

**IN THE UNITED STATES DISTRICT COURT
FOR THE EASTERN DISTRICT OF PENNSYLVANIA**

JACOB BOGATIN,	:	CIVIL ACTION
Plaintiff	:	
	:	
v.	:	
	:	
FEDERAL INSURANCE COMPANY,	:	
Defendant	:	NO. 99-4441

Newcomer, S.J. June , 2000

This action pending before the Court is brought by an insured against his insurer for coverage under an Executive Protection insurance policy. Plaintiff alleges that he faces an array of litigation involving evidence and witnesses from countries in both North America and Eastern Europe, and entailing legal, factual and even cultural issues of immense complexity. Plaintiff contends that defendant has breached the Executive Protection insurance policy by refusing to afford him coverage. He asserts that defendant should advance him defense costs that were promised to him through the policy. Specifically, plaintiff seeks the advancement of defense costs with a reservation of rights by defendant to deny or rescind coverage based on the outcome of the underlying litigation.

Defendant claims that it is entitled to rescind its insurance policy as to plaintiff on the grounds that he knowingly misrepresented, and failed to disclose in the policy applications, information material to the insurer's underwriting risk. Further, defendant asserts that plaintiff breached his express contractual duty to cooperate in the insurer's coverage investigation by refusing to submit to an interview by defendant

and by refusing in his deposition to answer virtually every question the insurer posed to him concerning his knowledge of material information.

In accordance with Federal Rule of Civil Procedure 52, after a three day bench trial and upon consideration of the testimony of the witnesses, admitted exhibits, and arguments of counsel, as well as the parties' post-trial submissions, the Court makes the following findings of fact and conclusions of law.

FINDINGS OF FACT

I. THE PARTIES

1. Plaintiff Jacob Bogatin is the former President and Chief Executive Officer, and a former member of the Board of Directors, of YBM Magnex International, Inc. ("YBM"). YBM is a Canadian corporation with headquarters in Newtown, Pennsylvania. According to its published statements and reports, YBM and its subsidiaries were engaged in, among other things, the manufacture and distribution of industrial magnets.

2. Defendant Federal Insurance Company ("Federal") is a stock insurance company, organized and incorporated under the laws of the State of Indiana, with its principal place of business and administrative office in Warren, New Jersey. Federal is a subsidiary of Chubb & Son, Inc.

II. YBM'S EXECUTIVE PROTECTION INSURANCE POLICIES AND RENEWALS

A. 1996 APPLICATION AND POLICY

3. On or about May 1, 1996, YBM submitted an Executive Protection Policy Application ("1996 Application") to Chubb Custom Insurance Company ("Chubb"). The 1996 Application sought coverage for executive liability and indemnification with a \$5,000,000 policy limit for the period of May 1, 1996 to May 1, 1997.

4. As President of YBM, plaintiff Jacob Bogatin signed and dated the 1996 Application on May 1, 1996 on behalf of the company.

5. Immediately above plaintiff's signature, the 1996 Application included the following provisions:

9. FALSE INFORMATION

Any person, who, knowingly and with intent to defraud an insurance company or other person, files an application for insurance containing any false information, or conceals for the purpose of misleading, information concerning any fact material thereto, commits a fraudulent insurance act, which is a crime.

10. DECLARATION AND SIGNATURE

The undersigned declares that to the best of his or her knowledge and belief the statements set forth herein are true. . . . [T]he undersigned agrees that this application and its attachments shall be the basis of the contract should a policy be issued and shall be deemed attached to and shall form part of the policy.

6. Paragraph 5 of the 1996 Application was entitled "PAST ACTIVITIES" and required YBM to state whether "the Parent Organization, a subsidiary, any director, officer or other proposed Insured Person [had] been involved" in any: "[c]ivil or

criminal action or administrative proceeding charging violation of a federal or state security law or regulation" or "[a]ny other criminal actions." Details were to be attached if there had been any such involvement. The boxes labeled "No" were checked next to the questions posed in Paragraph 5 of the 1996 Application.

7. The 1996 Application also contained in Paragraph 8 a section entitled "PRIOR KNOWLEDGE/WARRANTY" that stated, in part:

No person proposed for coverage is aware of any facts or circumstances which he or she has reason to suppose might give rise to a future claim that would fall within the scope of the proposed coverage, except: (If no exceptions, please state.) _____

It is agreed that if such facts or circumstances exist, whether or not disclosed, any claim arising from them is excluded from this proposed coverage.

The words "No exceptions" were typed in the blank.

8. On or about May 7, 1996, Chubb issued an Executive Protection Policy to YBM with a \$5,000,000 policy limit effective May 1, 1996 through May 1, 1997 ("1996 Policy").

B. 1997 APPLICATION AND POLICY

9. On or about April 30, 1997, YBM submitted an Executive Protection Policy Application to Chubb for the period May 1, 1997 to May 1, 1998 ("1997 Application"). The 1997 Application requested a \$20,000,000 policy limit for executive liability and indemnification. The application also indicated that at that time YBM had a \$5,000,000 insurance policy from Chubb for the period May 1, 1996 to May 1, 1997 and another

\$5,000,000 policy from a separate insurance company for the period October 1, 1996 to May 1, 1997.

10. Like the 1996 Application, the 1997 Application had paragraphs entitled "Prior Knowledge/Warranty", "False Information", and "Declaration and Signature". Plaintiff signed and dated the 1997 Application on April 30, 1997.

11. On or about June 10, 1997, Chubb issued an Executive Protection Policy to YBM with a \$5,000,000 policy limit effective May 1, 1997 through May 1, 1998 ("1997 Policy").

C. 1998 RENEWAL APPLICATION AND POLICY

12. On or about April 14, 1998, YBM submitted to defendant Federal a Renewal Application for an Executive Liability and Indemnification Policy ("1998 Renewal Application"), requesting that Federal renew the Chubb policy for the period May 1, 1998 to May 1, 1999. YBM requested an increased policy limit of \$20,000,000.

13. The 1998 Renewal Application included paragraphs on "Declaration and Signature" and "False Information" as follows:

Declaration and Signature

The undersigned declares that to the best of his or her knowledge and belief the statements set forth herein are true. The undersigned agrees that this renewal application is supplemental to the original application submitted to the Company and together with that application and all attachments submitted shall be the basis of the renewal contract.

False Information

Any person, who, knowingly and with intent to defraud any insurance company or other person, files an application for insurance containing any false information, or conceals for the purpose of misleading, information concerning any fact material thereto, commits a fraudulent act, which is a crime.

Plaintiff read the "False Information" section of the 1998 Renewal Application.

14. Plaintiff signed and dated the 1998 Renewal Application on April 13, 1998.

15. Federal's renewal applications do not ask for as much information as Federal's new business applications. For instance, the renewal applications do not request the applicant to list all facts and circumstances which the applicant has reason to suppose might give rise to a claim in the future. However, when asked whether he would expect YBM to provide such information, Brad Sensibar, the underwriter responsible for acting on YBM's 1998 Renewal Application, testified that he would "expect YBM to provide any information that paints a better picture of their company as a whole, whether that is something that leads to a claim or not."

16. The 1998 Renewal Application also required YBM to attach its "[l]atest audited Annual Report (including balance sheet and income statement)." YBM submitted with the 1998 Renewal Application a copy of a document entitled "YBM Magnex international incorporated annual report 1997" ("1997 Annual Report").

17. The 1998 Policy contains a provision entitled "Representations and Severability" that states:

In granting coverage to any one of the **Insureds**, the Company has relied upon the declarations and statements in the written application for this coverage section and upon any declarations and statements in the original written application submitted to another insurer in respect of the prior coverage incepting as of the Continuity Date set forth in Item 9 of the Declarations for this coverage section. All such declarations and statements are the basis of such coverage and shall be considered as incorporated in and constituting part of this coverage section. (emphasis in original).

18. On or about July 7, 1998, based on its underwriter's analysis and recommendation, Federal issued an Executive Protection Policy to YBM and doubled YBM's policy limit to \$10,000,000 effective May 1, 1996 through May 1, 1997 ("1998 Policy").

19. The 1998 Policy is a "claims made" policy, and is triggered upon the filing of a claim against an insured. However, if during the policy period an insured becomes aware of circumstances which could give rise to a claim and gives notice of such circumstances to Federal, then any claims subsequently arising from such circumstances shall be considered to have been made during the policy period in which the circumstances were first reported to Federal.

20. The 1998 Policy provides the following coverage, up to a limit of \$10,000,000:

The Company [Federal] shall pay on behalf of each of the **Insured Persons** all **Loss** for 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** or, if exercised, during the Extended Reporting Period, for a **Wrongful Act** committed, attempted, or allegedly committed or attempted by such **Insured Person** before or during the **Policy Period**. (emphasis in original).

21. Under the 1998 Policy, it is the duty of the insured, and not the duty of Federal, to defend claims made against the insured. The Policy provides for the funding for the insured's own defense of such claims, and does so by providing coverage for any "loss" occasioned by such claims and defining "loss" to include "defense costs." "Defense costs" include the "reasonable costs, charges, fees (including but not limited to attorneys' fees and experts' fees) and expenses . . . incurred in defending or investigating Claims."

III. PLAINTIFF'S ALLEGED MISREPRESENTATIONS AND CONCEALMENT

A. MISREPRESENTATIONS AND CONCEALMENT OF INFORMATION IN THE 1996 APPLICATION

1. PLAINTIFF'S PRIOR KNOWLEDGE WARRANTY

22. In early 1996, two YBM employees who were citizens of Hungary were denied visas to reenter the United States. A representative of the State Department advised plaintiff that the visas were denied because "we have information from reliable sources that your company is involved in illegal activities."

23. Although YBM never received any subpoenas, or even informal requests, for documentation from any government agencies prior to the submission of the 1996 Application, according to a March 4, 1996 letter to plaintiff from Richard Rossman of Pepper, Hamilton & Scheetz ("Pepper Hamilton"), plaintiff had asked Pepper Hamilton "to take aggressive action to counter this adverse action being taken against YBM Magnex by the American authorities." Mr. Rossman wrote that "prompt action needs to be taken to attempt to determine if, in fact, U.S. law enforcement authorities are undertaking an investigation of the company or if the State Department is operating under a mistaken impression which must be dispelled."

24. By letter dated March 11, 1996, another Pepper Hamilton attorney wrote to plaintiff: "YBM has now heard from several sources . . . that the problem is company specific, and that there is no technical problem with the Visa, or personal problem with the Visa applicants." An accompanying draft letter

to the State Department asserted that the State Department's denial of the visas "is causing YBM substantial harm" by, among other things, "plac[ing] an unjustified cloud over YBM's reputation." The letter also noted that YBM could only speculate as to the basis of the State Department's action, and that YBM suspected that the visas were denied because of some previously dismissed court proceedings in 1995 in England regarding Arigon Co., a Channel Islands company that was a subsidiary of YBM. The accompanying letter was sent to the State Department and copied to plaintiff on or about March 14, 1996.

25. By fax dated April 4, 1996, plaintiff obtained a State Department letter dated March 20, 1996 which stated that the YBM employees had been denied visas pursuant to section 212(a)(3)(A)(ii) of the Immigration and Nationality Act. Section 212(a)(3)(A)(ii) denies visa eligibility and admission to the United States to "[a]ny alien who a consular officer or the Attorney General knows, or has reasonable ground to believe, seeks to enter the United States to engage solely, principally, or incidentally in . . . any . . . unlawful activity." 8 U.S.C. § 1182(3)(A)(ii).

26. By letter to plaintiff dated April 15, 1996 - just two weeks before plaintiff signed the 1996 Application - Pepper Hamilton forwarded a draft Complaint against the State Department which had been prepared at plaintiff's instruction. The Complaint was in an effort to obtain visas for the two YBM employees, but also "to have [YBM] removed from any 'watch lists'

maintained by the United States government" and "to compel the government to allow YBM to review (and to refute) any evidence or suspicions which the government had against YBM." The Complaint alleged "that it has been unjustly placed on a 'watch list'" and that "[t]he suspicion that YBM is involved in criminal wrongdoing has the potential to harm YBM in the future in many ways, including, but not limited to . . . depressing YBM's stock price, and triggering opportunistic securities lawsuits."

27. The State Department allegations, and other information available to plaintiff concerning those allegations, constituted "facts or circumstances which [plaintiff] . . . ha[d] reason to suppose might give rise to a future claim," given the nature of the following: (1) the State Department's allegations concerning YBM; (2) the State Department's denial of visas to YBM employees based on those allegations; and (3) communications from Pepper Hamilton which specifically drew plaintiff's attention to the possibility that the State Department allegations could depress the value of YBM stock and "trigger[] . . . securities lawsuits." As a result, plaintiff's representation in the 1996 Application that he was not aware of any such facts or circumstances was false and misleading.

2. PLAINTIFF'S REPRESENTATIONS CONCERNING INVOLVEMENT IN CRIMINAL ACTIONS

28. On June 1, 1995, in an action "In the High Court of Justice, Queen's Bench Division," London police officer John Anthony Sean Wanless submitted an affidavit in connection with a

criminal investigation of four individuals, which alleged that the various individuals, including "Semion Mogilevich," a noted member of Russian organized crime, had engaged in money-laundering in violation of United Kingdom law.

29. The affidavit identified these individuals as "criminal defendants" and specified the particular "offences" that "will be pursued" against those individuals by the Crown Prosecution Service. In addition, the affidavit alleged that YBM's wholly-owned subsidiary Arigon Company Limited "has been used as a conduit for the proceeds of crime" by Mogilevich and the other defendants. The affidavit sought a "Confiscation Order pursuant to section 71 of the Criminal Justice Act of 1988 . . . against the Defendants in the criminal proceedings," and sought an "ancillary . . . Restraint order against Arigon." The matters concerning the Confiscation Order and ancillary restraint orders were deemed to be civil, not criminal, in nature as described in a July 5, 1995 letter from the Crown Prosecution Service to defense counsel.

30. Based on Officer Wanless' affidavit, the court on June 6, 1995 ordered that "ARIGON COMPANY LIMITED be restrained . . . from dealing or attempting to deal in any way howsoever with its realisable property whether such property be situate within or without the jurisdiction"

31. By letter to YBM's and Arigon's London counsel dated June 27, 1995, plaintiff described the impact of Officer Wanless' affidavit and the restraining order as follows:

The allegations set forth in the affidavit have had a devastating impact on YBM . . . and its subsidiaries['] credibility in the United States, Canada, South America, and Europe irreparably. The freezing of Arigon Company Limited's assets have suspended our public offering proceedings and negatively impacted cash flow of both YBM Magnex, Inc. and its subsidiaries. Cash Flow constraints are effecting both the present and future of all YBM employees and shareholders.

Normal business operations are at a virtual standstill. Future merger plans have ground to a halt. As noted in the attached document . . . investment losses are more than substantial.

32. On July 14, 1995, after receiving further information from defense counsel, Officer Wanless retracted material portions of his June 5 affidavit. The proceedings against Arigon and the named defendants were then terminated by consent order on July 17, 1995. However, Officer Wanless did not withdraw his allegation that Arigon was being used as part of a money-laundering operation.

33. At a meeting of the YBM Board of Directors on April 29, 1996 - two days before the date of the 1996 Application - plaintiff "advised the board of a proposal to relocate the Company's wholly-owned subsidiary, Arigon Co. Ltd. from the Channel Islands, U.K., to the Cayman Islands." Plaintiff "explained that the rationale for such move was to bring Arigon's operations closer to the Company's North American headquarters." Plaintiff also "advised that upon the completion of such move, Arigon's name will most likely be changed to United Trade Limited."

34. At the same meeting, plaintiff also described YBM's "plans to sell Arbat International, Inc.," a Moscow based YBM subsidiary. Plaintiff explained that "the rationale for the [sale of Arbat] was that the Company's operations in Eastern Europe were difficult to supervise and exposed [YBM] to certain potential liability." By letter to plaintiff dated May 2, 1996 - one day after the date of the 1996 Application - YBM's London counsel stated that plaintiff had "asked me to arrange for the liquidation of Arigon Company Limited" and identified various steps that would need to be taken to conduct the liquidation.

35. Under an agreement executed by plaintiff and the various shareholders of Arigon - including Mogilevich - the assets and liabilities of Arigon were assigned to another YBM wholly-owned subsidiary, United Trade Limited effective April 1, 1996, and in exchange, Mogilevich and the other Arigon shareholders were issued shares in United Trade. The agreement recites that "YBM is the legal and beneficial owner of the entire issued share capital of Arigon," and does not purport to extinguish YBM's rights in Arigon.

36. Despite the criminal investigation that prompted Officer Wanless' affidavit which led to the ancillary restraining order on Arigon, said order was of a civil, not criminal, nature. Moreover, the action was dismissed over eight months before the YBM 1996 Application was submitted. Therefore, plaintiff's representation in the 1996 Application that no YBM subsidiary

"[h]as . . . been involved in . . . any . . . criminal action"
was not false.

**C. MISREPRESENTATIONS AND CONCEALMENT OF INFORMATION
IN THE 1998 RENEWAL APPLICATION**

1. 1997 ANNUAL REPORT

37. Plaintiff invoked his Fifth Amendment rights and refused to identify the 1997 Annual Report at trial. During his deposition, plaintiff refused to state whether he knew that the 1997 Annual Report would be submitted as part of the 1998 Renewal Application. The fact that his signature appears on page 45 of the 1997 Annual Report and on the 1998 Renewal Application gives rise to the inference that plaintiff knew of the Report and its contents, and was aware that the Report would be submitted as part of the 1998 Renewal Application.

38. The 1997 Annual Report contained the consolidated financial statements for the years ending December 31, 1995 through 1997. The front page of the 1997 Annual Report bears the handwritten notation "Draft". A section of the 1997 Annual Report entitled "Management's Responsibility for Financial Reporting" states:

The consolidated financial statements have been prepared in accordance with generally accepted accounting principles and include some amounts that are based on management's informed judgments and best estimates. . . . The Company's independent certified public accountants, Deloitte & Touche, have audited the Company's consolidated financial statements as described in their report.

Plaintiff's signature appears at the bottom of the page containing these statements. A copy of the 1997 Annual Report

bearing plaintiff's signature was discussed at a Board meeting attended by all directors, including plaintiff. Plaintiff did not object to the fact that his signature appeared on this page of the 1997 Annual Report.

39. The following page of the 1997 Annual Report contained a section entitled "Report of Independent Certified Public Accountants" which states:

We have audited the accompanying consolidated balance sheets of YBM Magnex International, Inc. and subsidiaries (the "Company") as of December 31, 1997 and 1996, and the related consolidated statements of operations, shareholders' equity and changes in financial position for each of the years then ended . . . which . . . have been prepared on the basis of accounting principles generally accepted in Canada In our opinion, such 1997 and 1996 financial statements present fairly, in all material respects, the financial position of the Company at December 31, 1997 and 1996, and the results of its operations and the changes in its financial position for the years then ended in conformity with accounting principles generally accepted in Canada.

This page of the 1997 Annual Report is not signed and provides space for a date: "March , 1998".

a. DELOITTE'S CONCERNS AND PLAINTIFF'S MISREPRESENTATIONS AND/OR CONCEALMENTS REGARDING THE 1997 ANNUAL REPORT

40. Deloitte was engaged to audit YBM's 1997 financial records on January 22, 1998.

41. At a Board of Directors Meeting held on February 20, 1998, Dan Gatti, YBM's Chief Financial Officer, informed the Board that "at present 80% of the Audit by D & T has been completed."

42. In the course of the audit, however, Deloitte raised concerns regarding procurement transactions pursuant to which YBM's subsidiary United Trade Limited had placed \$32 million in escrow with Swiss Union Bank Corporation, an off-shore financial agent which had ties to the other parties involved in these transactions.

43. Subsequently, on March 19, 1998, plaintiff issued several memoranda reprimanding Igor Fisherman, United Trade's Chief Operating Officer, for his actions related to the escrow arrangements. Plaintiff was aware of the seriousness of these actions, as he deemed them "unprofessional", "unconscionable", and "reckless" in his memoranda.

44. Plaintiff also knew that Deloitte would not issue an audit opinion at that time, as he noted in a fax cover sheet sent to Michael Purcell on March 20, 1998 that "YBM realizes the seriousness of the situation, which because of the issues raised has postponed sign-off of our audit."

45. On March 20, 1998, a Management Meeting was held where YBM's management discussed the fact that Deloitte was drafting its final report for the 1997 financials. On March 23, 1998, Deloitte met with YBM's Audit Committee and YBM's outside counsel and expressed concerns regarding certain YBM business partners. Deloitte responded by beginning its own investigation.

46. At the March 23, 1998 meeting, Deloitte also provided YBM's Audit Committee a one-page "Listing of Selected 1997 Contracts" ("Listing") which identified the transactions as

to which Deloitte had concerns. The Listing was divided into two categories: (1) "Procurement/Acquisition Contracts" amounting to over \$44.7 million, including the \$32.2 million worth of contracts covered by the escrow agreements described above; and (2) Resale Magnet Purchase Contracts amounting to almost \$24.2 million between United Trade and an entity identified as "SKS Group."

47. Stephen J. Coulter, an audit partner at Deloitte, testified that the dollar amounts of the contracts identified on the Listing were significant for purposes of conducting the audit of YBM because they were material amounts relative to YBM's financial statements.

48. At the conclusion of the March 23, 1998 meeting, YBM's Audit Committee held a brief meeting with most members of YBM management, including plaintiff, where it was conveyed that Deloitte wished the Audit Committee to address Deloitte's concerns with a number of transactions and that Deloitte would not render its opinion until such concerns were addressed.

49. At trial, plaintiff invoked his Fifth Amendment rights and refused to state: (1) whether he recalled receiving a copy of the Deloitte Listing on or about March 23, 1998; (2) whether as of March 23, 1998 he was aware that Deloitte had concerns about approximately \$69 million in 1997 transactions involving YBM; and (3) whether he was aware that Deloitte had taken the position that, until its concerns relating to the \$69 million dollars in contracts had been resolved, it would not sign

off on the audit. The fact that plaintiff was present at a meeting in which these issues were discussed gives rise to the inference that plaintiff knew of Deloitte's Listing and concerns with certain YBM transactions, as well as Deloitte's subsequent refusal to sign off on the audit until those concerns were addressed.

50. Shortly after he became aware of Deloitte's concerns regarding the United Trade transactions, Dan Gatti engaged in sales and purchases of YBM stock through which he realized a net gain of approximately \$510,000 by late March 1998. Mr. Gatti subsequently conducted his own review of the transactions identified by Deloitte. Based on his review, Mr. Gatti concluded and reported to the Audit Committee on or about April 7, 1998, that those transactions, among other things, "creat[ed] a condition where money can move in a circle," "created the possibility of a Foreign Corrupt Practices Act problem for [YBM]," and "could violate Russian and Ukrainian laws."

51. On April 9, 1998, YBM held a Meeting of the Board of Directors, where the YBM Board discussed the issues raised by Deloitte concerning the escrow arrangements and other transactions. Plaintiff attended a portion of the meeting where Deloitte's concerns were discussed. The following day, an interoffice memo describing a management meeting noted that YBM's management had discussed that "[n]obody can sell or buy any stock until D&T have given their report and signed off." That

determination was made just three days before the 1998 Renewal Application was signed by plaintiff and submitted with the 1997 Annual Report to Federal.

52. By letter to YBM Board member Owen Mitchell dated April 20, 1998, one week before Federal sent YBM a letter agreeing to renew the Executive Protection Policy, Deloitte raised a concern that certain individuals reputed to have ties with organized crime were associated with entities that did business with YBM. Deloitte also forwarded with the letter a "revised listing of 1997 contracts for which [Deloitte had] concerns" ("Revised Listing"). The Revised Listing identified almost \$160 million worth of United Trade acquisition, sales, and purchase contracts - including virtually all of the contracts identified in the original Deloitte Listing and more than a dozen new contracts.

53. The April 20 letter specifically stated:

[T]he information we have received to date has made us extremely concerned. Our preliminary search has found no information that confirms that certain entities involved in the transactions, including Swiss Union Bank Corp. and CBN Trust are legal entities registered to do business in Russia nor have we been able to confirm that SKS Group exists anywhere as a corporate entity.

Our preliminary search has also indicated that certain individuals associated with these entities and certain other related entities are reputed to have ties with organized crime. The information obtained heightens our serious concerns that these transactions may be bogus and are being used to cover the flow of money between these companies for other purposes.

54. The April 20 letter continued and informed YBM that Deloitte was responding to its concerns by suspending its audit of YBM.

We will not perform any further audit procedures or other services for YBM until the Committee completes its investigation and all matters are resolved to our satisfaction. Upon completion of the investigation, Deloitte & Touche will need to make a determination (i) whether it is willing to continue to be associated with YBM; (ii) whether it is able to issue an opinion on YBM's 1997 financial statements; and (iii) whether it will continue to be associated with YBM's 1996 financial statements.

We believe that it is highly unlikely that these issues can be resolved by your April 30 filing deadline. We are also concerned that you have released your 1997 earnings. Accordingly, we recommend that you consult with your securities counsel to address these issues.

55. By letter to Mr. Mitchell dated April 24, 1998, Mr Coulter of Deloitte provided additional information on entities and individuals referred to in the April 20, 1998 letter.

56. In another letter, dated April 28, 1998 - three days before the effective date of the renewed term of the Executive Protection Policy - Mr. Coulter reiterated "Deloitte & Touche LLP's concern that YBM . . . has released its first quarter 1998 earnings, because the issues relating to the transactions which occurred in 1997 have not been resolved and may impact first quarter earnings." In addition, Mr. Coulter noted Deloitte's "recommendation that you consult with your securities counsel to address the Company's need to disclose to the Ontario Securities Commission and the public that the audit of the Company's 1997 financial statements has been suspended

pending the completion of an investigation by the Audit Committee and outside counsel into certain transactions of the Company."

57. At trial, plaintiff invoked his Fifth Amendment rights and refused to answer any questions regarding the contents of Mr. Coulter's letters of April 20, 1998, April 24, 1998, and April 28, 1998.

58. Mr. Coulter wrote in a May 8, 1998 letter to YBM Board Chairman Harry Antes:

As we have indicated on several occasions and as we discussed yesterday, we are extremely concerned that the Company has issued its earnings releases for 1997 and for the first quarter 1998 but has failed to disclose that our audit has been suspended until the Company completes its investigation into the validity of certain significant transactions which took place in 1997 and which may impact those earnings. . . .

Since we first brought these transactions the Audit Committee's attention on March 23, 1998, we have not received detailed information about the scope, timing or results to date of the investigation despite discussing our concerns as to the sufficiency of the procedures on several occasions. . . .

In addition, we also recently learned that YBM has made filings with the U.S. Securities and Exchange Commission which trigger obligations under Section 10A of the Securities Exchange Act of 1934 when the auditor becomes aware of information indicating that one or more illegal acts may have occurred. We believe the information we have previously provided to you indicates that one or more illegal acts may have occurred which may have a material impact on the 1997 financial statements.

59. Deloitte never completed its audit of YBM's 1997 financial statements. On June 24, 1998, Mr. Coulter wrote to Harry Antes that upon review of the "Report of the Audit and Finance Committee - Investigation of Certain 1997 Business

Transactions" dated June 2, 1998 and appendices, the Report did not "fully address and resolve all questions and issues" raised in Deloitte's previous communications with the Audit Committee. Specifically, Mr. Coulter wrote:

The Report also does not provide sufficient competent auditable evidence for all the transactions in question. Further the Report raises additional unanswered questions and includes internal inconsistencies. We also note that the Report contains certain inaccurate statements regarding Deloitte & Touche LLP.

We have concluded, based on the questions and issues which remain after our review of the Report and the lack of competent auditable evidence, that it is unlikely that sufficient additional audit procedures could be performed which would reduce to an acceptable level the risk of material misstatement in [YBM's] financial statements for the year ended December 31, 1997 due to error or fraud.

Mr. Coulter concluded his letter by alerting Mr. Antes that Deloitte would not be able to report on YBM's 1997 financial statements and thereby resigned as YBM's auditor effective immediately.

60. The findings set forth in the above paragraphs establish that at the time of the 1998 Renewal Application, plaintiff knew: (a) that Deloitte had not completed its audit of YBM's 1997 Annual Report; (b) that Deloitte would not complete its audit until and unless YBM satisfactorily investigated and addressed the concerns raised by Deloitte; (c) that YBM had not addressed those concerns to Deloitte's satisfaction; (d) that the total value of the transactions questioned by Deloitte had grown from \$32.2 million in early March 1998 to \$68.9 million on March

23, 1998, to almost \$160 million on April 20, 1998; (e) that YBM's own Chief Operating Officer had engaged in "reckless" conduct with respect to \$32.2 million worth of the transactions questioned by Deloitte; and (f) that he had not alerted defendant Federal of any of these concerns.

61. Plaintiff's representations in the 1998 Renewal Application and the accompanying materials: (1) that the 1997 Annual Report constituted YBM's "[l]atest audited Annual Report"; (2) that "[t]he Company's independent certified public accountants, Deloitte & Touche, have audited the Company's consolidated financial statements as described in their report;" and (3) that the financial statements contained in the 1997 Annual Report fairly represented YBM's financial condition, were false when made. Contrary to his representations, plaintiff knew at the time of the 1998 Renewal Application that Deloitte had questioned substantial quantities of YBM transactions and had refused to complete its audit of YBM's 1997 financial statements because YBM had not addressed Deloitte's concerns regarding those transactions.

b. FEDERAL'S RELIANCE ON THE 1997 ANNUAL REPORT

62. On or about April 21, 1998, following Federal's receipt of the 1998 Renewal Application, Brad Sensibar prepared a "For Profit Worksheet" based on the 1997 Annual Report, including financial information found in the Report.

63. Mr. Sensibar reviewed the 1997 Annual Report, including the provision entitled "Management's Responsibility for Financial Reporting." Based on his reading of the language of the provision and plaintiff's signature underneath it, Mr. Sensibar understood that YBM management, including plaintiff, was responsible for the preparation, objectivity, and integrity of the consolidated financial statements and other information contained in the 1997 Annual Report. Mr. Sensibar also believed the Report to have been audited by Deloitte & Touche because of the provision's representations. Mr. Sensibar even indicated on the For Profit Worksheet that Deloitte had issued an "unqualified" audit opinion in March 1998 with respect to the financial statements contained in the Report.

64. As a result of reviewing the financial information in the 1997 Annual Report that was submitted with the 1998 Renewal Application, Mr. Sensibar set forth his conclusions in the For Profit Worksheet as follows:

Results seem to be solid. Liquidity and current ratio appear to be in good shape. Retained earnings and equity seem strong. Net income grew at a good rate. Margin is good. Cashflow from operations is strong while long term debt, although it has grown seems to be very manageable in comparison. Overall financial condition seems to be in very good shape.

65. On or about July 7, 1998, based on Mr. Sensibar's underwriting, analysis, and recommendation, Federal issued the 1998 Policy and doubled YBM's policy limit to \$10,000,000.

66. Mr. Sensibar was never informed before May 1, 1998, the effective date of the 1998 Policy, that Deloitte had

not signed off on its audit of YBM. If he had been so informed, Mr. Sensibar would have questioned why Deloitte had not signed off on the audit. Mr. Sensibar testified that while an audited annual report is preferred and that he would want to see an audited report, he would not flat out reject an unaudited report.

67. Mr. Sensibar was also never informed prior to May 1, 1998 that Deloitte had questioned \$67 million in transactions, including \$32 million in transactions that plaintiff himself believed were unprofessional, reckless, and in violation of the company's established policy and practices. If Mr. Sensibar had been so informed, he would not have issued a policy to YBM.

68. If Mr. Sensibar had been informed that Deloitte had concerns about \$160 million in transactions and was not going to sign off on the audit until those concerns were resolved, he would not have issued a policy to YBM.

69. At trial, plaintiff invoked his Fifth Amendment rights and refused to state whether he understood at the time the 1998 Renewal Application was submitted that having accurate financial statements was material to an assessment of the insurance risk and to the issuance of the 1998 Policy.

2. UNITED STATES JUSTICE DEPARTMENT INVESTIGATION OF YBM

70. By letter to plaintiff dated June 6, 1996, Peter Hearn, a Philadelphia Attorney, confirmed that he had agreed to "represent YBM in an aspect of its current 'suspected criminal activity' problem with the U.S. Department of State." Mr. Hearn

wrote that he would "act as co-counsel with Messrs. Rossman and Adler of Pepper, Hamilton & Scheetz" in this matter and would be responsible for "the preparation and making of a presentation to U.S. Senator Arlen Specter."

71. By letters to Mr. Hearn dated June 29, 1996 and July 2, 1996, copies of which were sent to plaintiff, Aaron Krauss of Pepper Hamilton forwarded memoranda concerning "the United States government's interest in YBM."

72. According to the memorandum entitled "FACTS RELATING TO THE UNITED STATES GOVERNMENT'S INTEREST IN [YBM] OF WHICH [YBM] IS AWARE," the State Department had informed YBM "that there is a 'large Justice Department file on YBM'" and that "it is the Justice Department, rather than any of the United States' intelligence agencies, which ha[s] an 'interest' in YBM."

73. According to another of the memoranda attached to Mr. Krauss' July 2, 1996 - entitled "STEPS WHICH [YBM] HAS TAKEN AS A RESULT OF THE UNITED STATES GOVERNMENT'S SCRUTINY OF THE COMPANY." - YBM took steps that included, among other things: "perform[ing] an internal investigation;" divest[ing] itself of its interest in its Russian subsidiary, Arbat International;" "divest[ing] itself of its interest in its U.K. subsidiary, Arigon Company Limited;" "retain[ing] legal counsel in the United States to investigate the reasons for the Government's interest in YBM;" and "offer[ing] to make its books and records available to the Department of State or the Justice Department."

74. By letter to plaintiff dated August 7, 1996, Mr. Hearn advised plaintiff that Senator Specter's office had declined to assist YBM because "it was the Senator's established policy not to discuss current Justice Department investigations." Mr. Hearn wrote plaintiff that he was further advised "to contact the FBI in Philadelphia." The letter went on to note that Mr. Hearn had requested a meeting with the United States Attorney in Philadelphia, Michael Stiles, but Stiles said that "he could not meet and that any offer of testimony [from YBM] would not be welcome" and that "a 'highly sensitive investigation' was involved."

75. On August 20, 1996, at a Special Meeting of the YBM Board, which plaintiff attended, the Board formed a special committee ("Special Committee") to investigate areas of concern and report back to the Board.

76. A November 1, 1996 interim Report of the Special Committee to the Board of Directors of YBM, which plaintiff reviewed and with which he was in agreement with its factual content and its recommendations, noted that on August 15, 1996 YBM management advised the YBM Board during a Board meeting that YBM management was made aware "of a pending investigation of the Company and its activities through U.S. Attorney's office in Philadelphia." The Report also outlined several possible sources for the investigation, including a "disgruntled former employee who had threatened the Company with financial harm," the "past employment of a number of employees in the CatchDisk department

with security agencies of the Former Soviet Union and the possible concerns the U.S. may have about national security sensitive encoding technology," and "[g]eneral concerns surrounding the trade goods business with Russia undertaken by Arbat and the difficulties in tracking this business from a control and reporting basis."

77. According to the November 1, 1996 report of the Special Committee, although the focus of the U.S. Attorney's Office's investigation of YBM was not disclosed, discussions with YBM counsel confirmed that "U.S. law enforcement agencies had placed a priority on uncovering infiltration of Organized Crime from the Former Soviet Union into U.S. business." The Report further states that "[g]iven the roots of YBM and its affiliates in Russia and the involvement of former Russian nationals as shareholders and managers of the Company, it was viewed to be a reasonable expectation that this would be the basis of such investigation." The Report concluded that "the potential seriousness of the allegations mandate further investigation."

78. With his letter to Mr. Rossman dated December 19, 1996, plaintiff forwarded an additional letter "To the Founding Shareholders of YBM Magnex International and Subsidiaries." The letter to the shareholders states:

This letter serves to inform you of events that are currently unfolding in the United States and Canada that could destroy our company in a short period of time if not addressed immediately.

As you may know, during 1996 management became aware that the United States government was performing an investigation into our company.

The letter refers to a deposition given by an FBI agent which asserted that an alleged "major Russian crime figure" had used Arbat - the former YBM subsidiary - "to conduct his criminal activities and launder criminal proceeds."

79. The letter further states:

We are aware that references to our company and alleged ties to organized crime have appeared in newspaper and magazine articles. However, this is the first documented evidence from authorities in the United States of this suspicion.

The letter goes on to outline several facts YBM management had confirmed, as well as the fact that within the last 60 days, Ernst & Young "has refused to do business with [YBM] and has resigned as auditors of Schwinn Csepel," "Dean Witter has asked that all YBM stock be removed from all accounts (regardless of citizenship)," "Ernst & Young in the Cayman Islands refuses to act as registered office for United Trade," and that YBM was "being asked to close affiliated accounts in off-shore banks."

80. The letter also noted that:

Our western securities lawyers tell us that we are very close to having an obligation to disclose these allegations to the general public. If this were to happen, our stock could be worthless in a short period of time. Since you are now informed about these allegations, we encourage you to avoid selling any YBM stock until these issues are resolved or risk prosecution under insider trading laws.

The letter asked each of its recipients to complete an enclosed "Questionnaire" concerning, among other things, their relations

with specified individuals and their knowledge "of any criminal activity conducted by any shareholder, officer, employee or sales representative of our companies."

81. The FBI affidavit referenced in plaintiff's December 19, 1996 letter describes the activities of Vyacheslav Kirillovich Ivankov, a leader of Russian organized crime who "belongs to an elite group of high-level criminals known in the Soviet Union and its successor states as 'thieves in law'." The affidavit alleges that:

Among the front companies that IVANKOV uses to conduct his criminal activities and launder criminal proceeds are . . . "Arbat International," which is also based in Moscow. IVANKOV uses Arbat to transmit large sums of money from Moscow to a company in Budapest, Hungary overseen by "Seva" Mogilevich, one of IVANKOV's closest associates.

82. YBM sold Arbat in the spring of 1996. Plaintiff explained to the YBM Board that "the rationale for the [sale of Arbat] was that the Company's operations in Eastern Europe were difficult to supervise and exposed [YBM] to certain potential liability. However, on the date of the FBI affidavit - March 31, 1995 - Arbat was a YBM subsidiary, and so the allegations in the affidavit relate to the period when Arbat was part of YBM.

3. THE FAIRFAX GROUP INVESTIGATION AND REPORTS

83. On or about November 8, 1996, YBM retained the Fairfax Group, Ltd., a private investigative firm, to assist the Special Committee in its investigations. According to its subsequent report, the Special Committee asked the Fairfax Group to, among other things: "[d]iscover if possible more details on

the 'ongoing investigation' of YBM by U.S. law enforcement authorities, and "provide background checks on YBM management and the Founding Shareholders." The Fairfax Group retainer agreement specifically provided that the Fairfax Group was being retained "in contemplation of potential future litigation."

84. On or about December 3, 1996, Philip Stern, Fairfax Group's Senior Managing Director and the Project Manager for the YBM engagement, prepared a memorandum summarizing "the facts and circumstances surrounding the YBM investigation up to the point [the Fairfax Group] got involved." The memorandum, which includes a chronology of events supplied by Pepper Hamilton, notes that YBM management believed that there is either: (1) an "illegal technology transfer investigation;" (2) a "national security inquiry concerning employees or shareholders;" or (3) a "criminal investigation involving money laundering/Russian Mafia." Mr. Stern obtained this information through discussions with Pepper Hamilton and YBM management, including plaintiff.

85. The first phase of the Fairfax Group investigation involved determining "what government agencies were investigating YBM and what they were looking at in specifics." With respect to this assignment, the Fairfax Group confirmed "that there were investigations directed at YBM" and determined through "sources in several agencies of the [U.S. Government]" that "the issues" in those investigations "involved national security and organized crime."

86. YBM also asked the Fairfax Group to conduct "background checks" on certain shareholders of the company to determine whether they "had affiliations with organized crime in the Soviet Union." In the course of its investigation, the Fairfax Group "confirmed and reported that [those individuals] had involvement with organized crime groups in the Soviet Union."

87. In March 1997, the Fairfax Group prepared written reports concerning the results of its investigation. The information that the Fairfax Group had obtained concerning the involvement of YBM's original shareholders in organized crime was set forth in a report labeled "Outline for Presentation on March 21, 1997" ("Fairfax Outline"). With respect to its sources, the Fairfax Outline notes:

I should say a word about the degree of confidence we have in the information we have obtained. With regard to our confidential sources, first of all they are sources we have used in the past and who have proven records of access and reliability. Secondly, the convergence of the substance of the reporting from sources reporting independently from four different countries is striking. There has not been a single divergence in this reporting. Each report has consistently reinforced and corroborated the others. This is particularly true with regard to the original investors and their backgrounds. Thirdly, the research conducted in the United States relies on official data bases at the state and county levels of local government.

88. The Fairfax Outline states:

The original investors included the following persons:

- Semion Mogilevich
- Anatoly M. Kulachencko
- Vitali Leibya
- Semion Ifraimov
- Alexandr Alexandrov
- Alexei Alexandrov

Each of these persons has been confirmed as not only members of Russian organized crime, but all have been identified as belonging to the Russian organized crime syndicate called Solntzevskaja or Solntzevo, the area in Moscow where it originated. . . .

The organization i[s] involved in narcotics sales and transport, general smuggling activities, money laundering, automobile theft and sales, protection rackets, clothing sales and prostitution. . . . One or more reliable sources has reported that the organization owns or controls companies in Russia, Belgium, the UK, Hungary, and Israel. The companies this source named in its reporting are:

- Arbat in Russia
- Arigon in the UK
- "Magnek" in Hungary, and
- Sunny Investment in Israel.

As noted above, Arbat and Arigon were former subsidiaries of YBM.

89. The Fairfax Outline, which the Fairfax Group prepared in connection with a March 21, 1997 presentation by the Fairfax Group to the YBM Board in Toronto, also was used during a March 22, 1997 meeting in Philadelphia attended by Mr. Stern, plaintiff, and other Fairfax Group and YBM personnel. In particular, the information contained in the Fairfax Outline concerning the U.S. Government's investigation of YBM and the original shareholders' involvement in organized crime was conveyed orally to plaintiff and the other attendees and discussed during the March 22, 1997 meeting. Notes taken by attendees at the meeting include specific references to this information.

90. During the March 22, 1997 meeting, in discussing options based on a threat of zero value of outstanding stock to original investors, the Fairfax Group made recommendations to

both the YBM Board and to YBM Management regarding "options that were available [dealing] with purchasing or getting those original shareholders out of the Company." Mr. Stern testified that "one of the things we had in our minds was that the stock would be virtually worthless if they didn't withdraw and the company had some problems with the government agencies investigating it and therefore, it would be in their interest to sell or get out of the company."

91. When asked why he thought YBM's stock would become worthless, Mr. Stern answered:

A public company that had organized crime we believe, or what we believe to have organized crime members as shareholders, that stock would have very little value if that information came out.

This information was also provided to plaintiff and others attending the March 22, 1997 meeting as part of the Fairfax Group's recommendations.

92. In an April 2, 1997 report, the Special Committee discussed certain of Fairfax Group's findings. Although the conclusions of the Special Committee included that "neither Fairfax nor the Committee has discovered any evidence that senior management of YBM is in any way involved in any illegal or improper activities" and that "Jacob Bogatin is completely committed to the business and is entirely focused on the growth and future success of YBM," under a section entitled "Most Significant Concern," the Committee noted that "the Board and management are very concerned that significant payments were made

from Arbat, a former subsidiary of YBM, to organized crime figures in Eastern Europe and that the basis for these payments, commission on trade goods sales, appears to be insupportable."

93. The report went on to state that Fairfax's review through its contacts identified Arbat as an alleged vehicle for criminal ends" and that "[u]nfortunately, despite the fact that Arbat has been sold and YBM no longer is involved in any way in its activities, ties remain." On page 2 of the report, the Committee identified that "the greatest threat to the Company would be an investigation which questioned the legitimacy of its core business. This legitimacy could be brought into question if employees or shareholders of the company were found to be involved in organized crime or if 'artificial' transactions were occurring."

94. On or about April 9, 1997, YBM Director Owen Mitchell sent a copy of the Special Committee's report to Mr. Stern. The Fairfax Group made a number of hand-written changes to the report and returned the marked-up copy to Mr. Mitchell. Among those changes was the following change to the sentence found on page 2 of the report as noted in the previous paragraph: the term "in organized crime" was circled, and a line was drawn from the circle to a note in the margin which states "they are." Mr. Stern testified at trial that the note "reflects [the Fairfax Group's] belief that, in fact, those shareholders were members of organized crime."

95. The Special Committee's report referenced the company's effort to acquire a Kentucky corporation called Crucible Magnetics, Inc. and recommended that YBM management be directed to [a]dvice the underwriters financing the acquisition of Crucible as to the background and results of this investigation." Those "underwriters" included First Marathon Securities Limited, a company headed by YBM Director and Special Committee member Owen Mitchell.

4. INS FRAUD INVESTIGATION

96. On March 17, 1998, Helena Astolfi, an attorney at Pepper Hamilton, forwarded to plaintiff a letter dated March 9, 1998 from Kevin O'Neil, an official of the U.S. Immigration and Naturalization Service, requesting that YBM "provide the Immigration Service with a complete list of non-immigrant and immigrant alien company employees." Mr. O'Neil represented that the request was "[i]n an earnest effort for Special Agent Ernest Gresco to clarify the status of pending unadjudicated petitions filed by YBM." Ms. Astolfi's letter to plaintiff that accompanied the March 9 letter noted that the INS letter "reaffirms Agent Gresco's position that the INS requires additional information prior to concluding the YBM investigation."

97. By letter dated March 30, 1998, Ms. Astolfi wrote to Mr. O'Neil that during a meeting with INS Agent Gresco on November 17, 1997, "he informed me that he was conducting a fraud investigation of YBM." Plaintiff was carbon copied on Ms.

Astolfi's March 30, 1998 letter - approximately two weeks before he signed the 1998 Renewal Application.

5. MATERIALITY OF THE MISREPRESENTATIONS AND CONCEALMENT IN THE 1998 RENEWAL APPLICATION

98. Brad Sensibar testified that prior to issuance of the 1998 Policy, or in connection with receipt of the 1998 Renewal Application, he was not informed of the following: (1) that YBM was under investigation by the Department of Justice with respect to national security and organized crime concerns; (2) that plaintiff believed that the Department of Justice investigation could destroy the company; (3) that plaintiff believed that if the allegations relating to the FBI investigation became public, the Company's stock would become worthless in a short period of time; or (4) that YBM was the subject of a fraud investigation by the Immigration and Naturalization Service. Mr. Sensibar testified that had he known of any of the aforementioned facts, he "would not have issued a policy."

99. Mr. Sensibar also testified at trial that one of the pieces of information that would have caused him to refuse the 1998 Policy was that YBM had been informed that U.S. law enforcement authorities were conducting investigations of YBM. Mr. Sensibar went on to note that even if he did not know anything about the investigations, "[i]t's a standard practice that if there is law enforcement investigations [sic], something that serious, . . . [defendant Federal] wouldn't want to issue a

policy without knowing about it so, therefore, I would not issue a policy."

100. Mr. Sensibar stated that he was never informed prior to the application and issuance of the 1998 Policy that a private investigative firm hired by YBM's Board had confirmed that the founding shareholders of YBM were members of a Russian organized crime syndicate. Had he been so informed, Mr. Sensibar "would have run like hell the other way. [He] would not have issued a policy." Mr. Sensibar further noted that "[i]t's a huge red flag when you see the words 'organized crime' so, therefore, I would not want to issue a policy."

101. Mr. Sensibar also testified that he would expect the information outlined above to be disclosed by an insured pursuant to the "False Information" provision on the second page of the 1998 Renewal Application. Although the particular paragraph on the 1998 Renewal Application concerning "False Information" does not specifically request the applicant to disclose any information that might give rise to a claim in the future, Mr. Sensibar testified that he believes it is implied.

102. At trial, plaintiff invoked his Fifth Amendment rights and refused to state whether he understood that any of the foregoing information "was material to an assessment of the insurance risk or to the issuance of an insurance policy." In light of Mr. Sensibar's unrefuted testimony as to the materiality of such information and plaintiff's own documented statements concerning the potential impact of that information on YBM,

plaintiff's refusal to testify on these subjects supports the adverse inference that plaintiff understood that such information would be material to defendant Federal's underwriting decision.

IV. EVENTS FOLLOWING THE ISSUANCE OF THE 1998 POLICY

103. On May 13, 1998, less than two weeks after the effective renewal date of the 1998 Policy, representatives of various United States law enforcement agencies, including the FBI and INS, executed a search warrant at YBM's headquarters in Newtown, Pennsylvania.

104. In the course of the search, law enforcement officials seized from a safe in plaintiff's office original YBM stock certificates for hundreds of thousands of shares issued to, among other persons, Semion Mogilevich, Semion Ifraimov, Alexandr Alexandrov, and Alexei Alexandrov - all of whom the Fairfax Group had "confirmed as . . . members of Russian organized crime." Plaintiff had obtained these stock certificates, as well as stock certificates issued in the name of Anatoly Kulanchenko - another shareholder identified as a member of Russian organized crime - after the certificates were released by an escrow agent in January 1997. At the same time, plaintiff had obtained powers of attorney for the shareholders identified as members of Russian organized crime.

105. YBM did not inform defendant Federal of the May 13, 1998 search prior to the date the 1998 Policy was issued. The first notice defendant received was in November 1998, when Federal's claim department received a letter from plaintiff's counsel seeking coverage for an investigation by federal authorities relating to YBM.

106. On June 7, 1999, YBM pled guilty to a one-count criminal information with a multi-object conspiracy to commit mail fraud and securities fraud. In support of the guilty plea, the government submitted a memorandum stating that from 1993 through May 1998:

YBM and its conspirators engaged in a complex fraudulent scheme to artificially inflate the value of YBM stock by creating the false appearance of record sales, high revenues, and substantial profits from the manufacture and distribution of industrial magnets and other YBM products worldwide. In its annual reports, press releases and public filings with the securities regulators in the United States and Canada, YBM made numerous material misrepresentations and omissions regarding, among other things, its management, ownership, the extent and nature of its business operations and its financial condition.

107. As part of its Guilty Plea Agreement, YBM admitted that it engaged in a:

conspiracy involving, among other things, YBM's creation, use and dissemination of false and misleading fraudulent statements between approximately 1993 and May 1998, including YBM's Annual Reports, press releases, prospectuses, public filings (Form 40-F) and periodic reports (Form 6-K) submitted to the SEC, which contained material misstatements and omissions, and YBM's engaging in acts and practices which operated as a fraud in connection with the offer, purchase and sale of YBM securities.

V. ACTIONS FOR WHICH PLAINTIFF SEEKS COVERAGE

A. THE CRIMINAL INVESTIGATION

108. By letter to plaintiff dated November 16, 1998, the U.S. Attorney for the Eastern District of Pennsylvania (the "U.S. Attorney") notified plaintiff:

You are presently a target of a grand jury investigation concerning, among others, violations of Title 18, United States Code, § 1962 (RICO), Title 18,

United States Code, §§ 1956, 1957, Money Laundering, and Title 15, United States Code, §§ 77 and 78, Securities Fraud, arising from your involvement with YBM Magnex International, Inc., its subsidiaries and affiliates, and your association with Semion Mogilevich, a/k/a "Seva."

109. By letter dated November 16, 1998, plaintiff's counsel notified defendant "that federal law enforcement are conducting a formal investigation related to YBM" ("Criminal Investigation") and asserted that the investigation constituted a "claim within the meaning of the policy." In response, by letter dated December 16, 1998, defendant notified plaintiff that "[a]fter careful review, Federal has concluded that there is no coverage for the allegations contained in the documentation as presently submitted" and that "the Criminal Investigation did not constitute a "Claim" within the meaning of the Policy and would not constitute a Claim "until the grand jury returns an indictment against Insured Persons." Federal also reserved its rights under the Policy and at law to assert additional grounds for denial, "including representations and omissions in connection with the application."

110. The 1998 Policy only provides coverage for "**Loss** . . . which the **Insured Person** becomes legally obligated to pay on account of any **Claim** first made against him" during the policy period. The Policy's definition of "Claim" is limited in relevant part to "civil proceeding[s] commenced by the service of a complaint or similar pleading . . . [and] criminal proceeding[s]"

commenced by a return of an indictment . . . against any **Insured Person.**"

111. Because the Criminal Investigation has not resulted in the return of an indictment against plaintiff, it does not constitute a Claim for which coverage is available under the Policy.

112. The 1996 Application, which the 1998 Application and the 1998 Policy incorporate by reference, provides that, in the event any "person proposed for coverage is aware of any facts or circumstances which he or she has reason to suppose might give rise to a future claim that would fall within the scope of the proposed coverage," "any claim arising from them is excluded" from coverage ("Prior Knowledge Exclusion").

113. The Criminal Investigation arises from the following facts or circumstances of which plaintiff was aware at the time of the 1996 Application and which plaintiff had reason to suppose might give rise to a future claim: (1) the State Department's belief that YBM was involved in illegal activities; (2) allegations and investigations of the involvement of Arigon, YBM's wholly-owned subsidiary, in a money-laundering scheme; (3) YBM's lack of control over the operations of Arbat, YBM's wholly-owned subsidiary; and (3) Semion Mogelivich's role in the operations of YBM or its subsidiaries. As a result, regardless of whether it results in a Claim as defined in the 1998 Policy, the Criminal Investigation would fall within the Prior Knowledge Exclusion specified in the 1996 Application.

B. THE PENNSYLVANIA CLASS ACTION LITIGATION

114. On December 11, 1998, plaintiff was named as a defendant in a securities class action lawsuit. Over the next few months, another four class actions were filed against plaintiff and other YBM directors and officers and later consolidated in the Eastern District of Pennsylvania in this Court in an action styled Paraschos, et al. v. YBM Magnex International, Inc., No. 98-CV-6444 (E.D. Pa.) ("Pennsylvania Class Action Litigation").

115. The plaintiffs in the Pennsylvania Class Action Litigation allege that during the period of January 19, 1996 (three months prior to the inception of the 1996 Policy) to May 14, 1998, plaintiff violated Sections 10(b) and 20(a) of the Securities Exchange Act and SEC Rule 10b-5 by knowingly or recklessly employing devices, schemes, and artifices to defraud and engaging in acts, practices, and a course of business which operated as a fraud and deceit upon the purchases of YBM securities, and engaged in insider trading.

116. Section 6(c) of the 1998 Policy excludes coverage for "any **Claim** . . . based upon, arising from, or in consequence of [any] **Insured Person** having gained in fact any personal profit, remuneration or advantage to which such **Insured Person** was not legally entitled" ("Personal Profit Exclusion").

117. The Pennsylvania Class Action Litigation is based upon, arises from, or is in consequence of plaintiff's having gained in fact a personal profit, remuneration or advantage to

which plaintiff was not legally entitled, including profits from the sale of YBM stock. As a result, the Pennsylvania Class Action Litigation falls within the Personal Profit Exclusion specified in Section 6(c) of the 1998 Policy.

118. The Pennsylvania Class Action Litigation also arises from the following facts or circumstances of which plaintiff was aware at the time of the 1996 Application and which plaintiff had reason to suppose might give rise to a future claim: (1) the State Department's belief that YBM was involved in illegal activities; (2) allegations and investigations of the involvement of Arigon, YBM's wholly-owned subsidiary, in a money-laundering scheme; (3) YBM's lack of control over the operations of Arbat, YBM's wholly-owned subsidiary; and (4) Semion Mogilevich's role in the operations of YBM or its subsidiaries. As a result, the Pennsylvania Class Action Litigation falls within the Prior Knowledge Exclusion specified in the 1996 Application.

C. THE CANADIAN CLASS ACTION LITIGATION

119. Plaintiff has been named as a defendant in a Canadian class action styled Mondor v. Fisherman, Court File No. 98-GD-4545 (Ontario Court, General Division). The Mondor action alleges that plaintiff made intentional misrepresentations concerning YBM's business in order to further his personal interests and gain. Plaintiff has not been served with a copy of this complaint.

120. The 1998 Policy only covers civil proceedings which have been "commenced by the service of a complaint or similar pleading." As a result, because plaintiff has not been served in the Mondor action, that action does not constitute a Claim for which coverage is available under the 1998 Policy.

121. Plaintiff also has been named as a defendant in a Canadian class action styled Royal Trust Corporation of Canada v. Fisherman, Court File No. 99-GD-46096 (Ontario Court, General Division). The Royal Trust action alleges that plaintiff made intentional misrepresentations concerning YBM's business in order to further his personal interests and gain.

122. The Mondor and Royal Trust actions are based upon, arises from, or in consequence of plaintiff's having gained in fact a personal profit, remuneration or advantage to which plaintiff was not legally entitled, including profits from the sale of YBM stock. As a result, both actions fall within the Personal Profit Exclusion specified in Section 6(c) of the 1998 Policy.

D. THE YBM RECEIVER'S ACTION

123. Plaintiff has been named as a defendant in an action brought by Ernst & Young YBM, Inc., which was appointed as YBM's bankruptcy receiver ("YBM Receiver"), styled YBM Magnex International, Inc. v. Bogatin, Court File No. 99-CL-3424 (Ontario Court, General Division) ("YBM Receiver's Action"). The YBM Receiver's Action alleges that plaintiff engaged in insider trading and tipping in violation of the Canadian Securities Act.

124. Section 5(c) of the Policy excludes coverage for "any **Claim** . . . brought or maintained by or on behalf of any **Insured** except: . . . a **Claim** that is a derivative action brought or maintained on behalf of an **Insured Organization** by one or more persons who are not **Insured Persons** and who bring and maintain the **Claim** without the solicitation, assistance or participation of any **Insured**." The 1998 Policy's definition of "**Insured**" includes the "**Insured Organization**," YBM Magnex International, Inc. Thus, because the YBM Receiver's Action names as the plaintiff "YBM Magnex International, Inc. by its Receiver and Manager Ernst & Young YBM Inc.," it is an action "brought or maintained by or on behalf of an[] **Insured**" that is not covered by any of the provided exceptions and coverage for the YBM Receiver's Action is precluded by Section 5(c) of the Policy.

125. Section 6(a) of the 1998 Policy provides that defendant shall not be liable on account of any "Claim" made against any "Insured Person", "for an accounting of profits made from the purchase or sale by such **Insured Person** of securities of the **Insured Organization** within the meaning of Section 16(b) of the Securities Exchange Act . . . or similar provisions of any federal, state or local statutory or common law." The YBM Receiver's Action seeks "an accounting pursuant to section 134(4) of the Securities Act, R.S.O. 1990, c.S.5, as amended . . . for every benefit or advantage received or receivable by each of the Defendants as a result of their purchase, sale or communication, as the case may be, of or in respect of the securities of YBM

Magnex International, Inc.” Section 134(4) of the Securities Act of Ontario is a “local statutory law of a similar nature to the Securities Act of 1934.”

126. In addition, the YBM Receiver’s Action is based upon, arises from, or is in consequence of plaintiff’s having gained in fact a personal profit, remuneration or advantage to which plaintiff was not legally entitled, including profits from the sale of YBM stock. As a result, the YBM Receiver’s Action falls within the Personal Profit Exclusion specified in Section 6(c) of the Policy.

E. THE ONTARIO SECURITIES COMMISSION ACTION

127. Plaintiff has been named as a defendant in an action brought by the Ontario Securities Commission styled In the Matter of the Securities Act and YBM Magnex International, Inc. (Ontario Securities Commission) (“OSC Action”). The OSC Action alleges that plaintiff made intentional misrepresentations concerning YBM’s business.

128. The OSC Action arises from the following facts or circumstances of which plaintiff was aware at the time of the 1996 Application and which plaintiff had reason to suppose might give rise to a future claim: (1) the U.S. government’s belief that YBM was involved in illegal activities; (2) allegations and investigations of the involvement of Arigon, YBM’s wholly-owned subsidiary, in a money-laundering scheme; (3) YBM’s lack of control over the operations of Arbat, YBM’s wholly-owned subsidiary; and (4) Semion Mogilevich’s role in the operations of

YBM or its subsidiaries. As a result, the OSC Action falls within the Prior Knowledge Exclusion specified in the 1996 Application.

VI. THE COVERAGE INVESTIGATION

129. In the course of its investigation of requests for coverage by plaintiff and other former YBM officers and directors, defendant requested that plaintiff and the other former YBM officers and directors actively seeking coverage under the 1998 Policy submit to interviews by Federal. Defendant's request for interviews was made in accordance with Section 10 of the Policy, which provides that:

The **Insureds** shall, as a condition precedent to exercising their rights under this coverage section, give to the Company such information and cooperation as it may reasonably require, including but not limited to a description of the **Claim** or circumstances, the nature of the alleged **Wrongful Act**, the nature of the alleged or potential damage, the names of actual or potential claimants, and the manner in which the **Insured** first became aware of the **Claim** or circumstance.

130. Plaintiff refused to submit to an interview by defendant. Everyone else seeking coverage agreed to submit to an interview and did, in fact, provide an interview to defendant. Plaintiff's refusal to submit to an interview cut off a very important source of information because defendant had substantial documentation that provided many bases for believing that plaintiff had significant knowledge about events and circumstances that he had not disclosed to Federal.

131. While the other YBM directors and officers were willing to submit to interviews, plaintiff was in a unique

position because his experience with the company went back to the origins of the company, documents revealed that he had significant tenure with the company, and documents showed that he had stronger relationships than any other insured persons with Mr. Semion Mogilevich. Consequently, plaintiff's refusal to submit to an interview prevented defendant from having as complete an understanding as it would like to have had about the claims it was asked to cover.

CONCLUSIONS OF LAW

I. ADVERSE INFERENCES MAY BE DRAWN AGAINST PLAINTIFF WITH RESPECT TO MATTERS ON WHICH HE REFUSED TO TESTIFY

1. "It is . . . settled law that a civil litigant's assertion of the Fifth Amendment permits an adverse inference against the litigant with respect to the matter for which the privilege is claimed." Aetna Cas. & Sur. Co. v. State Farm Mut. Auto. Ins. Co., 771 F.Supp. 704, 708 (W.D. Pa. 1991), aff'd, 961 F.2d 207 (3d Cir. 1992).

2. Because there is independent evidence, including documentary evidence, consistent with and supporting such an inference, defendant Federal is entitled to an adverse inference against plaintiff with respect to those questions which he refused to answer on Fifth Amendment grounds. United States v. Stelmokas, 100 F.3d 302, 311 (3d Cir. 1996), cert. denied, 520 U.S. 1242 (1997) (citing Baxter v. Palmigiano, 425 U.S. 318 (1976)).

II. RESCISSION OF THE 1998 POLICY

3. Plaintiff argues that as a claims made policy, defendant is obligated to advance his defense costs. Plaintiff relies on Little v. MGIC Indemnity Co, 836 F.2d 789 (3d Cir. 1987), to assert that defendant cannot withhold defense costs during a pending coverage dispute.

4. Defendant, however, argues that based on plaintiff's knowing misrepresentations and concealment of material information on YBM's insurance applications, the 1998 Policy should be rescinded as to plaintiff, and therefore, there should be no policy available to him. Defendant contends that said misrepresentations and concealment are not the same issues to be tried in the underlying cases which constitute plaintiff's insurance coverage claims.

5. This Court agrees with defendant and finds that plaintiff's alleged misrepresentations and concealment on YBM's insurance applications do not constitute the same issues to be tried in the underlying claims for which he seeks insurance coverage and defense costs. Defendant alleges plaintiff made fraudulent misrepresentations to and concealed material information from the insurer in obtaining the insurance policies at issue. Such acts constituting the alleged misrepresentations and concealment present a separate issue to be determined by this Court with respect to rescission of the 1998 Policy. Therefore, this Court is in a position now to determine whether plaintiff's representations made in YBM insurance policies were in fact

fraudulent, irrespective of whether plaintiff may be found to be guilty of or liable for the allegations presented in the underlying claims.

6. Consequently, since Pennsylvania law holds that an insurance policy is void ab initio for misrepresentation when the insurer can establish that the insured knowingly or in bad faith made a false representation which was material to the risk being insured, see Matinchek v. John Alden Life Ins. Co., 93 F.3d 96 (3d Cir. 1996), and to the extent that a rescission amounts to the unmaking of the policy and is not merely a termination of the rights and obligations of the parties towards each other, but an abrogation of all rights and responsibilities of the parties towards each other from the inception of the policy, see Klopp v. Keystone Ins. Cos. 595 A.2d 1, 4 n.6 (Pa. 1991), this Court will discuss the more dispositive rescission issue first, before ordering any advancement of defense costs to plaintiff.

A. STANDARDS FOR RESCISSION

7. Under Pennsylvania law an insurance policy is void or may be rescinded for misrepresentation if the insurer can establish by clear and convincing evidence the following three elements: (1) that the representation was false; (2) that the insured knew that the representation was false when made or made it in bad faith; and (3) that the representation was material to the risk being insured. See New York Life Ins. Co. v. Johnson, 923 F.2d 279, 281 (3d Cir. 1991); Lotman v. Security Mut. Life Ins. Co., 478 F.2d 868, 870 (3d Cir. 1973); A.G. Allebach, Inc. v. Hurley, 540 A.2d 289, 294 (Pa. Super. Ct. 1988).

8. An insurer may also rescind an insurance policy if it can prove by clear and convincing evidence that the insured knowingly failed to disclose information which was material to the risk against which the insured sought to be protected. Rohm & Haas Co. v. Continental Cas. Co., 732 A.2d 1236, 1251 (Pa. Super. Ct. 1999) (citing Tudor, 697 A.2d 1010, 1016 (Pa. Super. Ct. 1997)). However, "an applicant is under no duty to volunteer information where no question plainly and directly requires it to be furnished." Vella v. Equitable Life Assurance Society of the United States, et al., 887 F.2d 388, 392 (2d Cir. 1989); see also Sebring v. Fidelity-Phenix Fire Ins. Co., 174 N.E. 761 (N.Y. 1931) ("If fraud be absent, the assured may remain silent in respect to many matters concerning which the underwriter fails to question him.").

9. However, where the nondisclosure, as to a matter which the insured has not been directly asked, constitutes fraud, the policy may be voided. Sebring, 174 N.E. at 761. To constitute fraud, the nondisclosure must be "in bad faith with intent to mislead the insurer." Id. In other words, "[i]f the applicant is aware of the existence of some circumstance which he knows would influence the insurer in acting upon his application, good faith requires him to disclose that circumstance, though unasked." Id. See also Lighton v. Madison-Onondaga Mutual Fire Ins. Co., 106 A.D.2d 892, 483 N.Y.S.2d 515, 516 (N.Y.A.D. 4Dept 1984) ("Fraudulent concealment may void an insurance policy, even if the fact concealed was one not inquired into by the insurer.").

10. The standard for clear and convincing proof is sufficiently met if the evidence presented was "so clear, direct, weighty, and convincing as to enable the jury to come to a clear conviction, without hesitancy, of the truth of the precise facts in issue." Lessner v. Rubinson, 592 A.2d 678, 681 (Pa. 1991). Nonetheless, "fraud . . . is never proclaimed from the housetops nor is it done otherwise than surreptitiously with every effort to conceal the truth of what is being done. So fraud can rarely if ever be shown by direct proof. It must necessarily be largely inferred from the surrounding circumstances." Rohm & Haas Co., 732 A.2d at 1251 (quoting Shechter v. Shechter, 76 A.2d 753, 755 (Pa. 1950)).

11. "In order to show a policy is void ab initio on the basis of fraud, the insurer must prove that the intent to deceive was deliberate." Id. (citing Grimes v. Prudential Ins. Co. of America, 585 A.2d 29, 33 (Pa. Super Ct. 1991)).

Therefore,

Mere mistakes, inadvertently made, even though of material matters, or the failure to furnish all details asked for, where it appears that there is no intention of concealing the truth, does not work a forfeiture, and a forfeiture does not follow where there has been no deliberate intent to deceive, and the known falsity of the answer is not affirmatively shown.

Rohm & Haas Co., 732 A.2d at 1251.

B. PLAINTIFF'S MISREPRESENTATIONS AND CONCEALMENT AND THEIR MATERIALITY

12. Misrepresentations in the original 1996 Application, as well as subsequent applications, constitute grounds for rescinding the 1998 Policy because those previous applications were incorporated by reference in the 1998 Renewal Application.

13. It has been held that "[e]very fact is material which increases the risk, or which, if disclosed, would have been a fair reason for demanding a higher premium." New York Life, 923 F.2d 279, 282 (3d Cir. 1991) (quoting Hartman v. Keystone Insurance Co., 21 Pa. 466, 477 (1853)). "The law undoubtedly is, that a policy . . . will be vitiated by the misrepresentation of any fact which would increase the risk [A]nything which increases the risk cannot be immaterial." Id. (quoting Hartman 21 Pa. at 477 and citing McCaffrey v. Knights & Ladies of

Columbia, 63 A. 189, 189 (Pa. 1906) (pregnancy not material to risk because facts showed that insurer must have anticipated that possibility and yet did not demand higher premium: "A fact is material to the risk when, if known to the underwriter, it would have caused him to refuse the risk, or would have been a reason for his demanding a higher premium.").

14. In conjunction with the Findings of Fact outlined above, this Court finds that clear and convincing evidence demonstrates that plaintiff made a fraudulent and material misrepresentation on the 1996 Application by answering "no exceptions" as to whether he was aware of "any facts or circumstances which he . . . has reason to suppose might give rise to a future claim." The clear and convincing evidence also shows that plaintiff concealed material information from the 1996 Application, while knowing such concealment could constitute a fraudulent insurance act.

15. Plaintiff was specifically aware that the State Department suspected YBM of illegal activities. Plaintiff also acknowledged that the State Department allegations could depress the value of YBM stock and trigger securities lawsuits against the company. Plaintiff was also aware before the 1996 Application was submitted that a certain YBM subsidiary could "subject [YBM] to certain potential liability." Said facts were material to defendant Federal's underwriting decision as knowledge of them would have caused defendant to refuse the risk and deny YBM's applications for the policies.

16. In conjunction with the Findings of Fact outlined above, this Court finds that clear and convincing evidence demonstrates that the representations in the 1997 Annual Report attached to the 1998 Application that Deloitte had "audited [YBM's] consolidated financial statements as described in their report" and that Deloitte had prepared a "report" stating "[i]n our opinion, such 1997 and 1996 financial statements present fairly in all material respects, the financial position of [YBM] at December 31, 1997 and 1996" were false and material to defendant's underwriting decision.

17. In conjunction with the Findings of Fact outlined above, this Court finds that clear and convincing evidence demonstrates that plaintiff concealed material information from the 1998 Renewal Application. Plaintiff's failure to disclose the following information in the 1998 Renewal Application constituted material concealment: (1) that Deloitte had suspended its audit due to concerns it had regarding some of YBM's transactions that Deloitte thought may have been "bogus" and some of YBM's customers who were thought to have connections to organized crime; (2) that U.S. authorities were conducting investigations of YBM involving concerns of "national security" and "fraud"; (3) that the Fairfax Group had concluded that six of YBM's original shareholders were members of organized crime.

C. PLAINTIFF'S MISREPRESENTATIONS AND CONCEALMENT OF MATERIAL INFORMATION IN YBM'S INSURANCE APPLICATIONS WERE FRAUDULENT OR MADE IN BAD FAITH

18. A statement known to be false when it is made is presumptively fraudulent. Shafer v. John Hancock Mut. Life Ins. Co., 189 A.2d 234, 236 (Pa. 1963). An insured acts in bad faith when he makes a false statement while aware that he does not know whether or not his statement is true. See Royal Indemnity Co. v. Deli by Foodarama, No. CIV.A. 97-1267., 1999 WL 178543, at *3 (E.D. Pa. March 31, 1999) (citing Evans v. Penn Mut. Life Ins. Co., 186 A. 133, 138 (Pa. 1936)).

19. Signing an application that contains a certification of the accuracy of its contents without reviewing the application to ensure its accuracy also constitutes bad faith as a matter of law. Peer v. Minnesota Mut. Fire & Cas. Co., No. CIV.A. 93-2338, 1995 WL 141899, at *6 (E.D. Pa. Mar. 27, 1995).

20. In accordance with the Findings of Fact as well as the Conclusions of Law outlined above, this Court finds that clear and convincing evidence demonstrates that plaintiff's material misrepresentations and omissions with respect to YBM insurance policies were fraudulent or in bad faith.

21. In light of the substantial documentary evidence indicating that plaintiff was aware that the State Department's suspicion that YBM was involved in criminal activity could damage YBM's business and "trigger[] opportunistic lawsuits," plaintiff's refusal to testify gives rise to an adverse inference that he knew that the Prior Knowledge Warranty in the 1996 Application was false, and therefore establishes fraud as a matter of law.

22. In light of the substantial documentary evidence demonstrating that plaintiff knew, when he submitted the 1997 Annual Report in response to the renewal application's request for YBM's "[l]atest audited annual report," that Deloitte had not completed its audit, plaintiff's refusal to testify gives rise to an adverse inference that he knew that the representations in the 1997 Annual Report regarding the status of Deloitte's audit were false, and therefore establishes fraud as a matter of law.

23. Given the substantial documentary evidence that plaintiff believed that the U.S. authorities' investigation could have a devastating effect on the company and lead to lawsuits, plaintiff's refusal to testify whether he was aware that the existence of the investigation was material to Federal gives rise to the inference that he was aware of that fact, and therefore establishes bad faith.

24. Given the substantial documentary evidence that plaintiff was aware that reports of the company's ties to organized crime could have a devastating effect on the company's business, plaintiff's refusal to testify whether he was aware that the results of the Fairfax Group investigation were material to Federal gives rise to the inference that he was aware of the fact, and therefore establishes bad faith.

25. Plaintiff cannot avoid responsibility for the misrepresentations and omissions in the 1998 Renewal Application by claiming that he was unaware of their submission because he signed the application that "to the best of his . . . knowledge

and belief the statements set forth herein are true." See Jung v. Nationwide Mut. Fire Ins. Co., 949 F.Supp. 353, 358 (E.D. Pa. 1997).

D. PLAINTIFF'S REFUSAL TO COMPLY WITH COOPERATION REQUIREMENT OF POLICY

26. Federal is not required to pay benefits under the 1998 Policy if it can establish that plaintiff materially breached the terms and conditions of the Policy. See, e.g., Paxton Nat'l Ins. Co. v. Brickajlick, 522 A.2d 531 (Pa. 1987).

27. Section 10 of the 1998 Policy required plaintiff to cooperate and give defendant information as a condition precedent to plaintiff's exercising his rights under the Policy.

28. Federal is entitled to deny coverage under the 1998 Policy if it can prove that plaintiff breached his duty to cooperate and that Federal was substantially prejudiced by that breach. See, e.g., Prudential Property & Cas. Co. v. Erie Ins. Co., 660 F.Supp. 79, 81 (E.D. Pa. 1986).

29. Defendant's requests for information concerning plaintiff's knowledge of misrepresentations and omissions in the 1996 Application and the 1998 Renewal Application were reasonable. In refusing to submit to defendant's requests for information, plaintiff argues that his duty to provide reasonable cooperation does not require him to waive his Fifth Amendment rights. However, a Fifth Amendment privilege against self-incrimination does not trump an insurance policy's duty to cooperate requirement. Aetna Cas. & Sur. Co. v. State Farm Mut.

Auto. Ins. Co., 771 F.Supp. 704, 708 (W.D. Pa. 1991), aff'd, 961 F.2d 207 (3d Cir. 1992). While a person may not be penalized for asserting the Fifth Amendment privilege against self incrimination, that does not mean that if a person refuses to make a statement in a civil proceeding that the failure to provide evidence may not have adverse consequences. Id.

30. The Court finds that plaintiff breached his duty to cooperate by failing to disclose information and documents reasonably requested by defendant and by refusing to submit to an interview. Furthermore, in accordance with the Findings of Fact outlined above, the Court finds that plaintiff's failure to cooperate substantially prejudiced defendant's ability to complete its investigation.

III. 1998 POLICY DOES NOT COVER OR EXCLUDES COVERAGE FOR THE ACTIONS FOR WHICH PLAINTIFF REQUESTS COVERAGE

31. Irrespective of this Court's holding on the issue of rescission, defendant seeks a declaratory judgment that plaintiff is not entitled to coverage based on the terms, conditions, and exclusions contained in the policy.

32. Plaintiff has the initial burden of establishing by a preponderance of the evidence that the proceedings for which he seeks coverage fall under the Policy's affirmative grant of coverage. Koppers Co. v. Aetna Cas. & Sur. Co., 98 F.3d 1440, 1446 (3d Cir. 1996).

33. The burden of proving the applicability of any exclusions or limitations on coverage lies with the insurer, as

those are affirmative defenses. See id. Regardless of whether plaintiff can meet his burden of establishing that the proceedings for which he seeks coverage fall within the Policy's affirmative grant of coverage, defendant may avoid liability for any loss relating to those proceedings if it can establish that coverage is precluded by exclusions or limitations in the policy. Ehrgood v. Coreqis Ins. Co., 59 F.Supp.2d 438, 442 (M.D. Pa. 1998).

A. PLAINTIFF'S REQUESTS FOR COVERAGE ARE BARRED BY THE POLICY'S EXCLUSIONS

34. The Prior Knowledge Exclusion in the 1996 Application, which is incorporated by reference in the 1998 Renewal Application and the 1998 Policy, precludes coverage for claims arising from facts and circumstances of which any person proposed for coverage was aware on or before May 1, 1996 and which a reasonable person would have supposed "might give rise to a future claim that would fall within the scope of proposed coverage."

35. In accordance with the Findings of Fact outlined above, this Court finds Coverage for the Criminal Investigation, the Pennsylvania Class Action Litigation, and the OSC Action is precluded by the Prior Knowledge Exclusion.

36. The Personal Profit Exclusion in Section 6(c) of the Policy precludes coverage for "any **Claim** . . . based upon, arising from, or in consequence of [any] **Insured Person** having

gained in fact any personal profit, remuneration or advantage to which such **Insured Person** was not legally entitled."

37. In accordance with the Findings of Fact outlined above, this Court finds that coverage for the Pennsylvania Class Action Litigation, the Mondor Action, the Royal Trust Action, and the YBM Receiver's Action is precluded by the Personal Profit Exclusion.

38. Section 5(c) of the Policy precludes coverage for "any **Claim** . . . brought or maintained by or on behalf of any **Insured**." The definition of "Insured" includes the "Insured Organization," YBM.

39. Section 6(a) of the 1998 Policy provides that defendant shall not be liable on account of any Claim made against any Insured Person "for an accounting of profits made from the purchase or sale by such **Insured Person** of securities of the **Insured Organization** within the meaning of Section 16(b) of the Securities Exchange Act . . . or similar provisions of any federal, state or local statutory law or common law."

40. In accordance with the Findings of Fact outlined above, this Court finds that coverage for the YBM Receiver's Action is precluded by Section 5(c) and Section 6(a) of the Policy.

B. THE MONDOR LITIGATION DOES NOT FALL WITHIN THE POLICY'S AFFIRMATIVE GRANT OF COVERAGE

41. Coverage under the 1998 Policy is limited to losses "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** or, if exercised, during the Extended Reporting Period."

42. The 1998 Policy only covers civil proceedings which have been "commenced by the service of a complaint or similar pleading." Because plaintiff has not been served in the Mondor action, that action does not constitute a Claim for which coverage is available under the 1998 Policy and plaintiff is not entitled to coverage for costs relating to the Mondor litigation.

IV. CONCLUSION

The Court concludes that clear and convincing evidence demonstrates that plaintiff Jacob Bogatin made certain material misrepresentations to and concealed a great deal of material information from defendant Federal throughout the period during which YBM sought insurance coverage. More importantly, plaintiff made these misrepresentations and omissions on YBM's insurance applications to defendant Federal, who in turn relied on them in making their underwriting decisions and in granting YBM the insurance policies.

Therefore, this Court finds JUDGMENT in favor of defendant Federal Insurance Company and against plaintiff Jacob Bogatin. The 1998 Policy is found to be void ab initio, is

rescinded, and is without legal force or effect as to plaintiff Bogatin. Furthermore, it is declared that plaintiff is not entitled to coverage based on the terms, conditions and exclusions contained in the 1998 Policy. Federal has no obligation or duty to provide coverage for any claim(s) asserted by plaintiff Bogatin under the 1998 policy.

An appropriate Order follows.

Clarence C. Newcomer, S.J.

**IN THE UNITED STATES DISTRICT COURT
FOR THE EASTERN DISTRICT OF PENNSYLVANIA**

JACOB BOGATIN,	:	CIVIL ACTION
Plaintiff	:	
	:	
v.	:	
	:	
FEDERAL INSURANCE COMPANY,	:	
Defendant	:	NO. 99-4441

O R D E R

AND NOW, this day of June, 2000, upon consideration of the testimony of the witnesses, admitted exhibits, and arguments of counsel, as well as the parties' post-trial submissions, the Court hereby ORDERS as follows:

(1) JUDGMENT is ENTERED in favor of defendant Federal Insurance Company and against plaintiff Jacob Bogatin.

(2) The 1998 Policy is FOUND to be VOID ab initio, is RESCINDED, and is without legal force or effect as to plaintiff.

(3) It is DECLARED that plaintiff is not entitled to coverage based on the terms, conditions and exclusions contained in the 1998 Policy. Federal has no obligation to provide coverage for any claims asserted by plaintiff under the Policy.

(4) All outstanding motions are denied as moot, this Court having rendered judgment in this action.

AND IT IS SO ORDERED.

Clarence C. Newcomer, S.J.