

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

In re CITY LINE BEHAVIORAL HEALTHCARE, LLC, Debtor.	Case No. 2:19-bk-12493 Chapter 7 Adversary No. _____
GARY F. SEITZ, in his capacity as Trustee for City Line Behavioral Healthcare, LLC, Plaintiff, v. WESCO INSURANCE COMPANY, Defendant.	COMPLAINT & JURY DEMAND

Plaintiff Gary F. Seitz (“Plaintiff” or the “Trustee”), in his capacity as bankruptcy trustee for City Line Behavioral Healthcare, LLC (f/k/a Liberation Behavioral Health, LLC) (“LBH” or the “Company”), by and through his attorneys Spiro Harrison, and by way of complaint against defendant Wesco Insurance Company (“Defendant” or “Wesco”), hereby alleges as follows:

PRELIMINARY STATEMENT

1. This case relates to Wesco Policy No. EUW 1522606-00 (the “Policy”), an insurance policy for, in relevant part, director and officer and private company liability insurance, that Wesco issued to LBH for the period of July 27, 2018 to July 27, 2019 (the “Policy Period”). LBH entered into the Policy for the benefit of itself and its directors, officers, and employees.

2. In 2019, during the Policy Period, the Trustee issued a written demand letter to Wesco for coverage under the Policy (the “Demand Letter”) for, among other things, claims

relating to breaches of fiduciary duties and other misconduct by the Company's directors and officers (the "D&Os") during the Policy Period.

3. Wesco denied coverage for the claims in the Demand Letter based principally on its contention that all claims were excluded under the Policy because they were based upon Wrongful Acts¹ or Related Wrongful Acts that were subject to exclusions in the Policy for certain prior criminal acts (the "Prior Acts"). Through subsequent communications, Wesco maintained its denial of coverage even as to Claims against the D&Os, who joined the Company in December 2017 (or later) through an acquisition transaction that removed the officers and directors who had been involved in the Prior Acts. The Trustee's Claim thus involved only Wrongful Acts that occurred after the completion of the Prior Acts by D&Os who were not involved in the Prior Acts.

4. On September 20, 2021, the Trustee filed an adversary proceeding against the D&Os in the United States Bankruptcy Court for the Eastern District of Pennsylvania, captioned *Seitz v. Rothmel, et al.*, Adversary No. 21-00075-mdc, alleging breach of fiduciary duties and corporate waste claims (the "D&O Action").² The Trustee provided Wesco with a copy of the Complaint the same day.

5. The Trustee's fiduciary duty claims in the D&O Action are based on two sets of events involving the breach of the D&Os' duties to the Company after the removal of the directors and officers who engaged in the Prior Acts. The first is the settlement of a lawsuit the D&Os caused to be filed by LBH and its direct and indirect parents, LBH Holdco Corp. ("LBH Holdco") and LBH Holdings, LLC ("LBH Holdings," and collectively, the "Delaware Plaintiffs"),

¹ Capitalized terms not defined here are defined in the Policy.

² The Complaint has since been amended to also include a claim for unjust enrichment.

respectively, in Delaware Chancery Court under the caption *Liberation Behavioral Health, LLC v. Coluccio, et al.*, Case No. 2018-0598-JTL (the “Delaware Action”). The Trustee alleges that the settlement of the Delaware Action was woefully inadequate, particularly considering the strength of the claims against the Sellers (including claims that were not even asserted in the Delaware Action), the amount of the alleged damages, and the fact that the Sellers did not have to pay anything out of pocket.

6. The second set of facts underlying the Trustee’s claims against the D&Os concerns LBH’s acquisition of a Florida-based rehabilitation business called Life of Purpose, LLC (“LOP”) in October 2018 (the “LOP Acquisition”). LBH paid over \$500,000 for LOP at a time when it was severely financially distressed. The D&Os also spent considerable sums pursuing other potential acquisitions that were never consummated. The Trustee claims that these pursuits constituted corporate waste.

7. The D&Os also asserted counterclaims against the Trustee in the D&O Suit (“Counterclaims”), including claims for indemnification of the D&Os’ losses, attorneys’ fees, and expenses incurred in connection with the Trustee’s suit against him.

8. After the Trustee provided a copy of the Complaint to Wesco, the D&Os’ counsel also submitted a request for coverage to Wesco. Wesco has continued to maintain the position, in bad faith and without any reasonable justification, that the Claims of the Trustee and the D&Os are excluded based upon the Prior Acts.

9. In light of the controversy regarding the coverage under the Policy, the Trustee brings this action for a declaration that the Claims made in the Demand Letter, the D&O Action, and the Counterclaims, and any subsequent claims that are related to those Claims, are covered by

the Policy up to its limit of \$2,000,000. The Trustee also alleges that Wesco's failure to provide coverage under the Policy constitutes a breach of contract and bad faith under 42 Pa.C.S. § 8371.

JURISDICTION

10. This is an adversary proceeding in which the Plaintiff is seeking a declaratory judgment.

11. This Court has jurisdiction pursuant to 28 U.S.C. §§ 157 and 1334.

12. This is a non-core proceeding pursuant to 28 U.S.C. § 157(c). Plaintiff consents to the entry of a final order or judgment by a U.S. Bankruptcy Judge.

13. Plaintiff has standing to bring this action pursuant to 11 U.S.C. § 323.

14. Venue is proper pursuant to 28 U.S.C. § 1409(a) and pursuant to 28 U.S.C. § 1391(b)(2) because a substantial part of the events giving rise to Plaintiff's claims occurred in this District.

PARTIES

15. Plaintiff Gary F. Seitz, in his capacity as trustee for LBH, is an attorney licensed in Pennsylvania and Delaware. He was appointed as the trustee on April 17, 2019.

16. Defendant Wesco is, upon information and belief, a corporation organized under the laws of the State of Delaware, with a principal place of business in Cleveland, Ohio. Wesco is engaged in the business of selling insurance products in multiple States, including Pennsylvania.

ALLEGATIONS APPLICABLE TO ALL COUNTS

A. The Policy

17. The Policy was issued by Wesco to LBH³ in July 2018. A copy of the Policy is attached as Exhibit A. The General Declarations provide that the Policy covers (i) Claims first made against an Insured during the Policy Period, and (ii) other matters, circumstances or Wrongful Acts first occurring during the Policy Period that are otherwise covered under the Policy. Section 6 of the Policy's General Terms and Conditions also provides that "[a]ny subsequent **Claim** which is made against the **Insureds** and reported to the **Insurer** alleging, arising out of, based upon or attributable to the facts alleged in a prior **Claim** for which notice already has been given, or which alleges any **Wrongful Act** which is the same as or is a **Related Wrongful Act** to an alleged prior **Claim** for which notice already has been given, shall be considered made at the time notice of the prior **Claim** originally was given." (Bolded terms are in the original and defined in the Policy.)

18. The Policy provides liability coverage under two "Coverage Elements." Relevant here is the Directors and Officers and Private Company Liability Coverage Element (the "D&O Coverage").

19. The D&O Coverage contains five Insuring Agreements. Relevant here are Insuring Agreements A and B.

20. Insuring Agreement A ("Side A"), entitled "Individual Insurance Coverage," provides that, "[t]he **Insurer** shall pay **Loss** of an **Individual Insured** arising from a **Claim** first made against such **Individual Insured** during the **Policy Period** . . . for any actual or alleged

³ By endorsement dated January 28, 2019, the Named Insured under the Policy was changed to "LBH Holding, LLC." It is believed this is a typo, and the proper entity is LBH Holdings.

Wrongful Act of such **Individual Insured**, except when and to the extent that a **Company** has indemnified the **Individual Insured** for such **Loss**.”

21. Insuring Agreement B (“Side B”), entitled “Company Reimbursement Coverage,” provides that, “[t]he **Insurer** shall pay **Loss** of a **Company** arising from a **Claim** first made against an **Individual Insured** during the **Policy Period** . . . for any actual or alleged **Wrongful Act** of such **Individual Insured**, but only when and to the extent that such **Company** has indemnified such **Individual Insured** for such **Loss**.”

22. Loss is defined in the D&O Coverage to include, among other things:

(1) the amount that any Insured becomes legally obligated to pay in connection with any covered **Claim**, including but not limited to:

(i) judgments (including pre-judgment and post-judgment interest on any covered portion thereof) and settlements; and

(ii) damages, including punitive, or exemplary damages and the multiple portion of multiplied damages relating to punitive or exemplary damages. . . ; [and]

(2) **Defense Costs**[.]

23. Defense Costs is defined in paragraph 6 of Endorsement No. 1 to mean “reasonable fees, costs and expenses consented to by the **Insurer** . . . resulting solely from the investigation, adjustment, defense and appeal of a **Claim** against an **Insured**”

24. Individual Insured is defined in the D&O Coverage to include, among other things, any Executive, which is in turn defined in the D&O Coverage to include, among other things, “any past, present or future duly elected or appointed director, officer, management committee member of a duly constitute committee or member of the Board of Managers of a Company.” Company is defined in the Policy’s General Terms and Conditions to include the Named Insured and any

Subsidiary. The Named Insured is LBH Holdings pursuant to Endorsement No. 16, and LBH is one of its Subsidiaries.

25. A Claim is defined in the D&O Coverage to include, in part:
1. a written demand . . . for monetary, non-monetary or injunctive relief . . . ; [or]
 2. a civil, criminal administrative, regulatory or arbitration proceeding for monetary, non-monetary or injunctive relief, which is commenced by:
 - (i) service of a complaint or similar pleading;

26. Paragraph 10 of Endorsement No. 1 defines a Wrongful Act as, in relevant part:
1. any actual or alleged breach of duty, neglect, error, misstatement, misleading statement, omission or act by an **Individual Insured** in their respective capacities as such, or any matter claimed against such **Individual Insured** by reason of his or her status as an **Executive** . . . ; or
 2. any actual or alleged breach of duty, neglect, error, misstatement, misleading statement, omission or act by a **Company**.

27. Related Wrongful Acts is defined in the General Terms and Conditions as, “**Wrongful Acts** which are the same, repeated or continuous **Wrongful Acts**, or **Wrongful Acts** which arise from a common causal connection or cause the same or related damages, or have a common nexus or nucleus of facts. . . .”

B. The Claims

28. Prior to the Policy Period, the Company and its former officers, directors, and employees (who were not Insureds under the Policy) engaged in illegal conduct, including, among other things, defrauding health insurance companies by paying the insurance premiums of patients seeking drug and alcohol dependence treatment, misrepresenting the residences of patients to obtain policies with the highest rates of reimbursement, operating as an unlicensed inpatient

facility, engaging in a kickback scheme with Florida urine testing companies, billing the insurance companies for medically unnecessary and substandard procedures, and creating affiliated companies and bank accounts to conceal this activity.

29. On December 11, 2017, two private equity funds, Fulcrum Equity Partners, Inc. (“Fulcrum”) and Vocap Ventures (“Vocap”), acting through affiliated special purpose vehicles established for the transaction, Fulcrum Growth Fund III, LLC, Fulcrum Growth Fund III QP, LLC, and Vocap Ventures II, LLC (the “Buyers”), acquired a controlling stake in the Company for \$41.6 million in a leveraged buyout transaction (“Fulcrum Transaction”). The illegal conduct ceased prior to the closing date.

30. After the closing of the Fulcrum Transaction, the D&Os joined the Company in the following capacities:

- a. Andrew Rothermel was immediately appointed to the board of managers of LBH and LBH Holdings and the board of directors of LBH Holdco. In May 2018, he became CEO of all three entities.
- b. Thomas Greer was immediately appointed to the LBH board and served as its Vice President and Secretary of LBH. He was also immediately appointed to the boards of LBH Holdings and LBH Holdco. He was appointed to these positions as a representative of Fulcrum.
- c. Jeffrey Muir was immediately appointed to the boards of LBH, LBH Holdings, and LBH Holdco, as a representative of Fulcrum.
- d. Vincent Olmstead was immediately appointed to the boards of LBH, LBH Holdings, and LBH Holdco, as a representative of Vocap.

31. On April 17, 2019, LBH and its subsidiary Life of Purpose-Pennsylvania, LLC (f/k/a Liberation Way, LLC) (“Liberation Way”) filed for bankruptcy and the Trustee was appointed as trustee for the bankruptcy estates.

32. In 2019, during the Policy Period, the Trustee issued the Demand Letter to, among others, the D&Os and Wesco (through its agent AmTrust North America), seeking coverage for, among other things, the D&Os’ breaches of fiduciary duties in connection with the settlement of the Delaware Action and corporate waste relating to the LOP Acquisition.

33. After the Trustee sent the Demand Letter to Wesco, Wesco denied coverage on September 23, 2019. A true and correct copy of Wesco’s September 23, 2019 letter is attached as Exhibit B.

34. On December 30, 2019, the Trustee responded by letter to explain the validity of the Company’s Claim. A true and correct copy of the Trustee’s December 30, 2019 letter is attached as Exhibit C.

35. However, Wesco—through its coverage counsel—reiterated its denial of coverage by letter dated February 4, 2020. A true and correct copy of Wesco’s February 4, 2020 letter is attached hereto as Exhibit D.

36. On September 20, 2021, the Trustee filed the D&O Action against the D&Os asserting causes of action for breach of fiduciary duty and corporate waste. A true and correct copy of the Complaint in the D&O Action is attached as Exhibit E. The Trustee provided Wesco with a copy of the complaint on the same day. The Complaint was later amended on May 4, 2022 to include a claim for unjust enrichment.

37. On October 29, 2021, counsel for the D&Os asserting a claim for coverage relating to the D&O Action (“D&O Demand”). On November 23, 2021, Wesco, responding to the Trustee

and the D&Os, again denied coverage with respect to the claims of the Trustee and D&Os, a copy of the denial letter is attached as Exhibit F, maintaining its position that all such Claims are excluded under the Policy based on upon Prior Acts.

38. On April 12, 2022, the D&Os asserted two counterclaims against the Trustee in the D&O Suit (“Counterclaims”). The first is asserted by Rothermel for, among other things, indemnification of his losses, attorneys’ fees, and expenses incurred in connection with the D&O Suit pursuant to an employment agreement with LBH. The second is asserted by all of the D&Os for indemnification of their losses, attorneys’ fees, and expenses under LBH’s Second Amended and Restated Operating Agreement, dated as of December 11, 2017.

B. The Trustee’s Position

39. The Trustee maintains that the Claims set forth in the Demand Letter, the D&O Suit, and D&O Demand relating to the D&Os’ settlement of the Delaware Action and their waste of corporate assets in connection with the LOP Acquisition fall within the scope of Side A.

40. It has not been disputed by Wesco that the Demand Letter, D&O Suit, and D&O Demand addressing these issues constitutes a Claim, that the D&Os and LBH are Insureds, or that the alleged breaches of fiduciary duties constitute Wrongful Acts under the Policy.

41. Accordingly, Wesco as the Insurer is obligated to pay the Loss, including Defense Costs, associated with the Claims.⁴

42. The Trustee also maintains that the D&Os’ indemnification Counterclaims in the D&O Action fall within the scope of Side B. The D&Os allege that Plaintiff is obligated to

⁴ Under Section VI(C) of the D&O Coverage, Defense Costs are to be advanced by Wesco.

indemnify them for Loss and Defense Costs incurred as a result of the D&O Action. This falls squarely within the language of Side B.

43. The Counterclaims are based on the Claims for the alleged Wrongful Acts, *i.e.*, indemnification for Loss on Claims based on the Wrongful Acts in connection with the settlement of the Delaware Action and the LOP Acquisition and are based upon or attributable to the Trustee's Claim. The Trustee seeks a declaration that Wesco is responsible for covering such Claims under the Policy.

C. Wesco's Position

44. Wesco has denied coverage for the Claims raised in the Demand Letter, the D&O Action, and D&O Demand based on several grounds. Each basis for denial, however, depends on Wesco's unsupportable contention that the Claims are based upon Prior Acts.

45. Wesco has denied coverage based on the following specific bases:

- a. The Claims are barred by the Specific Event Exclusion in Endorsement No. 7, which excludes Claims based on then-current regulatory investigations, including an investigation by the Pennsylvania Attorney General ("AG Investigation");
- b. The Claims are barred by the Prior Acts Exclusion in Endorsement No. 19, which excludes Claims relating to Wrongful Acts and/or Related Wrongful Acts committed before December 6, 2017;
- c. The Claims are barred by the Regulatory Exclusion in Endorsement No. 12, which excludes certain Claims based on Regulatory Wrongful Acts; and

- d. The Claims are barred by the “Prior/Pending Proceeding Exclusion” in Paragraph 12 of Endorsement No. 1, which excludes Claims arising out of demands pending as of July 27, 2018.

D. The Wesco Coverage Dispute

46. The Trustee maintains that Wesco’s position relies on the fundamentally incorrect conclusion that the Claims asserted are all based upon Prior Acts.

47. One of the Prior Acts that Wesco points to is a March 22, 2018 letter from the Pennsylvania Department of Drug and Alcohol Programs (“DDAP”), which outlines various regulations that LBH’s subsidiary, Liberation Way, was not in compliance with, and directs Liberation Way to shut down two facilities until the compliance issues are addressed.

48. Wesco also contends that the Trustee’s Claims arise out of the AG Investigation and a DDAP investigation. Those investigations related to widespread criminal frauds taking place at LBH and Liberation Way between 2015 and December 2017.

49. Separate from the AG Investigation itself, Wesco asserts that the Trustee’s Claims arise out of the pervasive fraudulent schemes that occurred at LBH and Liberation Way since 2015.

50. The Trustee disputes Wesco’s interpretation of the Claims. The Trustee’s Claims all relate to Wrongful Acts that first occurred during the Policy Period, and which were perpetrated by an entirely new slate of directors and officers that had no involvement in the Prior Acts.

51. The Trustee’s Claims involve the settlement of the Delaware Action, which involved claims for indemnification under the Purchase Agreement that were, at most, tangentially related to the misconduct of the prior officers and directors. The breach of fiduciary duties by the D&Os—who were not even at LBH while the criminal frauds were taking place—for relinquishing LBH’s then-most significant asset for woefully inadequate compensation are based on an entirely

distinct Wrongful Act. Further, the LOP Acquisition was wholly unrelated to the Prior Acts, as it was simply a corporate acquisition that had no factual nexus with the AG Investigation, DDAP investigation, DDAP March 18, 2022 letter, or any of the criminal frauds that took place at the Company.

52. Wesco's ongoing position denying coverage to the Company and the D&Os is unsupported by the facts. The Trustee's Claims and D&Os' Claims do not arise from a common cause or share a common nucleus of operative facts to the Prior Acts. The Prior Acts were wholly distinct from the breaches of fiduciary duty of D&Os. Indeed, the D&Os were not even officers or directors of the Company at the time of the Prior Acts.

53. Wesco's coverage position, including its complete denial of coverage, is in error and made in bad faith, and is legally and factually unsupportable.

COUNT I
Declaratory Judgment

54. Plaintiff incorporates by reference the preceding paragraphs of this Complaint as though set forth herein in their entirety.

55. Wesco has failed and/or refused to discharge its responsibilities and obligations under the Policy in a manner consistent with the rights of the Company or its third-party beneficiaries.

56. The Company has at all times acted reasonably, in good faith, and within the scope and terms of the Policy.

57. The Company relied on the terms of the Policy as identifying coverage and the duties and obligations of Wesco to the Company and its officers and directors.

58. Wesco must provide coverage for the Claims under Side A and Side B of the Policy and is estopped from denying coverage to the Company, or its officers and directors, or from refusing to pay for Loss in connection with the Claims.

59. An actual and justiciable controversy has arisen and now exists between (i) Plaintiff and Wesco concerning coverage under Side B of the D&O Coverage, and (ii) Plaintiff, as a party who contracted with Wesco for the benefit of its officers and directors, and Wesco, concerning coverage under Side A of the D&O Coverage.

60. A prompt and judicial determination is necessary and appropriate so that the parties may ascertain their rights, duties, and obligations under the Policy. The issuance of declaratory relief will terminate the existing controversy among the parties.

COUNT II
Breach of Contract

61. Plaintiff incorporates by reference the preceding paragraphs of this Complaint as though set forth herein in their entirety.

62. The Policy constituted a contract binding both the Company and Wesco, for the benefit of the Company and its officers and directors.

63. The Company has performed and satisfied all of the terms, conditions, covenants, and obligations imposed on and required of it under the terms of the Policy or by law.

64. The Loss sustained by the Company and its officers and directors are covered under the Policy.

65. Wesco has materially breached its obligations under the Policy by, among other things, refusing to provide coverage for Loss under the Policy.

66. As a direct and proximate result of Wesco's breach of the Policy, the Company has been deprived of the benefit of insurance coverage under the Policy, for itself and its officers and directors, for which the Company paid substantial premiums, and the Company has incurred and continues to incur significant damages.

COUNT III
Bad Faith under 42 Pa.C.S. § 8371

67. Plaintiff incorporates by reference the preceding paragraphs of this Complaint as though set forth herein in their entirety.

68. Through the Demand Letter, coverage correspondence, and D&O Complaint that the Company provided to Wesco, and the D&O Demand that the D&Os made on Wesco, Wesco received evidence of a Claim and connected Loss under the Policy.

69. Despite having received the Demand Letter, D&O Action Complaint, and D&O Demand, Wesco breached its duty to deal in good faith and fairly with the Company by:

- a. Unreasonably and frivolously delaying and refusing to provide coverage and pay for covered Loss under the Policy;
- b. Not exercising reasonable care in investigating the Claims fairly and objectively;
- c. Taking erroneous and misleading coverage positions that Wesco knew were unsupported by the Policy and applicable law;
- d. Refusing to reconsider its coverage position when the facts clearly demonstrated that Wesco had erroneously relied on a factually baseless position in support of its denial of coverage;

- e. Acting with a dishonest purpose or reckless disregard for Company's rights under the Policy;
- f. Avoiding payment to the Company for its own purposes and financial gain;
- g. Intentionally and recklessly failing to perform its duties under the Policy and applicable law;
- h. Compelling the Trustee to institute this action to obtain benefits due and owing the Company under the Policy.

70. Wesco does not have a reasonable basis for refusing coverage of the Claims and delaying and refusing to provide benefits to the Company and D&Os under the Policy.

71. Wesco knows it has no reasonable basis for refusing coverage of the Claims but continues to refuse coverage anyway.

72. Despite the Trustee's demands for reconsideration of Wesco's denial of the Claims, Wesco refuses to investigate or scrutinize the faulty basis for denying coverage even though it was aware or should have been aware of information that plainly contradicted its basis for denying coverage.

73. Wesco's failure and refusal to provide coverage constitutes bad faith within the meaning of 42 Pa.C.S. §8371.

WHEREFORE, Plaintiff prays for judgment entered in its favor and against Defendant as follows:

- a. Declaring that the Claims in the Demand Letter, D&O Action, D&O Demand, and Counterclaims are covered Claims under the Policy and that Wesco is obligated to pay for the Loss in connection with the Claims up to the Policy limit of \$2,000,000;
- b. compensatory damages in an amount to be proven at trial;

- c. pre- and post-judgment interest;
- d. costs of suit;
- e. punitive damages;
- f. attorneys' fees; and
- g. Such other and further relief that the Court may deem necessary, just, or appropriate under the circumstances.

Dated: July 1, 2022

/s/ Jason C. Spiro

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