

Case No. 08-1480

**IN THE UNITED STATES COURT OF APPEALS
FOR THE TENTH CIRCUIT**

**LOUIS E. RIVELLI,
RODNEY B. JOHNSON,
STEPHEN G. BURKE,
TERESA W. AYERS,
CRAIG L. STEVENSON, and
ROBERT T. HOFFMAN,**

Appellants/Plaintiffs,

v.

**TWIN CITY FIRE INSURANCE
COMPANY,
an Indiana corporation,**

Appellee/Defendant.

On Appeal from the United States District Court
for the District of Colorado
District Court No. 1:08-cv-01225-RPM, The Honorable Richard P. Matsch

APPELLANTS' OPENING BRIEF

Charles B. Hecht, Esq.
HAMIL/HECHT, LLC
140 East 19th Avenue, Suite 600
Denver, CO 80203
(303) 830-1383
Email: checht@h-hllc.com
*Attorney for Appellant/
Plaintiff Louis E. Rivelli*

Josiah O. Hatch, Esq.
DUCKER MONTGOMERY ARONSTEIN & BESS
1560 Broadway, Suite 1400
Denver, CO 80202
(303) 861-2828
E-mail: jhatch@duckerlaw.com
*Attorneys for Appellant/
Plaintiff Rodney B. Johnson*

ORAL ARGUMENT IS NOT REQUESTED

The attachment is in written format and Digital Form.

David A. Zisser, Esq.
ISAACSON ROSENBAUM, P.C.
633 17th Street, Suite 2200
Denver, CO 80202
(303) 256-3952
E-mail: dzisser@ir-law.com
Attorney for Appellant/Plaintiff
Stephen G. Burke

David Bayless, Esq.
COVINGTON & BURLING LLP
One Front Street
San Francisco, CA 94111
(415) 591-7005
Email: dbayless@cov.com
***Attorneys for Appellant/
Plaintiff Teresa W. Ayers***

John V. McDermott
BROWNSTEIN HYATT FARBER
SCHRECK, LLP
410 17th Street, Suite 2200
Denver, CO 80202-4437
(303) 223-1118
Email: Jmcdermott@bhfs.com
***Attorneys for Appellant/
Plaintiff Robert T. Hoffman***

Martin M. Berliner, Esq.
Steve W. McDonald, Esq.
BERLINER MCDONALD, PC
5670 Greenwood Plaza Blvd., # 418
Greenwood Village, CO 80111
(303) 830-1700
mberliner@berlinermcdonald.com
smcdonald@berlinermcdonald.com
Attorney for Appellant/Plaintiff
Craig L. Stevenson

Matthew J. Smith, Esq.
HUSCH BLACKWELL SANDERS, LLP
1700 Lincoln Street, Suite 4700
Denver, CO 80203
(303) 749-7206
matthew.smith@huschblackwell.com
***Attorneys for Appellant/
Plaintiff Robert T. Hoffman***

Ross W. Pulkrabek, Esq.
STARRS MIHM & PULKRABEK LLP
707 17th Street, Suite 2600
Denver, CO 80202
(303) 592-5900
rpulkrabek@starrslaw.com
***Attorneys for Appellant/
Plaintiff Teresa Ayers***

TABLE OF CONTENTS

STATEMENT OF PRIOR OR RELATED APPEALS.....v

I. STATEMENT OF JURISDICTION.....1

 A. Jurisdiction in the District Court.....1

 B. Basis For the Court of Appeals' Jurisdiction.....1

 C. Filing Dates Establishing Timeliness of Appeal.....2

 D. The Appeal Is From a Final Order or Judgment.....2

II. STATEMENT OF ISSUES PRESENTED FOR REVIEW.....2

III. STATEMENT OF THE CASE.....3

IV. STATEMENT OF RELEVANT FACTS.....7

V. SUMMARY OF THE ARGUMENT.....12

VI. ARGUMENT.....13

 A. Standard of Review.....13

 B. The District Court Erred in Holding That Twin City
Carried Its Substantial Burden of Establishing That a Policy
Exclusion Excused It From Paying Defense Costs.....14

 1. Colorado Law Strongly Protects An Insured's
Right To Defense Costs, Especially Where An Insurer
Declines To Advance Costs Under a Reservation Of Rights 14

 2. The Policy Exclusion Invoked by Twin City Requires
Actual Subjective Knowledge of Facts or Circumstances
That Are Understood to Be the Basis of a Potential Claim...17

3.	The District Court Improperly Determined That the Prior Knowledge Exclusion Excused Twin City From Advancing Defense Costs.....	19
a.	The District Court Improperly Construed the Prior Knowledge Exclusion to be Triggered by Knowledge Established Under an Objective Standard.....	19
b.	The District Court Improperly Applied the Complaint Rule.....	20
c.	The SEC Complaint, as a Whole, Does Not Allege That the Insureds Had Subjective Knowledge That Facts Known to Them Could Give Rise to a Claim Under the Twin City Policy.....	23
d.	The SEC Complaint Contains Claims Which Are Not Subject to the Prior Knowledge Exclusion.....	26
e.	Because the SEC's Claims May be Proved Without Proof of Subjective Knowledge of Misconduct, the Prior Knowledge Exclusion Is Inapplicable.....	31
C.	This Court Should Enter Summary Judgment In Favor of the Insureds.....	33
VII.	CONCLUSION.....	34
	CERTIFICATE OF COMPLIANCE WITH FED.R.APP.P. 32(a)(7).....	37
	CERTIFICATION OF DIGITAL SUBMISSION.....	38
	CERTIFICATE OF SERVICE	38

TABLE OF AUTHORITIES

Cases

Aaron v. SEC,
 446 U.S. 680 (1980).....29

American Guar. and Liab. Ins. Co. v. Fojanini,
 90 F.Supp.2d 615 (E.D. Pa. 2000).....18

Blackhawk-Central City Sanitation Dist. v. American Guar. and Liab. Ins. Co.,
 214 F.3d 1183 (10th Cir. 2000) 16, 24

Carl's Italian Rest. v. Truck Ins. Exch.,
 183 P.3d 636 (Colo. App. 2007) 16, 19, 30, 33

Cincinnati Ins. Co. v. American Hardware Mfrs. Ass’n.,
 898 N.E.2d 216 (Ill. App. Ct. 1st Dist. 2008).....24

Cincinnati Ins. Co. v. Willow Fin. Bank,
 2008 WL 4348010 (E.D. Pa. Sept. 23, 2008)28

City of Philadelphia v. Fleming Cos., Inc.,
 264 F.3d 1245 (10th Cir. 2001) 21, 23, 29

Clearone Commc’n Inc. v. National Union Fire Ins. Co. of Pittsburgh, Pa.,
 494 F.3d 1238 (10th Cir. 2007)22

Cotter Corp. v. American Empire Surplus Lines Ins. Co.,
 90 P.3d 814 (Colo. 2004) 16, 17

Cyprus Amax Minerals Co. v. Lexington Ins. Co.,
 74 P.3d 294 (Colo. 2003) 14, 31, 32

Equal Employment Opportunity Comm’n v. Southern Publ’g Co., Inc.,
 894 F.2d 785 (5th Cir. 1990)32

Executive Risk Indem., Inc. v. Pepper Hamilton, LLP,
 865 N.Y.S.2d 25 (N.Y. App. Div. 2008)18

Faulkner v. American Cas. Co. of Reading, Pa.,
 584 A.2d 734 (Ct.App.Md. 1991)24, 32

Hecla Mining Co. v. New Hampshire Ins. Co.,
 811 P.2d 1083 (Colo. 1991) 14, 16, 19, 25, 33

Illinois Union Ins. Co. v. Cliff Berry, Inc.,
 2006 WL 3667230 (S.D. Fla. Nov. 17, 2006).....30

In re Worldcom, Inc. Sec. Litig.,
 354 F.Supp.2d 455 (S.D. N.Y. 2005)26

<u>K-Tel Int’l Inc. Sec. Litig.</u> , 300 F.3d 881 (8 th Cir. 2002).....	21
<u>National Union Fire Ins. Co. of Pittsburgh, Pa. v. Emhart Corp.</u> , 11 F.3d 1524 (10 th Cir. 1993).....	33
<u>Pompa v. American Family Mut. Ins. Co.</u> , 520 F.3d 1139 (10 th Cir. 2008).....	13, 15, 20, 21, 24
<u>SEC v. Cohen</u> , 2007 WL 1192438 (E.D. Mo. Apr. 19, 2007).....	21
<u>Stifel Fin. Corp. v. Cochrane</u> , 809 A.2d 555 (Del. 2002).....	26
<u>Thompson v. Maryland Cas. Co.</u> , 84 P.3d 496 (Colo. 2004).....	14, 15, 32

Statutes

15 U.S.C. § 77q(a)(1).....	29
15 U.S.C. § 77q(a)(2) and (3).....	29
15 U.S.C. § 78j(b).....	29
28 U.S.C. § 1291.....	1
28 U.S.C. § 1332.....	1
COLO. REV. STAT. §§ 7-109-101—108 (2008).....	26

Rules and Regulations

17 C.F.R. § 240.10b-5.....	29
Fed. R. Civ. P. 54(b).....	2, 7
Fed. R. Civ. P. 56(c).....	33

STATEMENT OF PRIOR OR RELATED APPEALS

There are no prior or related appeals.

Appellants Louis E. Rivelli, Rodney B. Johnson, Stephen G. Burke, Teresa W. Ayers, Craig L. Stevenson, and Robert T. Hoffman (hereinafter referred to collectively as the "Insureds"), submit this Opening Brief, seeking reversal of the trial court's summary judgment declaring that Appellee Twin City Fire Insurance Company ("Twin City") is not obligated under a Directors and Officers Liability policy to advance defense costs to the Insureds in a pending action brought against them by the Securities and Exchange Commission, and entry of summary judgment in favor of the Insureds declaring that Twin City is obligated to advance defense costs to the \$5 million policy limit.

I. STATEMENT OF JURISDICTION

A. Jurisdiction in the District Court

The District Court had jurisdiction under 28 U.S.C. § 1332, in that there is complete diversity of citizenship between the Appellants/Plaintiffs Insureds on the one hand, and Appellee/Defendant Twin City on the other, and the amount in controversy exceeds \$75,000.

B. Basis For the Court of Appeals' Jurisdiction

This Court has jurisdiction over this appeal under 28 U.S.C. § 1291, in that the Insureds are appealing a final decision of a United States District Court.

C. Filing Dates Establishing Timeliness of Appeal

The final Order from which the Insureds appeal was entered November 21, 2008. The Insureds filed their Notice of Appeal on December 12, 2008.

D. The Appeal Is From a Final Order or Judgment

The November 21, 2008 Judgment was entered pursuant to Fed. R. Civ. P. 54(b), and disposes of the Insureds' First Claim for Relief with respect to all parties.

II. STATEMENT OF ISSUES PRESENTED FOR REVIEW

1. Whether the District Court properly applied Colorado's Complaint Rule in determining that an insurer which sold a director and officer liability policy was excused by a prior knowledge exclusion in the policy from advancing defense costs in an underlying action against the Insureds where the District Court assumed the existence of disputed matters not alleged in the underlying action.

2. Whether the District Court properly applied Colorado's Complaint Rule in determining that an insurer which sold a director and officer liability policy was excused by a prior knowledge exclusion in the policy from advancing defense costs in an underlying action against the Insureds where the District Court failed to adopt a reasonable construction of ambiguous language in the exclusion which, if adopted, would not have excused the insurer from advancing defense costs.

3. Whether the District Court properly applied Colorado's Complaint Rule in determining that an insurer which sold a director and officer liability policy was excused by a prior knowledge exclusion in the policy from advancing defense costs in an underlying action against the Insureds where the court construed alternative and contradictory allegations in the Complaint in the underlying action as establishing that the claims were solely and entirely within the prior knowledge exclusion.

4. Whether the District Court properly applied Colorado's Complaint Rule in determining that an insurer which sold a director and officer liability policy was excused by a prior knowledge exclusion in the policy from advancing defense costs in an underlying action against the Insureds where the claims stated in the Complaint in the underlying action could be satisfied by mere negligence or recklessness insufficient to trigger the policy exclusion.

III. STATEMENT OF THE CASE

This is a case to compel the advancement of defense costs under a directors and officers insurance policy so that the Insureds may fully defend an underlying action in which they are defendants now pending in the United States District Court for the District of Colorado.

The Insureds are former officers or directors of Fischer Imaging Company ("Fischer Imaging"), a now-dissolved Delaware corporation headquartered in Colorado. Fischer Imaging developed, manufactured, and sold medical diagnostic devices. The Insureds are defendants in a civil enforcement action brought by the United States Securities and Exchange Commission (the "SEC"), SEC v. Rivelli, et al., Case No. 1:05-cv-01039-RPM, now pending in the District Court for the District of Colorado (the "Underlying SEC Action"). The thrust of the Underlying SEC Action is that the Insureds caused Fischer Imaging to issue financial statements and report financial results not in accordance with generally accepted accounting principles ("GAAP"). The Complaint in the Underlying SEC Action alleges a variety of violations of the federal securities laws, many of which can be established by proof of recklessness or even negligence; not "knowing" misconduct.

Twin City is an insurance company that wrote an excess financial products insurance policy which "followed form" to an Executive Protection/Executive Liability and Indemnification policy written by Federal Insurance Company (the "Federal Policy"), generally adopting the Federal Policy's terms and conditions. The Federal Policy provided coverage to a limit of \$5 million. At the time relevant to this dispute, the Twin City policy provided an excess layer of coverage of \$5

million, which represented an increase in coverage from the original excess policy limit of \$2.5 million.

In 2003, Fischer Imaging timely presented Federal and Twin City with a notice of claim, first relating to a class action,¹ and then to the Underlying SEC Action, which both arose from the same general set of facts. Both insurers accepted coverage subject to a reservation of rights. The policy limits of the Federal Policy were exhausted in approximately December, 2007. When the exhaustion of the Federal Policy limits became imminent, Twin City admitted that the Underlying SEC Action fell within policy coverage. But it took the position that contentions made during discovery triggered a "prior knowledge" policy exclusion applicable to the \$2.5 million increase in policy limits excusing coverage to the extent of that increase.

The Insureds filed a Complaint in the District Court, seeking a declaratory judgment that Twin City was obligated to provide benefits to the full \$5 million limit of liability. The Insureds also sought damages under theories of breach of contract, bad faith, and violations of the Colorado Consumer Protection Act.

On June 10, 2008, the Insureds filed a Motion for Preliminary Injunction to compel Twin City to advance defense costs to the policy limit of \$5 million. On

¹ The class action was eventually dismissed for failure to state a claim, and was not re-filed.

June 30, 2008, Twin City filed both an answer and jury demand, and a Motion to Dismiss the Insureds' claim under the Colorado Consumer Protection Act. At a hearing on October 10, 2008, the District Court dismissed the claim under the Colorado Consumer Protection Act, and heard argument on the Motion for Preliminary Injunction. The District Court continued that hearing to allow the parties to discuss issues relating to a bond.

On October 22, 2008, the Insureds filed a Motion for Partial Summary Judgment on their claim for declaratory relief, arguing that Twin City, as a matter of law, was obligated under the terms of the policy to provide defense costs to the full policy limit of \$5 million. On November 5, 2008, Twin City filed its opposition to the Insureds' Motion for Summary Judgment, and cross-moved for summary judgment on all claims.

By its Order Denying Plaintiffs' Motion for Partial Summary Judgment and Granting Defendant's Cross Motion for Summary Judgment dated November 21, 2008 (the "Order") (App. 1-16), the District Court denied the Insureds' Motion for Preliminary Injunction and for partial summary judgment, and granted Twin City's cross-motion for summary judgment as it related to declaratory relief. It held that Twin City had established that its prior knowledge exclusion, as a matter of law, eliminated the \$2.5 million in additional policy limits. Further, the District Court,

in the November 21, 2008 Order, entered judgment on the Insureds' claim for declaratory judgment pursuant to Fed. R. Civ. P. 54(b). On December 24, 2008, the District Court stayed the remaining issues raised in the Complaint pending this appeal.

IV. STATEMENT OF RELEVANT FACTS

The facts involved in this dispute are neither controverted nor complex.

Fischer Imaging was a corporation located in the Denver metropolitan area. It designed, manufactured, and sold medical diagnostic equipment such as x-ray and imaging systems. Order, p. 1 (App. p. 1). Fischer Imaging was required to, and did, file periodic reports with the SEC, and its common stock traded on the NASDAQ national market. First Amended Complaint, Underlying SEC Action (the "SEC Complaint"), p. 5 (App. p. 21).

Beginning in 1999, Mr. Rivelli was the Chief Operating Officer of Fischer Imaging, and then its Chief Executive Officer until he resigned in April, 2002. Mr. Johnson served as the Chief Financial Officer of Fischer Imaging from August 2000 until he left the employ of Fischer Imaging in October, 2002. Mr. Burke succeeded Mr. Johnson as Chief Financial Officer in mid-October, 2002. Immediately prior to becoming the Chief Financial Officer, Mr. Burke had been a consultant to the Fischer Imaging Board of Directors. Mr. Burke never served as

an officer, director, or employee of Fischer Imaging until his appointment as Chief Financial Officer in October, 2002. Ms. Ayers was an outside independent Fischer Imaging director from April 2002 until she resigned in 2003. Between 2000 and 2004, Messrs. Hoffman and Stevenson occupied various sales and marketing positions at Fischer Imaging. SEC Complaint, pp. 3-5 (App. p. 19-21).

Consistent with common practice, Fischer Imaging purchased insurance to protect itself and its officers and directors from a variety of potential claims, including alleged violations of the securities laws. Order, p. 2 (App. p. 2). A primary policy was purchased from the Federal Insurance Company, which contained a policy limit of \$5 million. Order, p. 3 (App. p. 3). Fischer Imaging also purchased excess coverage from Twin City. Initially, the Twin City policy had a limit of \$2.5 million. However, on or about April 30, 2002, Fischer Imaging increased the policy limit of the Twin City excess policy by \$2.5 million, to a total policy limit of \$5 million. Order, pp. 3-4 (App. pp. 3-4). This appeal centers around this increased policy limit of \$2.5 million.

As part of the renewal of the Twin City policy which increased the previous policy limits by \$2.5 million, Twin City provided Fischer Imaging with a letter dated April 30, 2002 for Fischer Imaging to execute containing the following representations:

No person or entity for whom this insurance is intended has any knowledge or information of any act, error, omission, fact, or circumstance which may give rise to a claim which may fall within the scope of the proposed insurance detailed above.

Order, p. 4 (App. p. 4).

The "proposed insurance detailed above" refers to the \$2.5 million increase in the policy limit. Id. The April 30, 2002 letter also provided:

IT IS AGREED THAT IF SUCH KNOWLEDGE OR INFORMATION EXISTS, ANY CLAIM ARISING THEREFROM (WHETHER OR NOT DISCLOSED HEREIN), IN ADDITION TO ANY OTHER REMEDY THE INSURER MAY HAVE, IS EXCLUDED FROM THE PROPOSED COVERAGE.

IT IS FURTHER AGREED THAT THIS LETTER SHALL BE DEEMED PART OF THE POLICY AND THE STATEMENT MADE THEREON SHALL BE DEEMED AN EXPRESS WARRANTY FOR ALL INSUREDS WHICH HAS BEEN RELIED UPON BY THE INSURER PURSUANT TO THE ISSUANCE OF THIS COVERAGE.

Id.

The Twin City policy is a "follows form" excess policy, meaning that it is subject to the same warranties, terms, conditions, definitions, exclusions, and endorsements that are contained in the Federal Policy, except as otherwise provided by Twin City. Order, p. 3 (App. p. 3).

The policies provide that the insurers will pay all "Loss" for which an insured person is not indemnified by the insured organization, (here, Fischer Imaging,) which the insured person is obligated to pay on account of any "Claim"

first made during the policy period for a wrongful act committed by an insured person before or during the policy period. The term "Loss" means the total amount that an insured "becomes legally obligated to pay" and includes defense costs.² Order, pp. 3-4 (App. pp. 3-4).

Fischer Imaging announced in April, 2003 that it would delay the filing of its annual report with the SEC on Form 10-K for 2002, and was likely to restate previously issued financial statements from 2000 through the third quarter of 2002. Order, p. 5 (App. p. 5). Predictably, a number of private securities class actions were filed against Fischer Imaging and certain of its officers and directors soon after the April, 2003 announcement. The SEC also began an investigation of the circumstances surrounding the contemplated restatement of financial results. Id.

Fischer Imaging provided timely notice to both Federal and Twin City of the claim. Both carriers agreed to provide coverage subject to a reservation of rights. Id.

Ultimately, the private securities class actions were consolidated and proceeded as one action, Sorkin LLC v. Fischer Imaging Corp., et al., Civil Action No. 1:03-cv-00631-RPM, in the United States District Court for the District of

² Because Twin City concedes coverage and this dispute relates solely to the applicability of a policy exclusion, the general description of the policy is more summary that might otherwise have been necessary.

Colorado. That action was dismissed on June 21, 2005 for failure to meet requisite pleading standards and was not re-filed after it was dismissed. Id.

The SEC investigation proceeded while the private class actions were pending. Fischer Imaging agreed to a settlement with the SEC whereby the agency entered a cease and desist order against Fischer Imaging by consent on November 15, 2004. On June 7, 2005 the SEC brought the Underlying SEC Action against the Insureds. Order, p. 6 (App. p. 6). The SEC alleged statutory violations which could be established through recklessness and negligence. SEC Complaint, pp. 34-35 (App. pp. 50-51).

Between 2003 and 2007, Federal paid defense costs in both the class actions and the Underlying SEC Action up to its policy limits, which were exhausted in December, 2007. Order, p. 6 (App. p. 6).

In late November, 2007, anticipating the exhaustion of the Federal policy, counsel for Twin City notified counsel for the Insureds that, upon exhaustion of the Federal policy, the Twin City policy would continue in force, but Twin City would pay defense costs up to only \$2.5 million in excess of the Federal policy limit. Twin City gave as a reason that information developed through discovery in the Underlying SEC Action (which Twin City unilaterally determined to be true)

triggered the prior knowledge exclusion created by the April 30, 2002 letter written to obtain the \$2.5 million increase in policy limits. Order, pp. 6-7 (App. pp. 6-7).

The Underlying SEC Action continued through the completion of discovery and the filing of motions for summary judgment. These motions are pending. The Underlying SEC Action has not been set for trial.

Twin City made advances of defense costs up to \$2.5 million, but has made no further payment. Order, p. 7 (App. p. 7). The Insureds now face the prospect of defending a complex SEC enforcement action without insurance to pay for counsel or expert witnesses.

V. SUMMARY OF THE ARGUMENT

The District Court erred in concluding that a prior knowledge exclusion excused Twin City's obligation to advance defense costs up to the \$5 million policy limit.

Colorado law is extremely protective of an insured's right to a defense. The District Court deviated from the requirements of Colorado law by failing to construe ambiguous provisions in a prior knowledge policy exclusion in a way that supported coverage and improperly went beyond the allegations of the Complaint in the underlying action to determine that the prior knowledge exclusion had been triggered.

The Insureds are entitled to an advancement of defense costs to the full \$5 million limit of the Twin City policy. The allegations of the SEC Complaint in the underlying action are not solely and entirely within the prior knowledge exclusion, which is the test under Colorado law. Rather, the SEC Complaint in the underlying action alleges both facts and claims that would not fall within the prior knowledge exclusion. Under Colorado law, if an insurer has an obligation to defend any claims in the underlying action, it must defend all claims.

The grant of summary judgment in favor of Twin City was erroneous and should be reversed. Moreover, the record establishes that the Insureds met the standards for summary judgment on their claim for a declaratory judgment that Twin City is obligated to advance defense costs up to the \$5 million policy limit. Therefore, this Court should enter summary judgment in favor of the Insureds' claim for declaratory judgment.

VI. ARGUMENT

A. Standard of Review

The issues are subject to de novo review in this Court under the same legal standards as applied by the District Court. Pompa v. American Family Mut. Ins. Co., 520 F.3d 1139, 1142 (10th Cir. 2008).

- B. The District Court Erred in Holding That Twin City Carried Its Substantial Burden of Establishing That a Policy Exclusion Excused It From Paying Defense Costs.
 - 1. Colorado Law Strongly Protects An Insured's Right To Defense Costs, Especially Where An Insurer Declines To Advance Costs Under a Reservation Of Rights.

The parties agree that Colorado law governs their dispute. Order, p. 7 (App. p. 7).

Colorado strongly protects an insured's expectation to receive advances of defense costs as incurred, even during the pendency of a coverage dispute.

Under Colorado law, an insurer's obligation to its insured is a matter of contract law, and an insurance policy's terms are construed according to the principles of contract interpretation. Thompson v. Maryland Cas. Co., 84 P.3d 496, 501 (Colo. 2004) (citing Hecla Mining Co. v. New Hampshire Ins. Co., 811 P.2d 1083, 1090 (Colo. 1991)).

In determining whether an insurer has an obligation to defend, Colorado follows the "complaint" or "four corners" rule (the "Complaint Rule"), which means that courts may not look beyond the four corners of the underlying complaint in determining whether a duty to defend exists. Cyprus Amax Minerals Co. v. Lexington Ins. Co., 74 P.3d 294, 299 (Colo. 2003). The Complaint Rule deliberately casts a broad net in favor of coverage. Id. at 301. Thus, an insurer has

a duty to defend where a complaint against the insured alleges any facts or claims that might fall within the coverage of the policy. Id.

Significantly, Colorado courts recognize that, because insurance policies are typically prepared by the insurer and offered on a "take it or leave it" basis, the courts have a heightened responsibility to ensure that terms in an insurance policy comply with public policy and principles of fairness. Therefore, courts construe any ambiguity in an insurance policy against the insurer. Thompson v. Maryland Cas. Co., 84 P.3d at 501–502, and review the applicability of exclusions defeating coverage of defense costs in a manner most favorable to the insured's expectation that they would receive such advancements. Pompa v. American Family Mut. Ins. Co., 520 F.3d at 1146.

An insurer is not excused from the duty to defend unless it is clear that there is no legal or factual basis on which the insurer might eventually be held to indemnify. Id.

Where, as here, the carrier concedes that the claims raised in the underlying complaint are within the policy's coverage, but bases a refusal to defend upon a policy exclusion, "the insurer has a duty to defend unless the insurer can establish that the allegations in the complaint are solely and entirely within the exclusions in

the insurance policy." Hecla Mining Co. v. New Hampshire Ins. Co., 811 P.2d at 1090 (emphasis added).

If even one claim in the underlying complaint is arguably within policy coverage, the insurer must defend the insured against all claims presented in the complaint. Blackhawk-Central City Sanitation Dist. v. American Guar. and Liab. Ins. Co., 214 F.3d 1183, 1189 (10th Cir. 2000); Carl's Italian Rest. v. Truck Ins. Exch., 183 P.3d 636, 639 (Colo. App. 2007).

The proper course of action for an insurer which believes that it is under no obligation to defend is to provide a defense to the insured under a reservation of rights. Hecla Mining Co. v. New Hampshire Ins. Co., 811 P.2d at 1089. In Cotter Corp. v. American Empire Surplus Lines Ins. Co., 90 P.3d 814 (Colo. 2004), the Colorado Supreme Court elaborated on its decision in Hecla Mining, and explained that its intention was to provide an incentive to insurers to tender a defense under a reservation of rights by allowing insurers who do so an exception from the Complaint Rule. Under that exception, an insurer's duty to defend may be determined by facts developed at trial. As a further incentive, insurers who provide a defense under a reservation of rights were allowed to bring an action for recoupment of defense costs if it is ultimately determined that coverage did not

exist. Cotter Corp. v. American Empire Surplus Lines Ins. Co., 90 P.3d at 828-829.

Here, however, Twin City failed to advance defense costs under a reservation of rights. Rather, it claimed that the prior knowledge exclusion was triggered by matters developed in discovery in the Underlying SEC Action, (and not alleged in the SEC Complaint,) Order, p. 7 (App. p. 7), and eliminated coverage with respect to the \$2.5 million increase to policy limits. Therefore, Twin City's failure to provide a defense must be determined in strict conformity with the Complaint Rule, which its actions do not satisfy.

2. The Policy Exclusion Invoked by Twin City Requires Actual Subjective Knowledge of Facts or Circumstances That Are Understood to Be the Basis of a Potential Claim.

The prior knowledge exclusion on which Twin City relies is ambiguous on its face. The operative language is contained in the April 30, 2002 letter:

No person or entity for whom this insurance is intended has any knowledge or information of any act, error, omission, fact or circumstance which may give rise to a claim which may fall within the scope of the proposed insurance detailed above.

Order, p. 4 (App. p. 4).

That language is unclear as to the nature of the knowledge or information that an insured person must possess to trigger the exclusion. Specifically, the exclusion does not specify whether the requisite knowledge or information must be

actual subjective knowledge, and whether the knowledge or information need relate both to the facts and circumstances, and that the facts and circumstances could give rise to a claim that may fall within the scope of the proposed insurance.

The prior knowledge exclusion applies only if Twin City demonstrates that the SEC Complaint unambiguously alleges that an intended insured had actual subjective knowledge both of certain acts, errors and omissions, and that such person had actual knowledge that the facts could give rise to a claim under the policy. Requiring actual knowledge of both facts and circumstances and that the facts and circumstances could give rise to a claim is a reasonable interpretation of the exclusion. See, American Guar. and Liab. Ins. Co. v. Fojanini, 90 F.Supp.2d 615, 620 (E.D. Pa. 2000) (insured must know of facts related to acts, errors and omissions and must believe such facts would or could give rise to a claim).

If Twin City had intended the representation to relate to what an insured objectively should have known, or had reason to believe, it could have employed language to effectuate that intention. Indeed, Twin City has employed such language in a "prior knowledge" exclusion in other policies. Executive Risk Indem., Inc. v. Pepper Hamilton, LLP, 865 N.Y.S.2d 25, 29 (N.Y. App. Div. 2008).

Properly construing the prior knowledge exclusion to require subjective knowledge both that there were acts and omissions, and that such acts and omissions could give rise to a claim under the policy is both required under Colorado law and essential to a correct determination of Twin City's obligation. And this is where the District Court went off track.

3. The District Court Improperly Determined That the Prior Knowledge Exclusion Excused Twin City From Advancing Defense Costs.

The District Court decided that the prior knowledge exclusion eliminated Twin City's obligation to fund defense costs up to the \$5 million policy limit. This decision is correct if, and only if, the claims in the four corners of the Complaint are "solely and entirely within the exclusions in the insurance policy" and "the exclusions are not subject to any other reasonable interpretation." Hecla Mining Co. v. New Hampshire Ins. Co., 811 P.2d at 1090; Carl's Italian Rest. v. Truck Ins. Exch., 183 P.3d at 639. But the District Court departed from these standards, and, as a result, reached an erroneous conclusion.

a. The District Court Improperly Construed the Prior Knowledge Exclusion to be Triggered by Knowledge Established Under an Objective Standard.

The District Court rejected as flawed the Insureds' argument that the allegations of the SEC Complaint did not establish that the Insureds had actual,

subjective knowledge of facts which they were aware could result in a claim made under the policy. The District Court stated that this argument was flawed "...because it ignores basic information that a CEO and CFO of a publicly traded company must know." Order, p. 15 (App. p. 15). Thus, the District Court construed the prior knowledge exclusion as being satisfied by an objective test of knowledge, rather than the subjective standard urged by the Insureds.

As discussed above, the language of the prior knowledge exclusion does not specify whether subjective or objective knowledge triggers the exclusion. Because of that ambiguity, Colorado law requires that the knowledge element be construed in a manner most favorable to finding coverage. Pompa v. American Family Mut. Ins. Co., 520 F.3d at 1146. The Insureds' construction of the knowledge requirements is at least as reasonable as the objective standard adopted by the District Court. Therefore, the District Court committed reversible error by failing to construe ambiguous language in the prior knowledge exclusion in a way that most favored the Insureds.

b. The District Court Improperly Applied Colorado's Complaint Rule.

In addition, the District Court's opinion of what a CEO or CFO of a company "must" know both reaches beyond the four corners of the SEC's Complaint, and applies a standard that does not exist.

The District Court did not identify the basis for its assertion of what a corporate officer "must" know. In fact, nothing supports that assertion. This case is unlike Pompa v. American Family Mut. Ins. Co., 520 F.3d at 1149, where this Court, in evaluating an insurer's duty to defend considered undisputed facts outside the Complaint subject to judicial notice. Here, there are no facts about the subjective states of mind of the Insureds that can be judicially noticed.

Even if the prior knowledge exclusion could be satisfied by an objective standard of knowledge, there are no established criteria of what a corporate officer "must" know subject to judicial notice.

The alleged wrongful conduct and potential claims at issue in the Underlying SEC Action relate to the interpretation of accounting guidelines under GAAP. However, it is well-established that the generality and complexity of GAAP is such that departures from it do not raise an inference of intentional or knowing conduct. City of Philadelphia v. Fleming Cos., Inc., 264 F.3d 1245, 1261 (10th Cir. 2001); accord, K-Tel Int'l Inc. Sec. Litig., 300 F.3d 881, 889-890 (8th Cir. 2002). Further, courts are unwilling to impute knowledge of wrongdoing, especially with respect to accounting matters, simply from an individual's position as a senior officer of a company. SEC v. Cohen, 2007 WL 1192438 at *16 (E.D. Mo. Apr. 19, 2007) (citing City of Philadelphia v. Fleming Cos., Inc., 264 F.3d at 1264).

This Court's decision in Clearone Commc'n Inc. v. National Union Fire Ins. Co. of Pittsburgh, Pa., 494 F.3d 1238 (10th Cir. 2007) is instructive. That case, like this one, involved an insured which issued financial statements in SEC filings which it later disclosed were inaccurate. The inaccuracies resulted from sales practices used to accelerate revenue recognition, similar to the practices alleged in the SEC Complaint here. The insurer sought to rescind the policy on the theory that the policy application contained misrepresentations (in the form of the SEC filings which were made part of the application). This Court applied Utah law, which allowed rescission only where the person signing the application, Clearone's non-accountant chief executive officer, "knew or should have known" of the misrepresentations in the financial statements.

This Court reversed summary judgment in favor of the insurer, finding the existence of issues of fact regarding both actual knowledge and what objectively should have been known by Clearone's chief executive officer. This Court recognized that knowledge of problematic transactions does not equate to knowledge that the accounting for those transactions was improper. Clearone Commc'n, Inc. v. National Union Fire Ins. Co. of Pittsburgh, Pa., 494 F.3d at 1249. This Court also noted that the record was not sufficiently developed to allow it to conclude that the chief executive officer "should have known" of the

inaccuracies. Id. This Court, in contrast to the District Court here, did not rely on unidentified, and non-existent criteria of what a senior corporate officer "must know" to find that a corporate chief executive officer had the knowledge necessary to satisfy even a "knew or should have known" standard. The District Court's reliance on such criteria to establish subjective knowledge was error.

- c. The SEC Complaint, as a Whole, Does Not Allege That the Insureds Had Subjective Knowledge That Facts Known to Them Could Give Rise to a Claim Under the Twin City Policy.

Taken as a whole, the Complaint in the Underlying SEC Action does not contain unambiguous allegations of fact establishing that any of the Insureds, or anyone else, had actual, subjective knowledge that any of the alleged wrongdoing could give rise to a claim under the Twin City policy.

That the SEC alleged a fraudulent scheme under the federal securities laws does not trigger the prior knowledge exclusion because fraud under the securities laws can be proved by recklessness under the law of this (and every other) Circuit. City of Philadelphia v. Fleming Cos., Inc., 264 F.3d at 1258. Indeed, the SEC Complaint alleges that various of the Insureds acted "knowingly or recklessly" in not being aware of the allegedly wrongful nature of their conduct. SEC Complaint, pp. 14-16; 18-20; 25; 29-32 (App. pp. 30-32; 34-36; 41; 45-48). But allegations

relating to state of mind in the alternative of "knowing" or "reckless" have been held insufficient to make applicable a policy exclusion based upon knowingly wrongful misconduct. Faulkner v. American Cas. Co. of Reading, Pa., 584 A.2d 734, 751 (Ct.App.Md. 1991); Cincinnati Ins. Co. v. American Hardware Mfrs. Ass'n., 898 N.E.2d 216, 237 (Ill. App. Ct. 1st Dist. 2008). Alternative allegations of "knowing" or "reckless" conduct are not unambiguous allegations that the conduct is "knowing."

This Court's decision in Blackhawk-Central City Sanitation Dist. v. American Guar. and Liab. Ins. Co., is to the same effect. There, the Court held that alternative allegations of intentional and negligent conduct relating to the release of pollutants left open the possibility of negligent conduct, which was not sufficient to trigger an exclusion requiring knowing conduct.

This Court's analysis of the Complaint Rule in Pompa v. American Family Mut. Ins. Co., 520 F.3d 1139, also is instructive. There the Court recognized that Colorado's Complaint Rule should be construed to effectuate its purposes, one of which was to preserve an insured's legitimate expectation of a defense. 520 F.3d at 1147-48. The Court determined that it was appropriate to take judicial notice of a criminal conviction not alleged in the underlying Complaint, which triggered a policy exclusion, because the insured could not have a reasonable expectation of

coverage in light of that conviction. This Court recognized that, under Colorado law, the Complaint Rule should not be applied in a way that enables the pleader in the underlying action to be the sole arbiter of the existence of a right to a defense, without regard as to whether the allegations are bona fide or unsupported. Id.

So too here. There is nothing that suggests that the Insureds, or any reasonable insured, had or could have an expectation that Twin City's obligation to advance defense costs up to the full \$5 million policy limit could be summarily excused by disputed, inconsistent and potentially frivolous allegations, the proof of which would not be necessary to the establishment of any claim. Colorado law does not compel such a result. To the contrary, by recognizing that an insurer's duty to defend may be excused under a policy exclusion only where the allegations of the Complaint are "solely" and "entirely" within an exclusion, Hecla Mining Co. v. New Hampshire Ins. Co., 811 P.2d at 1090, Colorado law requires an insurer to provide a defense where the complaint contains unnecessary, alternative and conflicting allegations regarding any Insured's knowledge of the wrongfulness of his or her conduct.

Colorado's policy of construing an insurer's obligation to provide a defense in accordance with an insured's reasonable expectation should apply with undiminished force in the arena of directors and officers liability policies. There is

a strong public policy in attracting capable people to serve as corporate officers and directors. Stifel Fin. Corp. v. Cochrane, 809 A.2d 555, 561 (Del. 2002). This public policy is advanced by providing officers and directors with strong indemnification rights, which can be supported by the type of insurance at issue here. COLO. REV. STAT. §§ 7-109-101—108 (2008). Unless capable and honest people can rely on protections provided by director and officers liability policies, such people will be reluctant to serve corporations. In re Worldcom, Inc. Sec. Litig., 354 F.Supp.2d 455, 469 (S.D. N.Y. 2005). The Underlying SEC Action, while serious, contains allegations common to many complaints alleging GAAP violations, and for which corporate directors and officers have a reasonable expectation that insurance will provide them with a defense.

d. The SEC Complaint Contains Claims Which Are Not Subject to the Prior Knowledge Exclusion.

A proper construction of the term "claim" in the Twin City prior knowledge exclusion further supports the Insureds' right to continued advancement of defense costs. The District Court erred in determining that the word "claim" as used in the prior knowledge exclusion is broader in meaning than a single claim for relief for several reasons. First, the District Court erroneously relied on the definition of "Claim" in Section 18 of the Federal Policy, as modified by Endorsement No. 7. The definition, as modified, states:

Claim Means:

- (i) a written demand for monetary damages or non-monetary relief;
- (ii) a civil proceeding commenced by the service of a complaint or similar pleading;
- (iii) a criminal proceeding commenced by the service of an indictment; or
- (iv) a formal administrative or regulatory proceeding commenced by the filing of a notice of charges, formal investigative order or similar document,
against any Insured Person for a Wrongful Act or Interrelated Wrongful Act, including any appeal therefrom.

However, Endorsement 7 did not become effective until May 1, 2002, after the April 30, 2002 Twin City letter containing the prior knowledge exclusion. Endorsement 7 to Federal Policy, p. 1 (App. p. 73); Order, p. 4 (App. p. 4).

The District Court was wrong also in applying the definition of "Claim" in Section 18 of the Federal Policy because Section 18 of the Federal Policy provides expressly that the definitions apply "When used in this coverage section:..." Federal Policy, p. 8 of 10.³ (App. p. 61). Although the April 30, 2002 letter

³ Section 18 of the Federal Policy provides in relevant part:
18. When used in this coverage section:
Claim means:
(i) a written demand for monetary damages,
(ii) a civil proceeding commenced by the service of a complaint or similar pleading.
(iii) a criminal proceeding commenced by a return of an indictment, or
(iv) a formal administrative or regulatory proceeding commenced by the filing of a notice of charges, formal investigative order or similar

containing the prior knowledge exclusion provides that it "shall be deemed part of the policy," it does not state that it is part of the "coverage section" of the policy. Nor does the April 30, 2002 letter otherwise incorporate the definition of Section 18 of the Federal Policy. (App. 74). Moreover, where "Claim" in Section 18 is a defined term, initially capitalized for use within the coverage section, the April 30 letter did not capitalize "claim," except when the entire word was capitalized, suggesting that the term was not intended by Twin City to be used as a defined term.

Without a clear expression of intention that the word "claim" was to be governed by the definition of "Claim" in Section 18 of the Federal Policy, the meaning of "claim" as used in the prior knowledge exclusion is ambiguous. While "claim" could be construed as having a meaning broader than a claim for relief, as the District Court held, it also could be construed to have a more narrow meaning, such as a separate claim for relief as alleged in the Complaint in the Underlying SEC Action. See, Cincinnati Ins. Co. v. Willow Fin. Bank, 2008 WL 4348010 at *6 (E.D. Pa. Sept. 23, 2008) (holding that "excluded claims work on a count-by-count basis, meaning that the inclusion of a single count based on excluded allegations will not remove [the insurer's] duty to defend the lawsuit so long as

document, against any Insured Person for a Wrongful Act, including any appeal therefrom.

other allegations do not fall under the policy exclusion" and rejecting insurer's argument that its obligation to defend was precluded "whenever a civil proceeding as a whole involves any allegations excluded from coverage"). Because ambiguities in the policy exclusion must be construed against Twin City, the term "claim" should be construed to mean a particular claim for relief for purposes of the prior knowledge exclusion.

The SEC Complaint in the Underlying SEC Action alleges claims that can be established without proof that an Insured had actual knowledge of wrongdoing. The First and Third Claims for Relief, violations of Section 17(a)(1) of the Securities Act of 1933 [15 U.S.C. § 77q(a)(1)] and Section 10(b) of the Exchange Act [15 U.S.C. § 78j(b)] and Rule 10b-5 (17 C.F.R. § 240.10b-5), can be established by reckless conduct. City of Philadelphia v. Fleming Cos., Inc., 264 F.3d at 1258. The Second Claim for Relief, violation of Section 17(a)(2) and (3) of the Securities Act [15 U.S.C. § 77q(a)(2) and (3)] can be established by proof of negligence. Aaron v. SEC, 446 U.S. 680, 697 (1980).

The SEC Complaint also alleges "claims" based on facts that could post-date May 1, 2002, the date Fischer Imaging executed the letter containing the prior knowledge exclusion. Claims based on facts that occurred only after the prior knowledge exclusion was effective cannot trigger the prior knowledge exclusion

because the Insureds could not have had prior knowledge of a fact before it came into existence. Illinois Union Ins. Co. v. Cliff Berry, Inc., 2006 WL 3667230 at *7 (S.D. Fla. Nov. 17, 2006) ("Defendants cannot be alleged to have had prior knowledge of criminal conduct that had not yet occurred prior to the continuity date.").

For example, the Fifth Claim for Relief in the SEC Complaint alleges that the Insureds deceived Fischer Imaging's auditors. SEC Complaint, p. 36 (App. p. 52). Factual allegations relating to that claim appear at paragraphs 62 through 73 of the SEC Complaint, SEC Complaint, pp. 24-28 (App. pp. 40-44), and encompass alleged activities occurring after the May 1, 2002 effective date of the prior knowledge exclusion.

As a result, facts giving rise to the SEC's Fifth Claim for Relief, Deceit of Auditors, did not come into being until after the effectiveness of the prior knowledge exclusion, and cannot be a "claim" that arose from facts known during the time covered by the prior knowledge exclusion. Because an insurer must provide a defense for all claims if even one claim is not subject to an exclusion, Carl's Italian Rest. v. Truck Ins. Exch., 183 P.3d at 639, Twin City's obligation to advance defense costs for the Underlying SEC Action is not excused.

- e. Because the SEC's Claims May Be Proved Without Proof of Subjective Knowledge of Misconduct, the Prior Knowledge Exclusion Is Inapplicable.

The District Court's determination that there is no relevance to the fact that almost every claim asserted in the SEC Complaint can be established without proving subjective knowledge of wrongdoing essentially turns Colorado law on its head. Rather than recognizing that the existence of any claim for which indemnification might exist requires finding a duty to defend, the District Court held that the existence of any allegation of fact raising an inference of knowing wrongdoing establishes a prior knowledge exclusion as a matter of law, and eliminates a duty to defend in its entirety.

Colorado law does not provide that the Complaint Rule is to be applied without consideration of both the facts alleged and the claims asserted. Cyprus Amax Minerals Co. v. Lexington Ins. Co., 74 P.3d at 301. Because a duty to defend exists whenever there is a legal or factual basis on which an insurer might be required to indemnify, it is essential to review the claims asserted to determine whether proving such a claim necessarily establishes a policy exclusion.

The SEC has asserted claims against the Insureds that do not require proof of actual knowledge of wrongdoing. Such claims do not fall within the prior knowledge exclusion and, therefore, the Insureds are entitled to advancement of

defense costs. As the court noted in Faulkner v. American Cas. Co. of Reading, Pa.,

...individual defendants ... were accused of 'knowingly and/or recklessly' issuing, causing to be issued, or participating in the issuance of, or aiding and abetting the preparation and issuance of public statements and reports that were materially false and misleading.... Had the allegation been merely that he *knowingly* participated, coverage might be deniable because of the exclusion from coverage of claims brought about or contributed to by the dishonestly of directors or officers. But, if Faulkner as might be shown without variance from the pleading, acted *recklessly* instead of *knowingly*, the dishonestly exclusion would not apply and the claim would clearly be covered." (emphasis in original).

584 A.2d at 751.

Colorado law is no different. In Cyprus Amax Minerals Co. v. Lexington Ins. Co., 74 P.3d at 301, the court noted that "...when the underlying complaint alleges any *facts* or claims that might fall within the ambit of the policy, the insurer must tender a defense." (Emphasis in original.) Similarly, in Equal Employment Opportunity Comm'n v. Southern Publ'g Co., Inc., 894 F.2d 785, 790 (5th Cir. 1990), cited with approval in Thompson v. Maryland Cas, Co., 84 P.3d at 508, the court held that where knowingly false statements and negligently false statements were both alleged, the Complaint Rule required a defense with respect to the negligently false statements.

Moreover, because Colorado law recognizes that if an insured has a right to defense costs for any claim in an underlying complaint, the insurer must pay defense costs for all claims, Carl's Italian Rest. v. Truck Ins. Exch., 183 P.3d at 689, Twin City is obligated to advance the Insureds' defense costs for the entirety of the SEC Complaint.

The District Court committed reversible error in not recognizing this point.

C. This Court Should Enter Summary Judgment In Favor of the Insureds.

The proper application of Colorado's Complaint Rule requires the conclusion that Twin City is obligated under its policy to advance costs of defense up to the \$5 million policy limit. The SEC Complaint in the Underlying SEC Action did not contain allegations which were "... solely and entirely within the exclusions in the insurance policy," Hecla Mining Co. v. New Hampshire Ins. Co., 811 P.2d at 1090, and, as a result, the prior knowledge exclusion does not excuse Twin City from advancing defense costs to the \$5 million policy limit.

This Court is free to enter an order granting summary judgment where the standards of Fed. R. Civ. P. 56(c) have been met, even if the District Court denied the motion. National Union Fire Ins. Co. of Pittsburgh, Pa. v. Emhart Corp., 11 F.3d 1524, 1534 (10th Cir. 1993). Those standards have been met.

VII. CONCLUSION

The prior knowledge exclusion on which Twin City relied to limit advancing defense costs to the Insureds was not triggered by the Complaint in the Underlying SEC Action. Therefore, the Order of the District Court granting Twin City's Cross-Motion for Summary Judgment should be reversed, and an order granting the Insureds' Motion for Summary Judgment on its claim for declaratory relief should be granted.

Dated this 9th day of February, 2009.

Respectfully submitted,

s/ Charles B. Hecht

s/ Josiah O. Hatch

Charles B. Hecht, Esq.
HAMIL/HECHT, LLC
140 East 19th Avenue, Suite 600
Denver, CO 80203
(303) 830-1383
Email: checht@h-hllc.com
Attorney for Appellant/Plaintiff
Louis E. Rivelli

Josiah O. Hatch, Esq.
DUCKER MONTGOMERY ARONSTEIN &
BESS, PC
1560 Broadway, Suite 1400
Denver, CO 80202
(303) 861-2828
E-mail: jhatch@duckerlaw.com
Attorneys for Appellant/Plaintiff Rodney
B. Johnson

s/ David A. Zisser

David A. Zisser, Esq.
ISAACSON ROSENBAUM, P.C.
633 17th Street, Suite 2200
Denver, CO 80202
(303) 256-3952
E-mail: dzisser@ir-law.com
***Attorney for Appellant/Plaintiff
Stephen G. Burke***

s/ Martin M. Berliner

Martin M. Berliner, Esq.
Steve W. McDonald, Esq.
BERLINER MCDONALD, PC
5670 Greenwood Plaza Blvd., Suite 418
Greenwood Village, CO 80111
(303) 830-1700
E-mail: mberliner@berlinermcdonald.com
smcdonald@berlinermcdonald.com
***Attorney for Appellant/Plaintiff Craig L.
Stevenson***

s/ David Bayless

David Bayless, Esq.
COVINGTON & BURLING LLP
One Front Street
San Francisco, CA 94111
(415) 591-7005
Email: dbayless@cov.com
***Attorneys for Appellant/Plaintiff
Teresa W. Ayers***

s/ Matthew J. Smith

Matthew J. Smith, Esq.
HUSCH BLACKWELL SANDERS, LLP
1700 Lincoln Street, Suite 4700
Denver, CO 80203
(303) 749-7206
E-mail:
matthew.smith@huschblackwell.com
***Attorneys for Appellant/Plaintiff Robert
T. Hoffman***

s/ John V. McDermott

John V. McDermott
BROWNSTEIN HYATT FARBER
SCHRECK, LLP
410 17th Street, Suite 2200
Denver, CO 80202-4437
(303) 223-1118
Email: Jmcdermott@bhfs.com
Attorneys for Appellant/Plaintiff
Robert T. Hoffman

s/ Ross W. Pulkrabek

Ross W. Pulkrabek, Esq.
STARRS MIHM & PULKRABEK LLP
707 17th Street, Suite 2600
Denver, CO 80202
(303) 592-5900
Email: rpulkrabek@starrslaw.com;
Attorneys for Appellant/Plaintiff
Teresa Ayers

CERTIFICATE OF COMPLIANCE WITH FED.R.APP.P. 32(a)(7)

Certificate of Compliance with Type-Volume Limitations,
Typeface Requirements, and Type Style Requirements.

This brief complies with the type-volume limitation of Fed.R.App.P. 32(a)(7)(B) because this brief contains 8,077 words, excluding the parts of the brief exempted by Fed.R.App. P. 32(a)(7)(B)(iii).

s/ David A. Zisser

David A. Zisser

Attorney for Appellant
Stephen G. Burke

Dated: February 9, 2009

CERTIFICATE OF DIGITAL SUBMISSION

All required privacy redactions, if any, have been made to said document, and with the exception of those redactions, every document submitted in digital form is an exact copy of the written document filed with the clerk, and said document has been scanned for viruses with Symantec Antivirus Corporation Edition, version 10.1.5.5000, updated continuously (last update February 8, 2009) and according to the program are free of viruses.

s/ David A. Zisser

David A. Zisser

CERTIFICATE OF SERVICE

I hereby certify that on this 9th day of February, 2009, I forwarded a true and correct copy of the foregoing Appellants' Opening Brief to counsel for Appellee, by depositing the same in the United States mail, postage pre-paid, and the brief was also submitted by digital submission as a native PDF file to the following:

Geoffrey S. Race, Esquire
L. Michael Brooks, Jr., Esquire
Adam P. O'Brien, Esquire
grace@warllc.com
mbrooks@warllc.com
aobrien@warllc.com
WELLS, ANDERSON & RACE LLC
1700 Broadway, Suite 1020
Denver, CO 80290

s/ David A. Zisser

David A. Zisser

IN THE UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF COLORADO
Senior District Judge Richard P. Matsch

Civil Action No. 08-cv-01225-RPM

LOUIS E. RIVELLI,
RODNEY B. JOHNSON,
STEPHEN G. BURKE,
TERESA W. AYERS,
CRAIG L. STEVENSON, and
ROBERT T. HOFFMAN

Plaintiffs,

v.

TWIN CITY FIRE INSURANCE COMPANY,

Defendant

ORDER DENYING PLAINTIFFS' MOTION FOR PARTIAL SUMMARY JUDGMENT AND
GRANTING DEFENDANT'S CROSS MOTION FOR SUMMARY JUDGMENT

Louis E. Rivelli, Rodney B. Johnson, Stephen G. Burke, Teresa W. Ayers, Craig L. Stevenson, and Robert T. Hoffman (collectively, "the Plaintiffs") are former officers or directors of Fischer Imaging Corporation ("Fischer"). Fischer is or was engaged in the business of designing, manufacturing and selling medical imaging systems. Fischer's common stock previously traded on the NASDAQ National Market.¹

¹"Fischer's common stock was traded on the NASDAQ National Market unit it was delisted on July 7, 2003, due to Fischer's failure to file timely reports with the SEC. On August 22, 2006, the company filed a petition under Chapter 11 of the United States Bankruptcy Code with the United States Bankruptcy Court for the District of Colorado." See Def.'s Ex. A-1, First Am. Compl. ¶ 14, filed May 7, 2007 [Doc. 113], in *SEC v. Rivelli, et al.*, Civil Action No. 05-cv-01039-RPM-MJW, in the United States District Court for the District of Colorado.

On June 7, 2005, the United States Securities and Exchange Commission brought a civil enforcement action against Rivelli, Johnson, Burke, Ayers, Hoffman, and Stevenson, alleging that these individuals participated in a fraudulent scheme involving improper accounting practices for the purpose of inflating Fischer's reported quarterly revenue and net income. In that action, designated as Civil Action No. 05-cv-01039-RPM-MJW ("the SEC Action"), the SEC seeks injunctive relief, disgorgement of ill-gotten gains, civil monetary penalties, pre-and post-judgment interest, and entry of an order permanently barring Rivelli, Johnson, Burke and Ayers from serving as an officer or director of any public company.

Fischer had obtained, for the benefit of itself and its officers and directors, primary and excess directors and officers liability insurance policies ("D & O policies"). Primary coverage was provided by Federal Insurance Company ("Federal"). Excess coverage was provided by Twin City Fire Insurance Company ("Twin City" or "the Defendant"). The central issue in this action is whether Twin City is obligated to continue advancing funds for the Plaintiffs' defense of the SEC Action, or whether Twin City may discontinue such funding on the basis of an exclusion set forth in a Warranty Letter incorporated in the Twin City Policy. The Plaintiffs and Twin City have filed cross motions for summary judgment addressing that issue.

The following facts are not in dispute:

Effective May 1, 2002, Federal issued Executive Protection Policy Number 8169-4079, insuring officers and directors of Fischer. (“Federal Policy,” Pls.’ Ex. A).² The Federal Policy provided, in the aggregate, \$5 million in primary D & O coverage.

Effective May 1, 2002, Twin City issued its Excess Financial Products Insurance Policy, No. NDA0153589-02. (“Twin City Policy,” Pls.’ Ex. B). The Twin City Policy provided \$5 million of excess coverage over the underlying Federal Policy.

As a “follows form” excess policy, the Twin City Policy is subject to the same warranties, terms, conditions, definitions, exclusions, and endorsements that are contained in the Federal Policy, except as otherwise provided in the Twin City Policy. (Twin City Policy, § III.A). Thus many provisions of the Federal Policy pertain to both policies.

Under the Federal Policy, “Insured Person” means any past, present or future director or officer of the Insured Organization and, in the case of a Securities Claim, any past, present or future employee. There is no dispute that the Plaintiffs are Insured Persons under the Twin City Policy.

The Federal Policy provides that the Insurer will pay “all Loss for which the Insured Person is not indemnified by the Insured Organization and which the Insured Person becomes legally obligated to pay on account of any Claim first made against him, individually or otherwise, during the Policy Period . . . for a Wrongful Act committed, attempted, or allegedly committed or attempted by such Insured Person before or during the Policy Period.” (Federal

²Unless otherwise noted, exhibit references are to those exhibits submitted with the Plaintiffs’ brief in support of their motion for partial summary judgment and the Defendant’s response brief. Plaintiffs’ exhibits are designated by letter (Pls.’ Ex. A), and the Defendant’s exhibits are designated by letter and number (Def.’s Ex. A-1).

Policy § 1). Under the Federal Policy, the term “Loss” means the total amount any Insured Person becomes legally obligated to pay, including Defense Costs, on account of each Claim made against them for Wrongful Acts for which coverage applies. (Federal Policy § 18, as modified by Endorsement 7). The Federal Policy provides, “it shall be the duty of the Insured Persons, and not the duty of [the Insurer] to defend Claims made against the Insured Persons.” (*Id.* § 11). Defense costs are part of the limits of liability and the payment of defense costs reduces the limits of liability. (*Id.*).

The Twin City Policy at issue was a renewal of a previous Twin City policy, which had provided \$2.5 million in excess coverage. As part of the renewal process, Fischer submitted to Twin City a Warranty Letter dated April 30, 2002, containing the following representation:

No person or entity for whom this insurance is intended has any knowledge or information of any act, error, omission, fact or circumstance which may give rise to a claim which may fall within the scope of the proposed insurance detailed above.

(Final Page of Twin City Policy, Pls.’ Ex. B). The “proposed insurance detailed above” refers to the additional \$2.5 million – the increase over the then existing \$7.5 million of primary and excess coverage. The Warranty Letter also provided:

IT IS AGREED THAT IF SUCH KNOWLEDGE OR INFORMATION EXISTS, ANY CLAIM ARISING THEREFROM (WHETHER OR NOT DISCLOSED HEREIN), IN ADDITION TO ANY OTHER REMEDY THE INSURER MAY HAVE, IS EXCLUDED FROM THE PROPOSED COVERAGE.

(*Id.*). The Warranty Letter further stated:

IT IS FURTHER AGREED THAT THIS LETTER SHALL BE DEEMED PART OF THE POLICY AND THE STATEMENT MADE THEREON SHALL BE DEEMED AN EXPRESS WARRANTY FOR ALL INSUREDS WHICH HAS BEEN RELIED UPON BY THE INSURER PURSUANT TO THE ISSUANCE OF THIS COVERAGE.

(*Id.*).

In April, 2003, Fischer announced that it was delaying the filing of its Form 10-K for 2002, and would likely restate certain of its previously issued financial statements from 2000 through the third quarter of 2002. Shortly after that announcement, private securities class actions were filed against Fischer and certain of its officers and directors. Fischer also became the subject of an SEC investigation. Fischer provided appropriate notice of these matters to both Federal and Twin City.

In October, 2003, Federal provided a coverage letter to Rivelli's counsel, stating that it would provide coverage for the class action suits, subject to reservations of rights. (Ex. E to Def.'s Br. in Resp. to Pls.' Mot. for Prelim. Inj. [Doc. 11-7]). Twin City adopted the essence of Federal's reservations of rights and reserved its rights to conduct its own independent investigation to determine whether rescission of the entire policy was appropriate or whether the exclusion in the Warranty Letter would preclude coverage for the top \$2.5 million.³

The private securities class actions proceeded as one suit, *Sorkin LLC v. Fischer Imaging Corporation, et al.*, Civil Action No. 03-cv-00631-RPM, in the United States District Court for the District of Colorado. That action was dismissed on June 21, 2005, on the ground that the amended class action complaint failed to meet the pleading standards applicable to private securities class actions. The *Sorkin* suit was not refiled after it was dismissed.

³The source of this statement is pages 8-9 of Twin City's brief [Doc. 11] in response to Plaintiffs' Motion for Preliminary Injunction.

On November 15, 2004, the SEC entered a Cease and Desist Order against Fischer, pursuant to a Settlement Agreement between Fischer and the SEC. (Ex. D to Pls.'s Br. in Supp. of Mot. for Prelim. Inj. [Doc. 3-8]).

On June 7, 2005, the SEC brought the enforcement action described above against Rivelli, Johnson, Burke, Ayers, Stevenson, and Hoffman.

By letter dated July 18, 2005, Federal stated that it would provide coverage for the SEC Complaint subject to the Policy terms and provisions and the reservations contained herein." (Pls.' Ex. F). By letters dated July 6, 2005 and August 3, 2005, Twin City set forth its coverage position with respect to the SEC Action. (Pls.' Exs. D and E). In its August 3, 2005 letter, Twin City stated, "Because the Twin City Policy, except to the extent that it provides otherwise, is generally subject to the same terms and conditions that are contained in the primary policy, Twin City adopts the views set forth in Federal's July 18, 2005 letter as its own and hereby reserves all of its rights and defenses under the Policy and at law Twin City also continues to reserve all of its rights and defenses in connection with the SEC Action in accordance with prior correspondence in this matter." (Pls.' Ex. E).

Between 2003 and 2007, Federal paid defense costs and other authorized sums on behalf of the Plaintiffs and other insureds. The limits of the Federal Policy were exhausted on or about December 6, 2007.

In a letter dated November 28, 2007, Twin City's counsel notified the Plaintiffs' counsel as follows:

It is our understanding that the limits of liability of the primary policy will soon be exhausted by the payment of defense costs. Upon such exhaustion, Twin City's Policy will continue in force as Primary Insurance, subject to its terms, conditions and exclusions. Subject to a full reservation of its rights and defenses, Twin City

will pay reasonable Defense Costs up to \$2.5 million in excess of the primary policy's limit of liability of \$5 million. Based on the information received to date and the provisions of the Warranty Letter, however, Twin City will decline to pay any liability incurred by the defendants in excess of \$7.5 million.

(Pls.' Ex. G). The author referred to documents and deposition testimony produced in the SEC Action to support Twin City's position.

Twin City has paid \$2.5 million in costs and expenses associated with the defense of the SEC Action.

The Plaintiffs commenced this suit against Twin City on June 10, 2008, seeking (1) a declaratory judgment that Twin City is obligated to pay the Plaintiffs' losses incurred in defending the SEC Action up to the policy limit of \$5 million; (2) damages for breach of contract; (3) damages for insurance bad faith, and (4) damages for violation of the Colorado Consumer Protection Act. Federal jurisdiction is provided by 28 U.S.C. § 1332, based on complete diversity of citizenship between the Plaintiffs and the Defendant. The parties agree that the substantive law to be applied is the law of Colorado.

Twin City responded to the Complaint by moving pursuant to Fed. R. Civ. P. 12(b)(6) to dismiss the Plaintiffs' fourth claim for violation of the Colorado Consumer Protection Act and answering the remaining allegations. The Defendant's motion to dismiss the fourth claim was granted during a hearing held on October 10, 2008.

The Plaintiffs filed a motion for a preliminary injunction to compel Twin City to continue funding the defense of the SEC Action.

On October 22, 2008, the Plaintiffs moved pursuant to Fed. R. Civ. P. 56(c), for partial summary judgment on their first claim for relief. The Defendant responded to that motion and filed a cross motion for summary judgment on November 5, 2008.

A hearing on the pending motions was held on November 7, 2008. The Plaintiffs' motion for preliminary injunction was denied. The Court announced that it would deny the Plaintiffs' motion for partial summary judgment and grant the Defendant's cross motion for summary judgment by a written order to be entered. This is that order.

In coverage disputes, the insured has the burden of proving that an asserted claim comes within the coverage of the policy, and the insurer has the burden of proving that the facts fall within the policy's exclusions. *See Hecla Mining Co. v. N.H. Ins. Co.*, 811 P.2d 1083, 1090 (Colo. 1991).

Twin City does not dispute that the claims asserted by the SEC fall within the coverage provided by the Twin City Policy. The issue is whether the exclusion set forth in the Warranty Letter applies to exclude the "top" \$2.5 million of coverage, thereby relieving Twin City of any obligation to pay additional defense costs.

The duty to defend is distinct from and broader than the duty to indemnify. *Hecla Mining Co.*, 811 P.2d at 1089. Under Colorado law, the duty to defend is to be determined solely from the complaint in the underlying action:

An insurer's duty to defend arises when the underlying complaint against the insurer alleges any facts that might fall within the coverage of the policy. The actual liability of the insured to the claimant is not the criterion which places upon the insurance company the obligation to defend. Rather, the obligation to defend arises from allegations in the complaint, which if sustained, would impose a liability covered by the policy. Where the insurer's duty to defend is not apparent from the pleadings in the case against the insured, but the allegations do state a claim which is potentially or arguably within the policy coverage, or there is some doubt as to whether a theory of recovery within the policy coverage has been pleaded, the insurer must accept the defense of the claim.

Hecla Mining Co., 811 P.2d at 1089 (citation, footnote, brackets and internal quotation marks omitted); see also *Cotter Corp. v. Am. Empire Surplus Lines Ins. Co.*, 90 P.3d 814, 828 (Colo. 2004); *Pompa v. Am. Family Mut. Ins. Co.*, 520 F.3d 1139, 1146 (10th Cir. 2008).

“The insurer has a duty to defend unless the insurer can establish that the allegations in the complaint are solely and entirely within the exclusions in the insurance policy. An insurer is not excused from its duty to defend unless there is no factual or legal basis on which the insurer might eventually be held liable to indemnify the insured.” *Compass Ins. Co. v. City of Littleton*, 984 P.2d 606, 614 (Colo. 1999). The insurer bears the burden of establishing that the allegations of the underlying complaint are solely and entirely within the exclusions of the insurance policy. *Cotter Corp.*, 90 P.3d at 829.

Under Colorado law, the applicability of the Warranty Letter’s exclusion must be determined based on the “four corners” of the SEC’s Complaint and Amended Complaint, without resort to extrinsic evidence.

Both the original Complaint and the SEC’s Amended Complaint, filed May 6, 2008, allege that the defendants (the Plaintiffs here) directed or participated in a fraudulent scheme involving the improper recognition of revenue for sales transactions having contingent terms contained in side letters that were not disclosed to Fischer’s accounting department or outside auditors, and the improper recognition of revenue for sales of equipment shipped to and stored in a Fischer-controlled warehouse. The SEC’s Amended Complaint asserts seven claims for relief: (1) violations of Section 17(a)(1) of the Securities Act; (2) violations of Sections 17(a)(2) and 17(a)(3) of the Securities Act; (3) violations of Section 10(b) of the Securities Exchange Act and Rule 10b-5; (4) falsification of books and records, in violation of Section 13(b)(5) of the

Securities Exchange Act and Rule 13b2-1; (5) deceit of auditors in violation of Exchange Act Rule 13b2-2; (6) aiding and abetting Fischer's filing of misleading SEC reports, in violation of Section 13(a) of the Securities Exchange Act and related rules, and (7) aiding and abetting Fischer's failure to maintain accurate books and records, in violation of Section 13(b)(2) of the Securities Exchange Act.

The Plaintiffs argue that language in the Colorado Supreme Court's opinion in *Hecla Mining* limits Twin City to two options: (1) continue paying the Plaintiffs' defense costs (up to the policy limit of \$5 million) under a reservation of rights, or (2) file a declaratory judgment action after the SEC Action has been adjudicated.

An insurer who disputes its contractual obligation is not limited to those two options. An insurer may disclaim a duty to defend or pay for defense costs when the insurer correctly concludes that the policy does not impose such a duty. *See, e.g., Thompson v. Maryland Casualty Company*, 84 P.3d 496 (Colo. 2004).

Review of the terms of the Warranty Letter and the SEC's complaints compels the conclusion that the SEC's allegations are within the exclusion of claims arising from an "act, error, omission, fact, or circumstance" of which an insured person had prior knowledge. The word "claim" as used in the Warranty Letter is broader than a single claim for relief and encompasses the following:

- (i) a written demand for monetary damages or non-monetary relief;
- (ii) a civil proceeding commenced by the service of a complaint or similar pleading;
- (iii) a criminal proceeding commenced by the service of an indictment; or
- (iv) a formal administrative or regulatory proceeding commenced by the filing of a notice of charges, formal investigative order or similar document,

against any Insured Person for a Wrongful Act or Interrelated Wrongful Act, including any appeal therefrom.

(Federal Policy, § 18, as modified by Endorsement No. 7). The Policy definitions apply to the Warranty Letter, which is part of the Policy.

The Warranty Letter explicitly states that the exclusion is non-severable. That is, if – at the time the Warranty Letter was signed – any insured person had knowledge of “any act, error, omission, fact, or circumstance” that would give rise to a claim, the top \$2.5 million of coverage is affected for all insured persons, even those without such personal knowledge. Accordingly, if any of the Plaintiffs had such knowledge, all of them are within the exclusion.

The Plaintiffs’ roles at Fischer as of May 1, 2002 are important to the analysis. Rivelli became Fischer’s Chief Operations Officer in September 1999. Rivelli became Fischer’s Chief Executive Officer (“CEO”) in December 2000, and served as Fischer’s CEO and President from December 2000 until his departure from Fischer in April 2002.⁴ Johnson served as Fischer’s Chief Financial Officer (“CFO”), vice president of finance, and secretary from August 2000, until his departure from Fischer in October 2002. Burke served as a consultant to Fischer’s Board of Directors from March 2002 through October 2002. In October 2002, Burke replaced Johnson as Fischer’s CFO, executive vice president of finance, and secretary. Burke served in those positions from October 2002 to January 2004. Ayers joined Fischer’s Board of Directors

⁴After Rivelli’s departure in April 2002, Gerald Knudson became Fischer’s CEO. Knudson was not named as defendant in the SEC Action.

in April 2002, and served as a director until approximately September 2003. Ayers served as chair of Fischer's Audit Committee from April 2002 to March 2003. Stevenson was a Vice-President of Sales and product manager at Fischer during the relevant time period. Hoffman was a regional sales manager, national sales manager and/or Vice-President of Sales at Fischer during the relevant time period.

The SEC's Amended Complaint alleges, *inter alia*:

- “Beginning at least as early as January 1, 2000 and continuing through the filing of Fischer’s report on Form 10-Q for the quarter ended September 29, 2002, the Defendants carried out a scheme to fraudulently inflate Fischer’s reported quarterly revenue and net income by recognizing revenue on equipment as to which customers had not yet agreed to accept delivery, and on transactions as to which there were material contingencies, including rights of return.” (SEC Am. Compl. ¶ 30).
- “Rivelli was aware that when Fischer shipped orders before customers agreed to take delivery of the products, Fischer shipped them to warehouses controlled and paid for by Fischer. Rivelli was notified of specific orders Fischer was holding in storage when he received emails from a Fischer employee with lists of orders that had been shipped to Fischer controlled storage facilities. In a March 2002 email, Rivelli acknowledged that, over the preceding three years, Fischer almost always had twelve or more systems in storage and paid the storage costs for all but two orders. Moreover, Rivelli was personally involved in transactions as to which he knew or was reckless in not knowing that Fischer improperly recognized revenue, where the customers had not agreed to take delivery of the equipment and Fischer shipped the equipment to a storage facility.” (*Id.* ¶ 39).
- “Rivelli knew that in May 2001 EPMed [one of the putative buyers of Fischer’s products] did not provide a requested delivery date or location because it had not yet entered into an agreement with a customer to buy the system or even identified what customer would buy it. Rivelli also knew that Fischer was responsible for delivering the system directly to EPMed’s customer when the customer requested delivery because EPMed never intended to take physical delivery of the equipment. Rivelli directed that Fischer ship this equipment to a Fischer controlled storage facility in May 2001 and Fischer recognized approximately \$532,000 of revenue on the equipment, which accounted for about 31% of Fischer’s net income for the quarter.” (*Id.* ¶ 40).

- “Between January 2000 and September 2002, Rivelli and Johnson were both aware of side agreements and backdated sales orders related to purported sales on which Fischer improperly recognized revenue. Rivelli and Johnson never provided any of the side agreements to Fischer’s independent auditors and never disclosed any side agreements or backdated sales orders to Fischer’s independent auditors.” (*Id.* ¶ 62).
- “Rivelli, Johnson, Burke, and Ayers each met with Fischer’s external auditors in connection with their reviews or audits of Fischer’s financial statements and discussed accounting and reporting issues, including Fischer’s revenue recognition practices. Rivelli, Johnson, Burke and Ayers knew that Fischer recognized revenue when it shipped equipment to Fischer controlled warehouses and omitted to state this material fact to Fischer’s external auditors.” (*Id.* ¶ 63).
- “Moreover, during their tenures at Fischer, Rivelli and Johnson directed a scheme to conceal contingencies and to obtain false and misleading documents after the end of every quarter in order to hide Fischer’s fraudulent revenue recognition from Fischer’s auditors. Several of Fischer’s employees termed the time between the end of each quarter and the date on which Fischer’s auditors arrived to perform audits or quarterly reviews the ‘clean up period.’ During the ‘clean up period,’ Rivelli and Johnson directed Fischer employees to ‘clear’ contingencies that were unresolved at the end of the quarter. If sales documents referenced contingencies, Rivelli and Johnson directed Fischer employees to ‘clean them up’ by obtaining purchase orders or sales contracts which did not reference the contingencies that were in effect. Further, in circumstances where customers had originally submitted purchase orders or sales contracts that contained FOB Destination terms, Rivelli and Johnson directed Fischer personnel to obtain sales documentation with false FOB Factory terms. Through their involvement in Fischer’s ‘clean up’ period, Rivelli and Johnson knew about, personally directed, and participated in, Fischer’s concealment of contingencies and other material facts from Fischer’s auditors and Fischer’s creation and provision to the auditors of false and misleading documents.” (*Id.* ¶ 68).
- “Stevenson and Hoffman used side letters to deceive Fischer’s accountants and Fischer’s external auditors. Stevenson withheld and failed to disclose side letters to Fischer’s sales administrator and accounting department when he knew or was reckless in not knowing that the terms contained in the side agreements made it improper for Fischer to recognize revenue. Stevenson also hid side agreements because he knew that if Fischer’s external auditors were aware of them, Fischer would not be permitted to recognize revenue from the transactions. On at least one occasion, Stevenson contracted with

a customer to keep the existence of a contingency contained in a side letter secret to prevent Fischer's auditors from finding out about it. On at least one occasion, Hoffman failed to disclose a side letter to Fischer's sales administrator and accounting department when he knew or was reckless in not knowing that it was wrong for Fischer to recognize revenue from the transaction as a result of the terms contained in the side agreement. Hoffman knew that when he did provide side agreements to Fischer's sales administrator, they were not provided to Fischer's external auditors because the auditors would not allow Fischer to recognize revenue from the transactions if they were aware of the terms contained in the side agreements." (*Id.* ¶ 72).

- "Rivelli, Johnson, Burke, Ayers, Stevenson, and Hoffman aided and abetted Fischer's violations of the books and records provisions of the federal securities laws because they knowingly or recklessly caused Fischer's books and records to be falsified. Each individual knew about and participated in Fischer's recognition of revenue from orders shipped to warehouses controlled by Fischer." (*Id.* ¶ 75.)

These allegations and others, when read together, show that Rivelli and Johnson knew of wrongful activities at Fischer that could give rise to a claim under the Twin City Policy before May 1, 2002.

The Plaintiffs argue that an insurer seeking to deny coverage based on a prior knowledge exclusion must show both that an officer or director knew of facts related to acts, errors, or omissions taking place before the effective date of the policy, and that the director or officer with such knowledge appreciated that those facts could give rise to a claim under the policy. The Plaintiffs argue that the subjective nature of this inquiry precludes summary judgment in favor of Twin City. Asserting that mere negligence could support liability on at least one claim alleged by the SEC, the Plaintiffs argue that merely negligent conduct would not implicate the Warranty Letter's exclusion. At the hearing held on November 7, 2008, Rivelli's counsel posited that Rivelli's knowledge of the contingent nature of particular sales transactions and his knowledge about the timing of Fischer's revenue recognition were not sufficient to trigger the Warranty

Letter's exclusion, because Rivelli could have failed to appreciate the wrongful nature of Fischer's accounting practices.

This argument is unavailing because it ignores basic information that a CEO and CFO of a publicly traded company must know. Anyone holding those positions could not fail to appreciate the potential for liability created by activities such as recognizing income on transactions having contingencies due to disguised side agreements, or recognizing income on products held in a company-controlled warehouse, while the company paid for the storage costs. All of the claims set forth in the SEC's Amended Complaint arise from and incorporate those factual allegations. The applicability of the Warranty Letter cannot be avoided simply because the scienter element for some claims for relief could be satisfied by recklessness or even negligence.

Finally, the Plaintiffs contend that Twin City is estopped from relying on the Warranty Letter's Exclusion, pointing out that Twin City initially stated that it would defend under a reservation of rights and then invoked the exclusion in November 2007, after the SEC Action had been proceeding for more than two years. This argument is without merit. Under Colorado law, the doctrines of waiver and estoppel cannot be used to create coverage where none previously existed under the terms of the policy. *See Compass Ins. Co.*, 984 P.2d at 620 (citing *Empire Cas. Co. v. St. Paul Fire & Marine Ins. Co.*, 764 P.2d 1191, 1198 (Colo.1988); *Hartford Live Stock Ins. Co. v. Phillips*, 150 Colo. 349, 352, 372 P.2d 740, 742 (1962)).

For the reasons set forth above, the Warranty Letter exclusion precludes coverage of defense costs as to the SEC Action for the second \$2.5 million of the \$5 million liability limit

provided in the Twin City Policy. Accordingly, Twin City has no obligation to pay additional costs and expenses for the Plaintiffs' defense of the SEC Action.

The motions for summary judgment have been considered only as to the Plaintiffs' first claim for relief. The remaining claims are not dependent on the exclusion of coverage issue. Due to the importance of this issue to the SEC enforcement action and its severability from the remaining claims, there is no just reason for delay in the entry of a final judgment dismissing the first claim for relief, making it appealable under Fed.R.Civ.P. 54(b).

It is now

ORDERED that the Plaintiffs' Motion for Partial Summary Judgment is denied, and it is

FURTHER ORDERED that the Defendant's Motion for Summary Judgment is granted for dismissal of the Plaintiffs' First Claim for Relief. It is

FURTHER ORDERED that the Clerk will enter a Final Judgment dismissing the Plaintiffs' First Claim for Relief pursuant to Fed. R. Civ. P. 54(b).

Dated: November 21, 2008

BY THE COURT:

s/Richard P. Matsch

Richard P. Matsch, Senior District Judge

LEXSTAT 15 U.S.C. § 77Q

UNITED STATES CODE SERVICE
Copyright © 2008 Matthew Bender & Company, Inc.
a member of the LexisNexis Group (TM)
All rights reserved.

*** CURRENT THROUGH PL 111-2, APPROVED 1/29/2009 ***

TITLE 15. COMMERCE AND TRADE
CHAPTER 2A. SECURITIES AND TRUST INDENTURES
DOMESTIC SECURITIES

Go to the United States Code Service Archive Directory

15 USCS § 77q

§ 77q. Fraudulent interstate transactions

(a) Anti-fraud and anti-manipulation enforcement authority. It shall be unlawful for any person in the offer or sale of any securities or any security-based swap agreement (as defined in section 206B of the Gramm-Leach-Bliley Act [*15 USCS § 78c* note]) by the use of any means or instruments of transportation or communication in interstate commerce or by use of the mails, directly or indirectly--

- (1) to employ any device, scheme, or artifice to defraud, or
- (2) to obtain money or property by means of any untrue statement of a material fact or any omission to state a material fact necessary in order to make the statements made, in light of the circumstances under which they were made, not misleading; or
- (3) to engage in any transaction, practice, or course of business which operates or would operate as a fraud or deceit upon the purchaser.

(b) Use of interstate commerce for purposes of offering for sale. It shall be unlawful for any person, by the use of any means or instruments of transportation or communication in interstate commerce or by the use of the mails, to publish, give publicity to, or circulate any notice, circular, advertisement, newspaper, article, letter, investment service, or communication which, though not purporting to offer a security for sale, describes such security for a consideration received or to be received, directly or indirectly, from an issuer, underwriter, or dealer, without fully disclosing the receipt, whether past or prospective, of such consideration and the amount thereof.

(c) Exemptions of section 3 not applicable to this section. The exemptions provided in section 3 [*15 USCS § 77c*] shall not apply to the provisions of this section.

(d) Limitations on authority of Commission. The authority of the Commission under this section with respect to security-based swap agreements (as defined in section 206B of the Gramm-Leach-Bliley Act [*15 USCS § 78c* note]) shall be subject to the restrictions and limitations of section 2A(b) of this *title* [*15 USCS § 77b-1*].

LEXSTAT 15 U.S.C. § 78J

UNITED STATES CODE SERVICE
Copyright © 2008 Matthew Bender & Company, Inc.
a member of the LexisNexis Group (TM)
All rights reserved.

*** CURRENT THROUGH PL 111-2, APPROVED 1/29/2009 ***

TITLE 15. COMMERCE AND TRADE
CHAPTER 2B. SECURITIES EXCHANGES

Go to the United States Code Service Archive Directory

15 USCS § 78j

§ 78j. Manipulative and deceptive devices

It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce or of the mails, or of any facility of any national securities exchange--

(a)

(1) To effect a short sale, or to use or employ any stop-loss order in connection with the purchase or sale, of any security registered on a national securities exchange, in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors.

(2) Paragraph (1) of this subsection shall not apply to security futures products.

(b) To use or employ, in connection with the purchase or sale of any security registered on a national securities exchange or any security not so registered, or any securities-based swap agreement (as defined in section 206B of the Gramm-Leach-Bliley Act [*15 USCS § 78c* note]), any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors.

Rules promulgated under subsection (b) that prohibit fraud, manipulation, or insider trading (but not rules imposing or specifying reporting or recordkeeping requirements, procedures, or standards as prophylactic measures against fraud, manipulation, or insider trading), and judicial precedents decided under subsection (b) and rules promulgated thereunder that prohibit fraud, manipulation, or insider trading, shall apply to security-based swap agreements (as defined in section 206B of the Gramm-Leach-Bliley Act [*15 USCS § 78c* note]) to the same extent as they apply to securities. Judicial precedents decided under section 17(a) of the Securities Act of 1933 [*15 USCS § 77q(a)*] and *sections 9, 15, 16, 20, and 21A* of this *title* [*15 USCS §§ 78i, 78o, 78p, 78t, and 78u-1*], and judicial precedents decided under applicable rules promulgated under such sections, shall apply to security-based swap agreements (as defined in section 206B of the Gramm-Leach-Bliley Act [*15 USCS § 78c* note]) to the same extent as they apply to securities.

LEXSTAT 28 USC 1291

UNITED STATES CODE SERVICE
Copyright © 2008 Matthew Bender & Company, Inc.
a member of the LexisNexis Group (TM)
All rights reserved.

*** CURRENT THROUGH PL 111-2, APPROVED 1/29/2009 ***

TITLE 28. JUDICIARY AND JUDICIAL PROCEDURE
PART IV. JURISDICTION AND VENUE
CHAPTER 83. COURTS OF APPEALS

Go to the United States Code Service Archive Directory

28 USCS § 1291

§ 1291. Final decisions of district courts

The courts of appeals (other than the United States Court of Appeals for the Federal Circuit) shall have jurisdiction of appeals from all final decisions of the district courts of the United States, the United States District Court for the District of the Canal Zone, the District Court of Guam, and the District Court of the Virgin Islands, except where a direct review may be had in the Supreme Court. The jurisdiction of the United States Court of Appeals for the Federal Circuit shall be limited to the jurisdiction described in sections 1292(c) and (d) and 1295 of this *title* [28 USCS §§ 1292(c) and (d) and 1295].

LEXSTAT 28 USC 1332

UNITED STATES CODE SERVICE
Copyright © 2008 Matthew Bender & Company, Inc.
a member of the LexisNexis Group (TM)
All rights reserved.

*** CURRENT THROUGH PL 111-2, APPROVED 1/29/2009 ***

TITLE 28. JUDICIARY AND JUDICIAL PROCEDURE
PART IV. JURISDICTION AND VENUE
CHAPTER 85. DISTRICT COURTS; JURISDICTION

Go to the United States Code Service Archive Directory

28 USCS § 1332

§ 1332. Diversity of citizenship; amount in controversy; costs

(a) The district courts shall have original jurisdiction of all civil actions where the matter in controversy exceeds the sum or value of \$ 75,000, exclusive of interest and costs, and is between--

- (1) Citizens of different States;
- (2) citizens of a State and citizens or subjects of a foreign state;
- (3) citizens of different States and in which citizens or subjects of a foreign state are additional parties; and
- (4) a foreign state, defined in section 1603(a) of this *title* [28 USCS § 1603(a)], as plaintiff and citizens of a State or of different States.

For the purposes of this section, section 1335 [28 USCS § 1335], and *section 1441* [28 USCS § 1441], an alien admitted to the United States for permanent residence shall be deemed a citizen of the State in which such alien is domiciled.

(b) Except when express provision therefor is otherwise made in a statute of the United States, where the plaintiff who files the case originally in the Federal courts is finally adjudged to be entitled to recover less than the sum or value of \$ 75,000, computed without regard to any setoff or counterclaim to which the defendant may be adjudged to be entitled, and exclusive of interest and costs, the district court may deny costs to the plaintiff and, in addition, may impose costs on the plaintiff.

(c) For the purposes of this section and section 1441 of this *title* [28 USCS § 1441]--

- (1) a corporation shall be deemed to be a citizen of any State by which it has been incorporated and of the State where it has its principal place of business, except that in any direct action against the insurer of a policy or contract of liability insurance, whether incorporated or unincorporated, to which action the insured is not joined as a party-defendant, such insurer shall be deemed a citizen of the State of which the insured is a citizen, as well as of any State by which the insurer has been incorporated and of the State where it has its principal place of business; and
- (2) the legal representative of the estate of a decedent shall be deemed to be a citizen only of the same State as the decedent, and the legal representative of an infant or incompetent shall be deemed to be a citizen only of the same State as the infant or incompetent.

(d) (1) In this subsection--

- (A) the term "class" means all of the class members in a class action;
- (B) the term "class action" means any civil action filed under *rule 23 of the Federal Rules of Civil Procedure* or similar State statute or rule of judicial procedure authorizing an action to be brought by 1 or more representative persons as a class action;

28 USCS § 1332

(C) the term "class certification order" means an order issued by a court approving the treatment of some or all aspects of a civil action as a class action; and

(D) the term "class members" means the persons (named or unnamed) who fall within the definition of the proposed or certified class in a class action.

(2) The district courts shall have original jurisdiction of any civil action in which the matter in controversy exceeds the sum or value of \$ 5,000,000, exclusive of interest and costs, and is a class action in which--

(A) any member of a class of plaintiffs is a citizen of a State different from any defendant;

(B) any member of a class of plaintiffs is a foreign state or a citizen or subject of a foreign state and any defendant is a citizen of a State; or

(C) any member of a class of plaintiffs is a citizen of a State and any defendant is a foreign state or a citizen or subject of a foreign state.

(3) A district court may, in the interests of justice and looking at the totality of the circumstances, decline to exercise jurisdiction under paragraph (2) over a class action in which greater than one-third but less than two-thirds of the members of all proposed plaintiff classes in the aggregate and the primary defendants are citizens of the State in which the action was originally filed based on consideration of--

(A) whether the claims asserted involve matters of national or interstate interest;

(B) whether the claims asserted will be governed by laws of the State in which the action was originally filed or by the laws of other States;

(C) whether the class action has been pleaded in a manner that seeks to avoid Federal jurisdiction;

(D) whether the action was brought in a forum with a distinct nexus with the class members, the alleged harm, or the defendants;

(E) whether the number of citizens of the State in which the action was originally filed in all proposed plaintiff classes in the aggregate is substantially larger than the number of citizens from any other State, and the citizenship of the other members of the proposed class is dispersed among a substantial number of States; and

(F) whether, during the 3-year period preceding the filing of that class action, 1 or more other class actions asserting the same or similar claims on behalf of the same or other persons have been filed.

(4) A district court shall decline to exercise jurisdiction under paragraph (2)--

(A) (i) over a class action in which--

(I) greater than two-thirds of the members of all proposed plaintiff classes in the aggregate are citizens of the State in which the action was originally filed;

(II) at least 1 defendant is a defendant--

(aa) from whom significant relief is sought by members of the plaintiff class;

(bb) whose alleged conduct forms a significant basis for the claims asserted by the proposed plaintiff class;

and

(cc) who is a citizen of the State in which the action was originally filed; and

(III) principal injuries resulting from the alleged conduct or any related conduct of each defendant were incurred in the State in which the action was originally filed; and

(ii) during the 3-year period preceding the filing of that class action, no other class action has been filed asserting the same or similar factual allegations against any of the defendants on behalf of the same or other persons; or

(B) two-thirds or more of the members of all proposed plaintiff classes in the aggregate, and the primary defendants, are citizens of the State in which the action was originally filed.

(5) Paragraphs (2) through (4) shall not apply to any class action in which--

(A) the primary defendants are States, State officials, or other governmental entities against whom the district court may be foreclosed from ordering relief; or

(B) the number of members of all proposed plaintiff classes in the aggregate is less than 100.

(6) In any class action, the claims of the individual class members shall be aggregated to determine whether the matter in controversy exceeds the sum or value of \$ 5,000,000, exclusive of interest and costs.

(7) Citizenship of the members of the proposed plaintiff classes shall be determined for purposes of paragraphs (2) through (6) as of the date of filing of the complaint or amended complaint, or, if the case stated by the initial pleading is not subject to Federal jurisdiction, as of the date of service by plaintiffs of an amended pleading, motion, or other paper, indicating the existence of Federal jurisdiction.

(8) This subsection shall apply to any class action before or after the entry of a class certification order by the court with respect to that action.

(9) Paragraph (2) shall not apply to any class action that solely involves a claim--

28 USCS § 1332

(A) concerning a covered security as defined under 16(f)(3) of the Securities Act of 1933 (*15 U.S.C. 78p(f)(3)*) and section 28(f)(5)(E) of the Securities Exchange Act of 1934 (*15 U.S.C. 78bb(f)(5)(E)*);

(B) that relates to the internal affairs or governance of a corporation or other form of business enterprise and that arises under or by virtue of the laws of the State in which such corporation or business enterprise is incorporated or organized; or

(C) that relates to the rights, duties (including fiduciary duties), and obligations relating to or created by or pursuant to any security (as defined under section 2(a)(1) of the Securities Act of 1933 (*15 U.S.C. 77b(a)(1)*) and the regulations issued thereunder).

(10) For purposes of this subsection and section 1453 [*28 USCS § 1453*], an unincorporated association shall be deemed to be a citizen of the State where it has its principal place of business and the State under whose laws it is organized.

(11) (A) For purposes of this subsection and section 1453 [*28 USCS § 1453*], a mass action shall be deemed to be a class action removable under paragraphs (2) through (10) if it otherwise meets the provisions of those paragraphs.

(B) (i) As used in subparagraph (A), the term "mass action" means any civil action (except a civil action within the scope of section 1711(2) [*28 USCS § 1711(2)*]) in which monetary relief claims of 100 or more persons are proposed to be tried jointly on the ground that the plaintiffs' claims involve common questions of law or fact, except that jurisdiction shall exist only over those plaintiffs whose claims in a mass action satisfy the jurisdictional amount requirements under subsection (a).

(ii) As used in subparagraph (A), the term "mass action" shall not include any civil action in which--

(I) all of the claims in the action arise from an event or occurrence in the State in which the action was filed, and that allegedly resulted in injuries in that State or in States contiguous to that State;

(II) the claims are joined upon motion of a defendant;

(III) all of the claims in the action are asserted on behalf of the general public (and not on behalf of individual claimants or members of a purported class) pursuant to a State statute specifically authorizing such action; or

(IV) the claims have been consolidated or coordinated solely for pretrial proceedings.

(C) (i) Any action(s) removed to Federal court pursuant to this subsection shall not thereafter be transferred to any other court pursuant to section 1407 [*28 USCS § 1407*], or the rules promulgated thereunder, unless a majority of the plaintiffs in the action request transfer pursuant to section 1407 [*28 USCS § 1407*].

(ii) This subparagraph will not apply--

(I) to cases certified pursuant to *rule 23 of the Federal Rules of Civil Procedure*; or

(II) if plaintiffs propose that the action proceed as a class action pursuant to *rule 23 of the Federal Rules of Civil Procedure*.

(D) The limitations periods on any claims asserted in a mass action that is removed to Federal court pursuant to this subsection shall be deemed tolled during the period that the action is pending in Federal court.

(e) The word "States", as used in this section, includes the Territories, the District of Columbia, and the Commonwealth of Puerto Rico.

Rule 10b-3

1934 ACT RULES

(b) It shall be unlawful for any municipal securities dealer directly or indirectly, by the use of any means or instrumentality of interstate commerce, or of the mails, or of any facility of any national securities exchange, to use or employ, in connection with the purchase or sale of any municipal security, any act, practice, or course of business defined by the Commission to be included within the term "manipulative, deceptive, or other fraudulent device or contrivance," as such term is used in section 15(c)(1) of the Act.

Rule 10b-5. Employment of Manipulative and Deceptive Devices

It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce, or of the mails or of any facility of any national securities exchange,

(a) To employ any device, scheme, or artifice to defraud,

(b) To make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or

(c) To engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person,
in connection with the purchase or sale of any security.

Rule 10b5-1. Trading "on the Basis of" Material Nonpublic Information in Insider Trading Cases

Preliminary Note to Rule 10b5-1: This provision defines when a purchase or sale constitutes trading "on the basis of" material nonpublic information in insider trading cases brought under Section 10(b) of the Act and Rule 10b-5 thereunder. The law of insider trading is otherwise defined by judicial opinions construing Rule 10b-5, and Rule 10b5-1 does not modify the scope of insider trading law in any other respect.

(a) General. The "manipulative and deceptive devices" prohibited by Section 10(b) of the Act and Rule 10b-5 thereunder include, among other things, the purchase or sale of a security of any issuer, on the basis of material nonpublic information about that security or issuer, in breach of a duty of trust or confidence that is owed directly, indirectly, or derivatively, to the issuer of that security or the shareholders of that issuer, or to any other person who is the source of the material nonpublic information.

(b) Definition of "on the basis of." Subject to the affirmative defenses in paragraph (c) of this rule, a purchase or sale of a security of an issuer is "on the basis of" material nonpublic information about that security or issuer if the person making the purchase or sale was aware of the material nonpublic information when the person made the purchase or sale.

(c) Affirmative defenses.

(1)(i) Subject to paragraph (c)(1)(ii) of this rule, a person's purchase or sale is not "on the basis of" material nonpublic information if the person making the purchase or sale demonstrates that:

(A) before becoming aware of the information, the person had:

(1) entered into a binding contract to purchase or sell the security,

(2) instructed another person to purchase or sell the security for the instructing person's account, or

LXSTAT FRCP 54

UNITED STATES CODE SERVICE
Copyright © 2008 Matthew Bender & Company, Inc.,
a member of the LexisNexis Group (TM)
All rights reserved.

*** CURRENT THROUGH CHANGES RECEIVED FEBRUARY 05, 2009 ***

FEDERAL RULES OF CIVIL PROCEDURE
TITLE VII. JUDGMENT

Go to the United States Code Service Archive Directory

USCS Fed Rules Civ Proc R 54

Rule 54. Judgments; Costs

(a) Definition; Form. "Judgment" as used in these rules includes a decree and any order from which an appeal lies. A judgment must not include recitals of pleadings, a master's report, or a record of prior proceedings.

(b) Judgment on Multiple Claims or Involving Multiple Parties. When an action presents more than one claim for relief--whether as a claim, counterclaim, crossclaim, or third-party claim--or when multiple parties are involved, the court may direct entry of a final judgment as to one or more, but fewer than all, claims or parties only if the court expressly determines that there is no just reason for delay. Otherwise, any order or other decision, however designated, that adjudicates fewer than all the claims or the rights and liabilities of fewer than all the parties does not end the action as to any of the claims or parties and may be revised at any time before the entry of a judgment adjudicating all the claims and all the parties' rights and liabilities.

(c) Demand for Judgment; Relief to Be Granted. A default judgment must not differ in kind from, or exceed in amount, what is demanded in the pleadings. Every other final judgment should grant the relief to which each party is entitled, even if the party has not demanded that relief in its pleadings.

(d) Costs; Attorney's Fees.

(1) *Costs Other Than Attorney's Fees.* Unless a federal statute, these rules, or a court order provides otherwise, costs--other than attorney's fees--should be allowed to the prevailing party. But costs against the United States, its officers, and its agencies may be imposed only to the extent allowed by law. The clerk may tax costs on 1 day's notice. On motion served within the next 5 days, the court may review the clerk's action.

(2) *Attorney's Fees.*

(A) Claim to Be by Motion. A claim for attorney's fees and related nontaxable expenses must be made by motion unless the substantive law requires those fees to be proved at trial as an element of damages.

(B) Timing and Contents of the Motion. Unless a statute or a court order provides otherwise, the motion must:

(i) be filed no later than 14 days after the entry of judgment;

(ii) specify the judgment and the statute, rule, or other grounds entitling the movant to the award;

(iii) state the amount sought or provide a fair estimate of it; and

(iv) disclose, if the court so orders, the terms of any agreement about fees for the services for which the claim is made.

(C) Proceedings. Subject to Rule 23(h), the court must, on a party's request, give an opportunity for adversary submissions on the motion in accordance with Rule 43(c) or 78. The court may decide issues of liability for fees before receiving submissions on the value of services. The court must find the facts and state its conclusions of law as provided in Rule 52(a).

USCS Fed Rules Civ Proc R. 54

(D) Special Procedures by Local Rule; Reference to a Master or a Magistrate Judge. By local rule, the court may establish special procedures to resolve fee-related issues without extensive evidentiary hearings. Also, the court may refer issues concerning the value of services to a special master under Rule 53 without regard to the limitations of Rule 53(a)(1), and may refer a motion for attorney's fees to a magistrate judge under Rule 72(b) as if it were a dispositive pretrial matter.

(E) Exceptions. Subparagraphs (A)-(D) do not apply to claims for fees and expenses as sanctions for violating these rules or as sanctions under *28 U.S.C. § 1927*.

LEXSTAT FED. R. CIV. P. 56

UNITED STATES CODE SERVICE
Copyright © 2008 Matthew Bender & Company, Inc.,
a member of the LexisNexis Group (TM)
All rights reserved.

*** CURRENT THROUGH CHANGES RECEIVED FEBRUARY 05, 2009 ***

FEDERAL RULES OF CIVIL PROCEDURE
TITLE VII. JUDGMENT

Go to the United States Code Service Archive Directory

USCS Fed Rules Civ Proc R 56

Rule 56. Summary Judgment

(a) By a Claiming Party. A party claiming relief may move, with or without supporting affidavits, for summary judgment on all or part of the claim. The motion may be filed at any time after:

- (1) 20 days have passed from commencement of the action; or
- (2) the opposing party serves a motion for summary judgment.

(b) By a Defending Party. A party against whom relief is sought may move at any time, with or without supporting affidavits, for summary judgment on all or part of the claim.

(c) Serving the Motion; Proceedings. The motion must be served at least 10 days before the day set for the hearing. An opposing party may serve opposing affidavits before the hearing day. The judgment sought should be rendered if the pleadings, the discovery and disclosure materials on file, and any affidavits show that there is no genuine issue as to any material fact and that the movant is entitled to judgment as a matter of law.

(d) Case Not Fully Adjudicated on the Motion.

(1) *Establishing Facts.* If summary judgment is not rendered on the whole action, the court should, to the extent practicable, determine what material facts are not genuinely at issue. The court should so determine by examining the pleadings and evidence before it and by interrogating the attorneys. It should then issue an order specifying what facts--including items of damages or other relief--are not genuinely at issue. The facts so specified must be treated as established in the action.

(2) *Establishing Liability.* An interlocutory summary judgment may be rendered on liability alone, even if there is a genuine issue on the amount of damages.

(e) Affidavits; Further Testimony.

(1) *In General.* A supporting or opposing affidavit must be made on personal knowledge, set out facts that would be admissible in evidence, and show that the affiant is competent to testify on the matters stated. If a paper or part of a paper is referred to in an affidavit, a sworn or certified copy must be attached to or served with the affidavit. The court may permit an affidavit to be supplemented or opposed by depositions, answers to interrogatories, or additional affidavits.

(2) *Opposing Party's Obligation to Respond.* When a motion for summary judgment is properly made and supported, an opposing party may not rely merely on allegations or denials in its own pleading; rather, its response must--by affidavits or as otherwise provided in this rule--set out specific facts showing a genuine issue for trial. If the opposing party does not so respond, summary judgment should, if appropriate, be entered against that party.

USCS Fed Rules Civ Proc R 56

(f) When Affidavits Are Unavailable. If a party opposing the motion shows by affidavit that, for specified reasons, it cannot present facts essential to justify its opposition, the court may:

- (1) deny the motion;
- (2) order a continuance to enable affidavits to be obtained, depositions to be taken, or other discovery to be undertaken; or
- (3) issue any other just order.

(g) Affidavit Submitted in Bad Faith. If satisfied that an affidavit under this rule is submitted in bad faith or solely for delay, the court must order the submitting party to pay the other party the reasonable expenses, including attorney's fees, it incurred as a result. An offending party or attorney may also be held in contempt.

C.R.S. 7-109-101

COLORADO REVISED STATUTES

*** THIS DOCUMENT REFLECTS CHANGES RECEIVED THROUGH DECEMBER 1, 2008 ***

TITLE 7. CORPORATIONS AND ASSOCIATIONS
CORPORATIONS - Continued
COLORADO BUSINESS CORPORATIONS
ARTICLE 109. INDEMNIFICATION

GO TO COLORADO STATUTES ARCHIVE DIRECTORY

C.R.S. 7-109-101 (2008)

7-109-101. Definitions

As used in this article:

- (1) "Corporation" includes any domestic or foreign entity that is a predecessor of a corporation by reason of a merger or other transaction in which the predecessor's existence ceased upon consummation of the transaction.
- (2) "Director" means an individual who is or was a director of a corporation or an individual who, while a director of a corporation, is or was serving at the corporation's request as a director, an officer, an agent, an associate, an employee, a fiduciary, a manager, a member, a partner, a promoter, or a trustee of, or to hold any similar position with, another domestic or foreign entity or of an employee benefit plan. A director is considered to be serving an employee benefit plan at the corporation's request if the director's duties to the corporation also impose duties on, or otherwise involve services by, the director to the plan or to participants in or beneficiaries of the plan. "Director" includes, unless the context requires otherwise, the estate or personal representative of a deceased director.
- (3) "Expenses" includes counsel fees.
- (4) "Liability" means the obligation incurred with respect to a proceeding to pay a judgment, settlement, penalty, fine, including an excise tax assessed with respect to an employee benefit plan, or reasonable expenses.
- (5) "Official capacity" means, when used with respect to a director, the office of director in a corporation and, when used with respect to a person other than a director as contemplated in section 7-109-107, the office in a corporation held by the officer or the employment, fiduciary, or agency relationship undertaken by the employee, fiduciary, or agent on behalf of the corporation. "Official capacity" does not include service for any other domestic or foreign corporation or other person or employee benefit plan.
- (6) "Party" includes a person who was, is, or is threatened to be made a named defendant or respondent in a proceeding.
- (7) "Proceeding" means any threatened, pending, or completed action, suit, or proceeding, whether civil, criminal, administrative, or investigative and whether formal or informal.

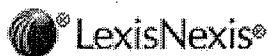
HISTORY: Source: L. 93: Entire article added, p. 789, § 1, effective July 1, 1994. L. 96: (2) amended, p. 1319, § 25, effective June 1. L. 2003: (2) amended, p. 2320, § 246, effective July 1, 2004. L. 2004: (2) amended, p. 1500, § 264, effective July 1.

Cross references: For the "Uniform Records Retention Act", see article 17 of title 6. Law reviews: For article, "Commercial and Corporate Law", which discusses recent Tenth Circuit decisions dealing with corporate law, see 64 Den. U. L. Rev. 165 (1987); for article, "Recent Judicial Developments in Delaware Takeover Law", see 19 Colo. Law. 47 (1990); for article, "Choice of Entities in Colorado", see 23 Colo. Law. 293 (1994); for article, "Choice of Entity in Colorado: An Update", see 25 Colo. Law. 3 (October 1996); for article, "Colorado Choice of Entity 1998", see 27 Colo. Law. 5 (June 1998); for article, "Colorado Choice of Form of Organization and Structure 2001", see 30 Colo. Law. 11 (October 2001); for article, "Entity and Trade Name Registration: 2001 Update", see 30 Colo. Law. 81 (October 2001); for article, "No Paper Required: Business Entity Legislation Makes Life Easier for Business Lawyers", see 33 Colo. Law. 6 (June 2004); for article, "Buying, Selling, and Combining Businesses Under the Colorado Business Corporation Act", see 33 Colo. Law. 73 (November 2004); for article, "Dissenters' Rights: The Colorado Supreme Court Finally Speaks", see 34 Colo. Law. 53 (April 2005).

Cross references: For additional definitions applicable to this title, see §§ 7-90-102 and 7-101-401.

ANNOTATION

A defense is "wholly successful" if an entire proceeding is disposed of on a basis that does not involve a finding of "liability"; thus, indemnification is mandated when jury found former director, officer, and employee breached a duty to the corporation but refused to award the corporation damages due to lack of causation. *Waskel v. Guaranty Nat'l Corp.*, 23 P.3d 1214 (Colo. App. 2000) (declining to follow *Quark, Inc. v. Harley*, 141 F.3d 1185 (10th Cir. 1998)).



[About LexisNexis](#) | [Terms & Conditions](#) | [Contact Us](#)
Copyright © 2009 LexisNexis, a division of Reed Elsevier Inc. All rights reserved.

C.R.S. 7-109-102

COLORADO REVISED STATUTES

*** THIS DOCUMENT REFLECTS CHANGES RECEIVED THROUGH DECEMBER 1, 2008 ***

TITLE 7. CORPORATIONS AND ASSOCIATIONS
CORPORATIONS - Continued
COLORADO BUSINESS CORPORATIONS
ARTICLE 109. INDEMNIFICATION

GO TO COLORADO STATUTES ARCHIVE DIRECTORY

C.R.S. 7-109-102 (2008)

7-109-102. Authority to indemnify directors

(1) Except as provided in subsection (4) of this section, a corporation may indemnify a person made a party to a proceeding because the person is or was a director against liability incurred in the proceeding if:

(a) The person's conduct was in good faith; and

(b) The person reasonably believed:

(I) In the case of conduct in an official capacity with the corporation, that such conduct was in the corporation's best interests; and

(II) In all other cases, that such conduct was at least not opposed to the corporation's best interests; and

(c) In the case of any criminal proceeding, the person had no reasonable cause to believe the person's conduct was unlawful.

(2) A director's conduct with respect to an employee benefit plan for a purpose the director reasonably believed to be in the interests of the participants in or beneficiaries of the plan is conduct that satisfies the requirement of subparagraph (II) of paragraph (b) of subsection (1) of this section. A director's conduct with respect to an employee benefit plan for a purpose that the director did not reasonably believe to be in the interests of the participants in or beneficiaries of the plan shall be deemed not to satisfy the requirements of paragraph (a) of subsection (1) of this section.

(3) The termination of a proceeding by judgment, order, settlement, conviction, or upon a plea of nolo contendere or its equivalent is not, of itself, determinative that the director did not meet the standard of conduct described in this section.

(4) A corporation may not indemnify a director under this section:

(a) In connection with a proceeding by or in the right of the corporation in which the director was adjudged liable to the corporation; or

(b) In connection with any other proceeding charging that the director derived an improper

personal benefit, whether or not involving action in an official capacity, in which proceeding the director was adjudged liable on the basis that the director derived an improper personal benefit.

(5) Indemnification permitted under this section in connection with a proceeding by or in the right of the corporation is limited to reasonable expenses incurred in connection with the proceeding.

HISTORY: Source: L. 93: Entire article added, p. 790, § 1, effective July 1, 1994. L. 2004: (1) and (4) amended, p. 1500, § 265, effective July 1.

ANNOTATION

Directors qualify for corporate indemnification if they are sued at least in part because, or by reason of the fact that, they are or were directors of a corporation. *Weisbart v. Agri Tech, Inc.*, 22 P.3d 954 (Colo. App. 2001).

Corporation is prohibited from indemnifying a director only when the director has been found "liable" to the corporation; when jury found former director breached a duty to the corporation but refused to award the corporation damages because of a lack of causation, indemnification was not prohibited. *Waskel v. Guaranty Nat'l Corp.*, 23 P.3d 1214 (Colo. App. 2000) (declining to follow *Quark, Inc. v. Harley*, 141 F.3d 1185 (10th Cir. 1998)).



LexisNexis®

[About LexisNexis](#) | [Terms & Conditions](#) | [Contact Us](#)

Copyright © 2009 LexisNexis, a division of Reed Elsevier Inc. All rights reserved.

C.R.S. 7-109-103

COLORADO REVISED STATUTES

*** THIS DOCUMENT REFLECTS CHANGES RECEIVED THROUGH DECEMBER 1, 2008 ***

TITLE 7. CORPORATIONS AND ASSOCIATIONS
CORPORATIONS - Continued
COLORADO BUSINESS CORPORATIONS
ARTICLE 109. INDEMNIFICATION

GO TO COLORADO STATUTES ARCHIVE DIRECTORY

C.R.S. 7-109-103 (2008)

7-109-103. Mandatory indemnification of directors

Unless limited by its articles of incorporation, a corporation shall indemnify a person who was wholly successful, on the merits or otherwise, in the defense of any proceeding to which the person was a party because the person is or was a director, against reasonable expenses incurred by the person in connection with the proceeding.

HISTORY: Source: L. 93: Entire article added, p. 791, § 1, effective July 1, 1994. L. 2004: Entire section amended, p. 1501, § 266, effective July 1.

ANNOTATION

Indemnification not mandated where former director was not "wholly successful" since the jury found him liable for breaching his fiduciary duty to the corporation and the mere fact that the jury refused to award the corporation damages does not negate that finding. *Quark, Inc. v. Harley*, 141 F.3d 1185 (10th Cir. 1998).

Indemnification is mandated when jury found former director breached a duty to the corporation but refused to award the corporation damages because of a lack of causation, since the defense was "wholly successful". *Waskel v. Guaranty Nat'l Corp.*, 23 P.3d 1214 (Colo. App. 2000) (declining to follow *Quark, Inc. v. Harley*, 141 F.3d 1185 (10th Cir. 1998)).



[About LexisNexis](#) | [Terms & Conditions](#) | [Contact Us](#)
Copyright © 2009 LexisNexis, a division of Reed Elsevier Inc. All rights reserved.

C.R.S. 7-109-104

COLORADO REVISED STATUTES

*** THIS DOCUMENT REFLECTS CHANGES RECEIVED THROUGH DECEMBER 1, 2008 ***

TITLE 7. CORPORATIONS AND ASSOCIATIONS
CORPORATIONS - Continued
COLORADO BUSINESS CORPORATIONS
ARTICLE 109. INDEMNIFICATION

GO TO COLORADO STATUTES ARCHIVE DIRECTORY

C.R.S. 7-109-104 (2008)

7-109-104. Advance of expenses to directors

(1) A corporation may pay for or reimburse the reasonable expenses incurred by a director who is a party to a proceeding in advance of final disposition of the proceeding if:

(a) The director furnishes to the corporation a written affirmation of the director's good faith belief that the director has met the standard of conduct described in section 7-109-102;

(b) The director furnishes to the corporation a written undertaking, executed personally or on the director's behalf, to repay the advance if it is ultimately determined that the director did not meet the standard of conduct; and

(c) A determination is made that the facts then known to those making the determination would not preclude indemnification under this article.

(2) The undertaking required by paragraph (b) of subsection (1) of this section shall be an unlimited general obligation of the director but need not be secured and may be accepted without reference to financial ability to make repayment.

(3) Determinations and authorizations of payments under this section shall be made in the manner specified in section 7-109-106.

HISTORY: Source: L. 93: Entire article added, p. 791, § 1, effective July 1, 1994. L. 2004: (1) amended, p. 1501, § 267, effective July 1.



[About LexisNexis](#) | [Terms & Conditions](#) | [Contact Us](#)
Copyright © 2009 LexisNexis, a division of Reed Elsevier Inc. All rights reserved.

C.R.S. 7-109-105

COLORADO REVISED STATUTES

*** THIS DOCUMENT REFLECTS CHANGES RECEIVED THROUGH DECEMBER 1, 2008 ***

TITLE 7. CORPORATIONS AND ASSOCIATIONS
CORPORATIONS - Continued
COLORADO BUSINESS CORPORATIONS
ARTICLE 109. INDEMNIFICATION

GO TO COLORADO STATUTES ARCHIVE DIRECTORY

C.R.S. 7-109-105 (2008)

7-109-105. Court-ordered indemnification of directors

(1) Unless otherwise provided in the articles of incorporation, a director who is or was a party to a proceeding may apply for indemnification to the court conducting the proceeding or to another court of competent jurisdiction. On receipt of an application, the court, after giving any notice the court considers necessary, may order indemnification in the following manner:

(a) If it determines that the director is entitled to mandatory indemnification under section 7-109-103, the court shall order indemnification, in which case the court shall also order the corporation to pay the director's reasonable expenses incurred to obtain court-ordered indemnification.

(b) If it determines that the director is fairly and reasonably entitled to indemnification in view of all the relevant circumstances, whether or not the director met the standard of conduct set forth in section 7-109-102 (1) or was adjudged liable in the circumstances described in section 7-109-102 (4), the court may order such indemnification as the court deems proper; except that the indemnification with respect to any proceeding in which liability shall have been adjudged in the circumstances described in section 7-109-102 (4) is limited to reasonable expenses incurred in connection with the proceeding and reasonable expenses incurred to obtain court-ordered indemnification.

HISTORY: Source: L. 93: Entire article added, p. 792, § 1, effective July 1, 1994.



[About LexisNexis](#) | [Terms & Conditions](#) | [Contact Us](#)
Copyright © 2009 LexisNexis, a division of Reed Elsevier Inc. All rights reserved.

C.R.S. 7-109-106

COLORADO REVISED STATUTES

*** THIS DOCUMENT REFLECTS CHANGES RECEIVED THROUGH DECEMBER 1, 2008 ***

TITLE 7. CORPORATIONS AND ASSOCIATIONS
CORPORATIONS - Continued
COLORADO BUSINESS CORPORATIONS
ARTICLE 109. INDEMNIFICATION

GO TO COLORADO STATUTES ARCHIVE DIRECTORY

C.R.S. 7-109-106 (2008)

7-109-106. Determination and authorization of indemnification of directors

(1) A corporation may not indemnify a director under section 7-109-102 unless authorized in the specific case after a determination has been made that indemnification of the director is permissible in the circumstances because the director has met the standard of conduct set forth in section 7-109-102. A corporation shall not advance expenses to a director under section 7-109-104 unless authorized in the specific case after the written affirmation and undertaking required by section 7-109-104 (1) (a) and (1) (b) are received and the determination required by section 7-109-104 (1) (c) has been made.

(2) The determinations required by subsection (1) of this section shall be made:

(a) By the board of directors by a majority vote of those present at a meeting at which a quorum is present, and only those directors not parties to the proceeding shall be counted in satisfying the quorum; or

(b) If a quorum cannot be obtained, by a majority vote of a committee of the board of directors designated by the board of directors, which committee shall consist of two or more directors not parties to the proceeding; except that directors who are parties to the proceeding may participate in the designation of directors for the committee.

(3) If a quorum cannot be obtained as contemplated in paragraph (a) of subsection (2) of this section, and a committee cannot be established under paragraph (b) of subsection (2) of this section, or, even if a quorum is obtained or a committee is designated, if a majority of the directors constituting such quorum or such committee so directs, the determination required to be made by subsection (1) of this section shall be made:

(a) By independent legal counsel selected by a vote of the board of directors or the committee in the manner specified in paragraph (a) or (b) of subsection (2) of this section or, if a quorum of the full board cannot be obtained and a committee cannot be established, by independent legal counsel selected by a majority vote of the full board of directors; or

(b) By the shareholders.

(4) Authorization of indemnification and advance of expenses shall be made in the same manner as the determination that indemnification or advance of expenses is permissible; except that, if the determination that indemnification or advance of expenses is permissible is

made by independent legal counsel, authorization of indemnification and advance of expenses shall be made by the body that selected such counsel.

HISTORY: Source: L. 93: Entire article added, p. 792, § 1, effective July 1, 1994.



LexisNexis®

[About LexisNexis](#) | [Terms & Conditions](#) | [Contact Us](#)

[Copyright ©](#) 2009 LexisNexis, a division of Reed Elsevier Inc. All rights reserved.

C.R.S. 7-109-107

COLORADO REVISED STATUTES

*** THIS DOCUMENT REFLECTS CHANGES RECEIVED THROUGH DECEMBER 1, 2008 ***

TITLE 7. CORPORATIONS AND ASSOCIATIONS
CORPORATIONS - Continued
COLORADO BUSINESS CORPORATIONS
ARTICLE 109. INDEMNIFICATION

GO TO COLORADO STATUTES ARCHIVE DIRECTORY

C.R.S. 7-109-107 (2008)

7-109-107. Indemnification of officers, employees, fiduciaries, and agents

(1) Unless otherwise provided in the articles of incorporation:

(a) An officer is entitled to mandatory indemnification under section 7-109-103, and is entitled to apply for court-ordered indemnification under section 7-109-105, in each case to the same extent as a director;

(b) A corporation may indemnify and advance expenses to an officer, employee, fiduciary, or agent of the corporation to the same extent as to a director; and

(c) A corporation may also indemnify and advance expenses to an officer, employee, fiduciary, or agent who is not a director to a greater extent, if not inconsistent with public policy, and if provided for by its bylaws, general or specific action of its board of directors or shareholders, or contract.

HISTORY: Source: L. 93: Entire article added, p. 793, § 1, effective July 1, 1994.

ANNOTATION

Officers qualify for corporate indemnification if they are sued at least in part because, or by reason of the fact that, they are or were officers of a corporation. *Weisbart v. Agri Tech, Inc.*, 22 P.3d 954 (Colo. App. 2001).

Indemnification is mandated when jury found former officers and employees breached a duty to the corporation but refused to award the corporation damages because of a lack of causation, since the defense was "wholly successful" and corporate bylaws indemnified employees to the same extent as directors. *Waskel v. Guaranty Nat'l Corp.*, 23 P.3d 1214 (Colo. App. 2000) (declining to follow *Quark, Inc. v. Harley*, 141 F.3d 1185 (10th Cir. 1998)).



C.R.S. 7-109-108

COLORADO REVISED STATUTES

*** THIS DOCUMENT REFLECTS CHANGES RECEIVED THROUGH DECEMBER 1, 2008 ***

TITLE 7. CORPORATIONS AND ASSOCIATIONS
CORPORATIONS - Continued
COLORADO BUSINESS CORPORATIONS
ARTICLE 109. INDEMNIFICATION

GO TO COLORADO STATUTES ARCHIVE DIRECTORY

C.R.S. 7-109-108 (2008)

7-109-108. Insurance

A corporation may purchase and maintain insurance on behalf of a person who is or was a director, officer, employee, fiduciary, or agent of the corporation, or who, while a director, officer, employee, fiduciary, or agent of the corporation, is or was serving at the request of the corporation as a director, officer, partner, trustee, employee, fiduciary, or agent of another domestic or foreign entity or of an employee benefit plan, against liability asserted against or incurred by the person in that capacity or arising from the person's status as a director, officer, employee, fiduciary, or agent, whether or not the corporation would have power to indemnify the person against the same liability under section 7-109-102, 7-109-103, or 7-109-107. Any such insurance may be procured from any insurance company designated by the board of directors, whether such insurance company is formed under the law of this state or any other jurisdiction of the United States or elsewhere, including any insurance company in which the corporation has an equity or any other interest through stock ownership or otherwise.

HISTORY: Source: L. 93: Entire article added, p. 793, § 1, effective July 1, 1994. L. 2003: Entire section amended, p. 2320, § 247, effective July 1, 2004. L. 2004: Entire section amended, p. 1501, § 268, effective July 1.



LexisNexis®

[About LexisNexis](#) | [Terms & Conditions](#) | [Contact Us](#)

Copyright © 2009 LexisNexis, a division of Reed Elsevier Inc. All rights reserved.