the only proper meaning for that provision. As such, failing to resolve the ambiguity in its favor, I am compelled, as a matter of law, to hold that Exclusion (x) excludes coverage under Rider 9 if Madoff and Madoff Securities were "acting" as securities brokers. The question that remains is whether Madoff and Madoff Securities were acting as securities brokers.

U.S. Fire has argued that the insureds' submission of Securities Investor Protection Corporation ("SIPC") claims is somehow inconsistent with the contention that the insureds' losses did not result from Madoff and Madoff Securities acting as their broker (Trial Tr. pp. 763-764). There is no inconsistency. SIPC payments are made pursuant to a statutory scheme to protect the "customers" of insolvent registered brokers. The only thing that a SIPC claimant must show -- and all that the insureds asserted -- was that they were "customers" of an insolvent registered securities broker. The statutory definition of "customer" includes any person who has deposited cash with the debtor securities broker for purchasing securities. The insureds did so when they sent the money to the Madoff Securities Chase account. The insureds had no reason to allege, and never did

allege, in their SIPC claims that their losses resulted from Madoff and Madoff Securities acting as a securities broker, and the insureds never disavowed their view that their losses stemmed from Madoff's and Madoff Securities' investment advisory fraud (Px 63, Px 64).

U.S. Fire next argues that Madoff and Madoff Securities were acting as securities brokers as a result of the following undisputed facts: Madoff and Madoff Securities did act as the insureds' securities brokers at least in entering into securities agreements with them, in accepting their monies in order to execute trades for their benefit and/or returning such monies to them when they made withdrawal requests, and in issuing to the insureds Account Information Verifications, trade tickets, monthly brokerage statements and annual IRS tax forms reflecting trades conducted by a broker.

The insureds argue that this activity is insufficient to prove that Madoff and Madoff Securities were "acting" as securities brokers. They point to the clear evidence that Madoff and Madoff Securities perpetrated a sophisticated Ponzi scheme that duped them and hundreds of other investors. In that regard, Madoff and Madoff Securities were able to further the illusion of actual brokerage activities by creating and sending to FEF and VC fictitious trade confirmations and bogus monthly brokerage account statements from Madoff Securities showing ostensibly

deposits and withdrawals for that month, and purporting to show the transactions executed each month, as well as dividends earned. These brokerage statements for the separate managed accounts for FEF and VC were completely fictitious (Dx V, p. 27; Small Trial Tr. at p. 357-359; Trillo Trial Tr. at p. 563-564, 567-568). Indeed, Madoff and Madoff Securities were not rogue brokers churning brokerage accounts to generate exorbitant fees; he was doing nothing more than running an elaborate confidence game -- he was a con man.

At trial, Trillo conceded that: there were no brokerage accounts ever set up for the defendants, the funds sent to the Chase account were never sent to a brokerage account but rather were stolen by Madoff, there were never any trades made by Madoff for the insureds, and there were no brokerage activities conducted by Madoff that caused the insureds' losses (Trial Tr. at pp. 563-568). Tibak similarly conceded that there were no securities actually purchased or sold by Madoff for the insureds (Trial Tr. at p. 504).

U.S. Fire asserts that the insureds' argument, that Madoff and Madoff Securities did not really act as securities brokers because they did not actually trade any securities on their behalf, the so-called "imposter defense" as coined by U.S. Fire, is without merit. In making this argument, U.S. Fire relies on the following federal cases: First Ins. Funding Corp. v Federal

Ins. Co., 284 F3d 799 (7th Cir 2002), Stanford Univ. Hosp. v Federal Ins. Co., 174 F3d 1077 (9th Cir 1999), The Stop & Shop Cos. v Federal Ins. Co., 136 F3d 71 (1st Cir 1998), Associate Community Bancorp, Inc. v The Travelers Cos., Inc., 2010 US Dist LEXIS 34799 (US Dist Ct, Conn 2010), and Colson Servs. Corp. v Insurance Co. of N. Am., 874 F Supp 65 (US Dist Ct, SD NY 1994). Although these cases are not binding on this Court, I, nonetheless, reviewed them to determine if they provide any guidance in resolving this argument.

To begin, Stanford Univ. Hosp., The Stop & Shop Cos., and Colson Servs. Corp., are factually distinguishable from the case herein. In those cases, the issue was whether the term "authorized representative" included the wrongdoers. The courts held that it did. Similarly, Associate Community Bancorp, Inc. provides no guidance because in that case the court dismissed the insured's declaratory judgment action based on an insolvency exclusion by finding that because Bernard L. Madoff Investment Securities, LLC was a securities broker and the loss was attributable to its insolvency the loss fell within the scope of the exclusion. Here, there is no dispute that Madoff and Madoff Securities are registered securities brokers and, as such, fall within the purview of Exclusion (x). The issue, here, unlike the issue in those cases, is whether Madoff and Madoff Securities

were "acting" as securities brokers so as to trigger the exclusionary language set forth therein.

First Ins. Funding Corp. v Federal Ins. Co., 284 F3d 799, supra, however, provides instructive insight with respect the "imposter defense". There, the court restated the insured's argument as follows:

> Based on the pleadings and counsel's concession at oral argument, we conclude that Colesons served as First Insurance's intermediary, finder or other representative of the same general character.
>
> Although this determination seemingly would preclude First Insurance from recovering its losses under the terms of the bond, it also has submitted that Colesons could not have functioned as an intermediary or finder during the fraudulent transactions. Intermediaries or finders bring two or more parties together for the purpose of conducting business. Because Colesons brought First Insurance together with a fictitious party during the fraudulent transactions, First Insurance posits that Colesons could not have functioned as finder or intermediary during the course of the forgery scheme thereby removing the claim for indemnification from the ambit of Exclusion 3.m.

(284 F3d at 806). The court disagreed with the "imposter defense" argument, which U.S. Fire quotes in its post-trial brief:

> We cannot accept this contention. The bond places squarely on First Insurance the risk associated with dishonest or fraudulent conduct perpetrated against it by a certain class of entities. In unequivocal terms, Exclusion 3.m states that First Insurance, rather than Federal, must bear losses caused by, among others, First Insurance's agents, intermediaries, finders or other representatives of the same general character. In this case, First Insurance cloaked Colesons with the authority to act as its intermediary, finder or other representative of the same general character. During

> the fraudulent transactions, First Insurance dealt with Colesons under the apprehension that Colesons was acting in such a capacity. ... Under the terms of the bond, First Insurance bore the risk of cloaking Colesons with the authority to act as its intermediary, finder or other representative of the same general character. Federal did not agree to indemnify First Insurance for such losses.

(Id. at 806). At first blush, this holding appears to indicate that the "imposter defense" is not available to the insureds, and undermines their argument that Madoff and Madoff Securities were not "acting" as securities brokers because the entire brokerage relationship was a charade. It does not.

First, the relevant facts concerning the relationship between the insured and Colesons is critical, and it is as follows:

> Once the broker [Colesons] and client complete and sign the finance agreement, they forward the document to First Insurance which then must review and approve the application. Once First Insurance approves the loan, it disburses the loan amount to the broker [Colesons] who, in turn, pays the insurance premium on behalf of its client.

(Id. at 802). Thus, the insured had a continuing duty to review and approve Colesons' documentation.

And, second, what U.S. Fire omitted from the quoted language from the court's holding, supra, is the following critical passage:

> [First Insurance] relied on Colesons' status as its intermediary in approving the loans to the fictitious customers and disbursing the funds to this independent insurance broker. Although employees of Colesons abused their employer's status as an intermediary or

> finder, this factor does not permit First Insurance to escape the plain implications of the exclusion clause.

(Id. at 806 [emphasis added]). The basis for the holding is clear -- First Insurance's retention of the continuing duty to review and approve Colesons' loan submissions places upon First Insurance, and not Federal, the risk of loss.

Here, unlike the facts in First Ins. Funding Corp., supra, Rabin testified that Madoff and Madoff Securities had complete, and total discretion without any supervision or oversight from the insureds:

> So what I thought is Bernie Madoff was making the decision on what to buy and sell. That's what he told us he would make the decision on what to buy and sell. It was his expertise that we relied on. Then he would have it done. You get a brokerage statement or some other statement showing this is what you owned. Somebody told us to buy and sell it, its in your account, here is how much it cost.

(Trial Tr. at p. 268). Small's testimony is not to the contrary. Indeed, the "Trading Authorization" provides Madoff and Madoff Securities with broad and comprehensive discretion and authority over the insureds' accounts:

> In all such purchases, sales or trades you are authorized to follow the instructions of Bernard L. Madoff in every respect concerning the undersigned's account with you; and he is authorized to act for the undersigned and in the undersigned's behalf in the same manner and with the same force and effect as the undersigned might or could do with respect to such purchases, sales or trades as well as with respect to all other things necessary or incidental to the furtherance or conduct or such purchases, sales or trades. All purchases, sales or trades shall be

> executed strictly in accordance with the established trading authorization directive.

(Px 59, 60). Nothing in the trial record indicates any curtailment of this discretion or authority. Because the insureds did not reserve for themselves any duty to review and approve what Madoff and Madoff Securities did with their investment accounts, whether the insureds should have to bear the loss depends not on Madoff and Madoff Securities status as securities brokers, as in First Insurance, supra, but on whether they were acting as securities brokers.

U.S. Fire's investigation failed to establish that the insureds viewed Madoff and Madoff Securities as "acting" as securities brokers:

> Q In fact, the meeting took place with the insured and their representatives in, I guess, it was February 10, 2009? Is that right?
>
> A It was early February. I don't remember the date but that's probably true.
>
> * * *
>
> Q Did Mr. Rabin indicate to you they went to Madoff because they thought he had a great brokerage operation and could execute trades?
>
> A I remember the meeting starting off with a comment that the claims were being made under Rider 9 which is under the outside investment advisor. Then I remember a lot of discussion about how Bernie Madoff was their broker, so to me I remember sitting in the meeting thinking okay, they are stating that the claim is being made under Rider 9 but they are talking about Bernie Madoff as their broker. That was sort of the interplay at the time.

Q Do you remember Mr. Rabin telling you why they chose Madoff?

A No.

Q No. He didn't indicate to you they chose Madoff because he had a great brokerage execution service; do you?

A I don't recall.

Q You don't recall anything about what Mr. Rabin told you the reason they went to Mr. Madoff other than what you've testified to?

A Correct.

Q And you came away from the meeting just with one thought in mind, essentially he was a broker?

A Not exactly. I came away from the meeting with that thought which sort of confirmed what we had learned up until the point of the meeting but I also came away from the meeting with this conflict so to speak that they were so clearly stating the claim was being made under Rider 9. This was February. We had the claim for about 60 days. We did not have a proof of loss yet obviously and the fact that they stated they were making the claim under Rider 9 and yet talked about how he was their broker didn't seem to jive because of the policy language.

So I walked away from the meeting saying I'm assuming this is going to become clearer or more clear to us when they submit their proof of loss and sort of explain the interplay between the two.

(Tibak Trial Tr. at pp. 453, 456-457).

Q What was the actual brokerage activity that caused a loss to FEF? Tell me -- describe for the Judge what brokerage activity caused the loss.

A The way I would see it is he accepted the money, set up or he didn't set up -- he put himself out to conducting trading stocks on behalf of his clients he just didn't do it. I mean again the

way I would see it is the way I would interpret it is at the time he is a broker dealer, accepts money as a broker dealer, he puts himself out as what he is whether he is a fraudster or not. I mean was the actual trading of stocks the cause of the loss, no, it was not. It was not.

Q Was there any brokerage activity that was the cause of the loss?

A The actual trading do you mean the actual trading of a stock?

Q What does a broker do?

A A broker actually keeps stock on behalf of a client.

Q Madoff didn't do that; did he?

A No, he did not.

(Trillo Trial Tr. at pp. 567-568)

Clearly, what matters in resolving the "acting" issue is the true relationship that was structured between the insureds, Madoff and Madoff Securities. In that regard, I have the following facts to consider: that Madoff and Madoff Securities were actually imposters who merely pretended to be or do something as part of their fraudulent scheme, that the insureds did not exercise any oversight over their activities, and that the entire brokerage relationship was phony and a figment of the insureds' imagination. Indeed, Rabin testified that "Madoff stole the money when he received it", and that "it never made its way anywhere else" (Trial Tr. at p. 597).

I also have the testimony of Paul S. Dzera, U.S. Fire's expert who it retained to review the Trustee's records to trace the insureds' monies deposited and/or wired into their investment accounts held at Madoff Securities (Trial Tr. at p. 703). In that regard, up until I granted U.S. Fire's application to call Dzera to testify as a rebuttal witness, I precluded the insureds from introducing into evidence Madoff's plea allocution. The following exchange took place with respect to U.S. Fire's application:

> THE COURT: The plea allocution; in other words, you mean the plea allocution?
>
> MR. NOVAK: Yes. And I also have brought with me today authorities, I know it's not the time now, that show that the argument --
>
> THE COURT: Are you prepared to do that? I will -- I'll change my mind about the plea allocution. It's going to come in as evidence, and you guys can go at this whole thing about the brokerage account at this point.
>
> MR. KEELEY: I don't think it matters.
>
> THE COURT: Well, you'd better be careful as to how you think it matters or not. Good cases fall on such comments. You open that door, it's going to --
>
> MR. KEELEY: I think I'm fine with it. Let me tell you why we want to keep it out.
>
> THE COURT: You know what? I don't want to hear why you put it out. If you want to put this in, I'm going to let Mr. Novak put into evidence that plea allocution and no holds barred. We'll see where it goes. This case can last another two weeks of: Oh, I have to bring another rebuttal witness in, Judge, because of what happened right now. Be careful, Mr. Keeley, where you want to go with this. I so far kept

that plea allocution out, I kept the letters out. If you want to put this witness in, that plea allocution comes in also. We will see where it goes from there.

* * *

MR. KEELEY: Can we have five minutes?

THE COURT: You can have ten minutes since it's a big deal right now, because Mr. Rabin is sitting here, too.

* * *

THE COURT: You can argue as much as you want. That's my ruling for the record. If you call or insist on calling this individual on the stand, I will give Mr. Novak full opportunity to use that plea allocution if he sees fit to cross-examine your witness. And I don't know what he's going to do with it, but I will let him do it. I've kept it out, I've kept it out all this time, but you know what? I'm going to give him this opportunity now if he believes he needs it. You guys have got to decide now. I gave you ten minutes. It's either yes or no.

MR. KEELEY: We'll do it, your Honor.

THE COURT: Okay.

(Trial Tr. at pp. 712-715).

Dzera's testimony does nothing to undermine the fact that the broker relationship between the insureds and Madoff and Madoff Securities was a farce. In fact, his testimony serves to support the position that Madoff and Madoff Securities were not acting as securities brokers, but were only acting as outside investment advisors. Dzera testified as follows:

Q You saw no evidence whatsoever that there ever actually existed a brokerage account for FEF or VC; correct?

A We were not provided any information that would suggest that.

Q Do you have any reason to believe that any such account existed?

A I have no basis for making a determination on that.

Q Isn't it true you read something in the Looby declaration that indicated that there were no such accounts?

A I do recall generally, now that you refreshed my memory on the declaration.

Q Did you ever read the plea allocution that Mr. Madoff gave when he pleaded guilty to the investment advisory fraud?

A No.

* * *

Q This is Mr. Madoff speaking. I'm going to read to you what he said.

A Okay.

Q "The essence of my scheme was that I represented to clients and prospective clients who wished to open investment advisory and individual trading accounts with me, that I would invest their money in shares of common stock, options, and other securities of large, well-known corporations and upon request would return to them their profits and principal. Those representations were false for many years. Up until I was arrested on December 11, 2008, I never invested these funds in the securities as I had promised. Instead, those funds were deposited in a bank account at Chase Manhattan Bank. When clients wished to receive the profits they believed they had earned with me or to redeem their principal, I used the money in the Chase Manhattan Bank account that belonged to them or other clients to pay the requested funds."

Now, having heard that testimony by Mr. Madoff, does that indicate to you what he described as consistent with the Ponzi scheme, and the documents you looked at were consistent with a Ponzi scheme?

A Certainly what he testified to was consistent with a Ponzi scheme. Again, I think you are jumping over to the documents we looked at in and of themselves. They are certainly not inconsistent with a Ponzi scheme.

* * *

Q Go to page 28, line 24. I'm going to read a portion of it.

"Specifically, I had" -- this is again Mr. Madoff testifying under oath -- "Specifically I had money transferred from the U.S. bank account of my investment advisory business to the London bank account of Madoff Securities International Limited, a United Kingdom corporation that was an affiliate of my business in New York. Madoff Securities International Limited was principally engaged in proprietary trading and was a legitimate, honestly-run and operated business. Nevertheless, to support my false statement that I purchased and sold securities for my investment advisory clients in European markets, I caused money from the bank account of my fraudulent advisory business located here in Manhattan to be wire-transferred to the London bank account of Madoff Securities International Limited."

In your review of the bank documents did you see that there were monies going from the 703 Chase account to this affiliate?

A No.

Q Line 12, page 29. "There were also times in recent years when I had money, which had originated in the New York Chase Manhattan Bank account of my investment advisory business, transferred from the London bank account of Madoff Securities International Limited to the Bank of New York operating bank account of my firm's

legitimate proprietary and market making business. That Bank of New York account was located in New York. I did this as a way of ensuring that the expenses associated with the operation of the fraudulent investment advisory business would not be paid from the operations of the legitimate proprietary trading and market making business."

* * *

When you read the Looby declaration you understood that Mr. Looby had examined in great detail the transactions in the 703 Chase account?

A Yes.

Q You understood that Mr. Looby understood the overall mechanics of the Ponzi scheme?

A I do recall getting that sense, yes.

Q You understood that Mr. Looby was an expert that was retained by the Trustee, the SIPC Trustee, Mr. Picard, to investigate what the facts were involving the Ponzi scheme; correct?

A That's my understanding.

Q You understood that Mr. Looby's declaration was submitted to the Federal Court to Judge Lifland in order to provide the facts before him as to what occurred in connection with the investment advisory scheme; correct?

A That was my understanding, yes.

Q And you have no reason to doubt that anything that Mr. Looby said was false or incorrect; isn't that so?

A That's correct. I don't have any basis for thinking anything that he said was false.

* * *

Q Let's go to page 29, line 23. This is Mr. Madoff again.

"In connection with the purported trades, I caused the fraudulent investment advisory side of my business to charge the investment advisory clients $0.04 per share as a commission. At times in the last few years these commissions were transferred from Chase Manhattan Bank account of the fraudulent investment advisory side of my firm to the account at Bank of New York, which was the operating account for the legitimate side of Bernard L. Madoff Investment Securities, the proprietary trading and market making side of my firm."

Did you see any evidence of transfers from the Chase Manhattan Bank account to the legitimate side of the business, or that was not what you were given?

A Not that I recall.

Q Now, you understood that Madoff Investment Securities was a registered broker-dealer correct?

A Yes.

Q You understood when you engaged in your enterprise here for the insurer that Bernard L. Madoff Investment Securities LLC was also a registered investment advisor; correct?

A That's what I recall.

(Trial Tr. at pp. 734, 738-743).

The totality of such evidence, supra, compels me to conclude that Madoff and Madoff Securities were not acting as securities brokers within the meaning of Exclusion (x) so as to trigger its exclusionary language, and that Madoff and Madoff Securities were acting solely as Outside Investment Advisors.

Accordingly, it is

ORDERED, ADJUDGED and DECLARED that Exclusion (x) is applicable to Rider 9; and it is further

ORDERED, ADJUDGED and DECLARED that Exclusion (x) is not triggered under the facts of this case, and, as such, coverage pursuant to the FEF U.S. Fire bond and VC U.S. Fire bond is not excluded; and it is further

ORDERED that defendant insureds are entitled to pre-judgment interest from July 1, 2009[1]; and it is further

ORDERED that the amount of damages to be awarded to defendant insureds shall be respectfully referred to a Judicial Hearing Officer or Special Referee to hear and report on that issue; and it is further

ORDERED that counsel shall serve a copy of this order and judgment, with notice of entry, upon the Clerk of Trial Support, and upon such service the Clerk is respectfully directed to assign this matter to a Judicial Hearing Officer or Special Referee for a hearing on damages.

Dated: 10/1/13

HON. JEFFREY K. OING, J.S.C.

[1]I find that the insureds are entitled to pre-judgment interest from July 1, 2009. Here, Trillo testified that a determination with respect to the exclusionary language set forth in Exclusion (x) could have been made in June or July 2009. Further, the information that U.S. Fire needed subsequent to the insureds submission of their proof of loss had nothing to do with interpreting Exclusion (x). Thus, I find that there was no credible basis for U.S. Fire to delay issuing its disclaimer letter after July 1, 2009.