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IN THE COURT OF APPEAL OF THE STATE OF CALIFORNIA

SECOND APPELLATE DISTRICT

DIVISION FOUR

INSURANCE COMMISSIONER OF THE STATE OF CALIFORNIA, Plaintiff and Appellant, v. EXECUTIVE LIFE INSURANCE COMPANY, et al., Defendants and Respondents.	B161368 (Los Angeles County Super. Ct. No. BS006912)

APPEAL from a judgment of the Superior Court of Los Angeles County, Gregory R. Alarcon, Judge. Affirmed.

Pachulski, Stang, Ziehl, Young & Jones, Richard M. Pachulski and Harry D. Hochman for Plaintiff and Appellant.

Alschuler, Grossman, Stein & Kahan, Lucia E. Coyoca and Peter M. Delvecchio for Defendant and Respondent Insurance Commissioner of the State of California.

Chapin, Shea, McNitt & Carter, Roger L. McNitt and Sarah N. Baker for Defendant and Respondent National Structured Settlements Trade Association.

Pillsbury & Winthrop, Phillip S. Warden, Robert L. Wallan and Catherine D. Meyer for Defendant and Respondent Indenture Trustees.

First Lincoln Holding Inc. appeals following the trial court's denial of its motion to compel payment of interest and other investment income. We affirm the judgment (order denying the motion to compel).

FACTUAL AND PROCEDURAL BACKGROUND

Executive Life Insurance Company (ELIC), an insolvent insurance company, was seized by the Insurance Commissioner of the State of California (the Insurance Commissioner) in April 1991. ELIC's parent corporation, First Executive Corporation (FEC), filed a petition under chapter 11 of the United States Bankruptcy Code (Title 11 U.S. Code) on May 13, 1991. The reorganized FEC changed its name to First Lincoln Holdings (FLH), and is the appellant in this action.[1]

As part of the plan of reorganization filed in the Bankruptcy Court in August 1992, the FEC Litigation Trust (the Trust) was formed, with the Insurance Commissioner named as Conservator and Trustee of the Trust. The Trust was established to receive the proceeds of certain unresolved claims of FEC against others involved in the management of FEC's finances and investments, and FEC's claims against its own officers and directors.

The terms of the Trust were set forth in a Trust Agreement dated September 11, 1992 (the Trust Agreement). The stated purpose of the Trust was "to liquidate the Trust Assets transferred to the trust, to obtain therefrom the maximum amount of proceeds and to distribute the liquidated proceeds from time to time as determined by the Trustee in his sole discretion in accordance with the terms of this Trust Agreement and subject to any necessary approval by the [Los Angeles Superior Court]." Stripped to its bare essentials, the Trust Agreement also

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[1] FEC and FLH are also referred to as "Newco."

provided for the Trustee to distribute amounts delineated as "Distribution Proceeds" to certain parties annually, after paying the Trust's administrative expenses and taxes. The first $30 million of the Distribution Proceeds ("Tier One") was to be paid to the Conservator (who then would distribute it to policyholders in accordance with a scheme outlined in the Trust Agreement). Anything over $30 million, but less than $102 million ("Tier Two") would be split 75/25, 75 percent to the Conservator for distribution to policyholders, and 25 percent to FLH. Anything over $102 million ("Tier Three") would go to the Conservator for distribution to policyholders.

Despite the clause in the Trust Agreement that provided for annual distributions, FLH did not receive its first distribution under the Trust Agreement until 1997. At that point, the amount designated as Distribution Proceeds was over $40 million, and had accrued almost $5 million in interest income. The Trustee (through an independent management company) distributed to FLH 25 percent of $10 million (the amount over $30 million), plus 25 percent of the $5 million in interest income, for a total of $3.5 million to FLH. After the initial distribution in 1997, the Commissioner changed the method of calculating distributions and did not include interest income and other earnings.

Accordingly, on January 25, 2002, FLH filed a motion to compel payment of interest and other investment income and for an accounting. After opposition was filed by the Commissioner, and other beneficiaries of the Trust,[2] the Superior Court issued a preliminary order requesting supplemental briefing on

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[2] Several financial institutions (Bank of New York Corporate Trust, Bank of New York, Chase Manhattan Trust Company, N.A., Union Planters Bank of Louisiana, and Wells Fargo Bank Minnesota, N.A.) as "Indenture Trustees and policyholders" filed a single opposition to the motion. Opposition was also filed by the National Structured Settlements Trade Association.

certain issues.[3] After considering the supplemental briefing, the superior court issued its ruling on July 5, 2002, denying FLH's motion for payment of interest and investment income, but granting the one for an accounting.

The court stated, inter alia, "After carefully considering the parties' responses to the specific issues raised by the Court, and the supplemental briefs on the issue of the contemporaneous Commercial Code definition of the term 'proceeds,' the Court has concluded that the more persuasive argument is that Distribution Proceeds do *not* include Income, and therefore FLH is not entitled to have the Income included in calculating when its 'Tier 2' right to a portion of the Distribution Proceeds is triggered. . . . [The] definition [of 'Distribution Proceeds' in the Trust Agreement] does not expressly include income on the funds generated by the Litigation Claims and Related Litigation Claims, and therefore may only be read to include Income if that inclusion may be inferred from the use of the terms 'aggregate' or 'proceeds.' . . . As to the term 'aggregate,' the Commissioner (and others) persuasively argues that the term, as used in this context, merely refers to the *sum* of the proceeds of multiple litigation claims, and therefore should not be

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[3] The Superior Court's preliminary order asked the parties to brief the following issues: "(1) If there was negative 'interest and investment income,' wouldn't that money reduce the amount available for Tier Two funds? If so, why shouldn't the money available for Tier Two funds be increased by *positive* 'interest and investment income.' Stated differently, if interest and investment income is going to be treated separately for Tier One and Tier Two Funds, wouldn't Tier One funds logically be required to absorb any losses created by negative income? And wouldn't that logical result be inconsistent with the overall distribution scheme under the Trust Agreement, which appears to be to assure other creditors a minimum amount of recovery prior to any recovery by FLH? [¶] (2) Are not 'proceeds on proceeds' also proceeds? In the same way as 'interest on interest' is also interest? Or 'income on income' is still income? [¶] (3) What are the parties' positions on precisely what income/interest/losses were or were not included in the 'any additions thereto and changes therein, and any other property or funds acquired from time to time by the Trustee with respect thereto' at the end of Article II?" (Italics in original.)

read to be inclusive of interest. This argument appears to the Court to be the most reasonable construction of this term. . . . [¶] As to the term 'proceeds,'. . . the Court has reached the conclusion that the contemporaneous definition of 'proceeds' in the context of the Commercial Code, which the Court believed could be considered as extrinsic evidence in determining what the parties to the Trust Agreement intended 'proceeds' to mean, was so inchoate as to render this extrinsic evidence useless for the purpose of determining the parties' intent. [¶] . . . [¶] Given this conclusion, and the absence of other competent, admissible extrinsic evidence of the parties' intent in using the word 'proceeds,' the Court sees no alternative but to determine the meaning of the word 'proceeds' as used in definition of Distribution Proceeds on the face of the Trust Agreement. . . . [¶] First, the drafters of the Trust Agreement . . . knew how to specify when income was included if they wanted to do so. Instead, . . . the drafters did not apparently contemplate the issue of Income on the Distribution Proceeds because the intention was that such assets were to be distributed quickly. Had that happened, each Tier of the Distribution Proceeds would have borne its own investment risk and obtained its own investment benefit on the Distribution Proceeds. As a result, it appears consistent with the 'quick distribution' intent of the Trust Agreement to find that each Tier in the Distribution is entitled to the Income, as they would have been liable for the losses of investments. Accordingly, the Court denies FLH's motion as to its request that the Court find that Income should be included in calculating when Tier 2 of the Distribution Proceeds is triggered. [¶] . . . [¶] As to FLH's request for an accounting, the request appears reasonable, particularly in light of the lengthiness of the Trust term, and is therefore granted." (Italics in original.)

On August 28, 2002, FLH filed its Notice of Appeal.[4]

DISCUSSION

1. *The Terms of the Trust Agreement*

According to the Trust Agreement, the Trustee can use proceeds from Litigation Claims and Related Litigation Claims (both defined terms) to pay administrative expenses, then must disburse 75 percent of the remaining amount to the Conservator. The remaining 25 percent of the Litigation Claims, plus Non-Litigation Trust Assets (also a defined term) go into the fund called Distribution Proceeds. The Trustee then is required to make annual distributions of what is termed as "Distribution Proceeds," after paying taxes on any proceeds, earnings or distributions. (Art. IV.)

Distribution Proceeds are defined as: "(a) 25% of the aggregate proceeds (after subtracting therefrom the Trust Administrative Expenses related to the Litigation Claims) of the Litigation Claims and 25% of the aggregate proceeds (after subtracting therefrom any reasonable costs, expenses and fees, including contingent fees, incurred by the Conservator in connection with the Related Litigation Claims) of the Related Litigation Claims and (b) 100% of the aggregate proceeds (after subtracting therefrom the Trust Administrative Expenses related to the Non-Litigation Trust Assets) of the Non-Litigation Trust Assets. Any expenditure by the Trustee that is a Trust Administrative Expense or any reasonable expenditure by the Conservator that is related to the Related Litigation Claims shall reduce Distribution Proceeds by an aggregate amount equal to, but not more than, the amount of such expenditure." (Art. II.)

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[4] On September 3, 2002, National Structured Settlements Trade Association filed a Notice of Appeal with respect to the same order. National Structured Settlements' appeal was dismissed pursuant to stipulation by the parties.

The crux of the problem is that in its definition of Distribution Proceeds, the Trust Agreement does not specify interest or investment income. FLH argues that the definition of Distribution Proceeds should be read to include interest and investment income earned by the Distribution Proceeds. FLH gives the following reasons for this interpretation: (1) the first distribution of proceeds under the Trust Agreement in 1997 included interest income; (2) the Trust Agreement provides for the distribution of all the trust assets, so interest income should necessarily be distributed to the various beneficiaries of the trust; (3) the Trust Agreement contemplates the Trustee's ability to accept non-cash items, and should therefore be read to include any appreciation in value of Trust Assets; and (4) the ordinary and popular meaning of the term "proceeds" would include interest income.

To resolve this dispute, we turn to the established rules of contract interpretation.

2. *Rules of Contract Interpretation*

Where the issue is one of contractual interpretation and there is no conflicting extrinsic evidence, the appellate court is not bound by the trial court's interpretation and must decide the issue de novo. (*City of Chino v. Jackson* (2002) 97 Cal.App.4th 377, 386; *Southern Pacific Land Co. v. Westlake Farms, Inc.* (1987) 188 Cal.App.3d 807, 817.)

"'Under statutory rules of contract interpretation, the mutual intention of the parties at the time the contract is formed governs interpretation. [Citation.] Such intent is to be inferred, if possible, solely from the written provisions of the contract. [Citation.] The "clear and explicit" meaning of these provisions, interpreted in their "ordinary and popular sense" unless "used by the parties in a technical sense or a special meaning is given to them by usage" [citation], controls

judicial interpretation. [Citation.] Thus, if the meaning a layperson would ascribe to contract language is not ambiguous, we apply that meaning.'" (*Santisas v. Goodin* (1998) 17 Cal.4th 599, 608, quoting *AIU Ins. Co. v. Superior Court* (1990) 51 Cal.3d 807, 821-822; Civ. Code, §§ 1636, 1644.) "Only these basic principles are needed to interpret contract language that is clear and unambiguous. [¶] The rules for recognizing ambiguity are also straightforward. Ambiguity exists when an insurance policy provision is susceptible of two or more constructions that are reasonable and not based on strained interpretations. (*Producers Dairy Delivery Co. v. Sentry Ins. Co.* (1986) 41 Cal.3d 903, 912.) Contract language interpretation involves considering the whole instrument and the circumstances of the case; ambiguity is not an abstract question. [Citation.]" (*Shell Oil Co. v. Winterthur Swiss Ins. Co.* (1993) 12 Cal.App.4th 715, 737.)

"[W]here practicable, the meaning of an agreement must be derived from a reading of the whole contract. (Civ. Code § 1641; *Foothill Properties v. Lyon/Copley Corona Associates* (1996) 46 Cal.App.4th 1542, 1550.) When an inconsistency exists in the language of a contract, courts must give effect to the parties' main purpose. (Civ. Code § 1653; 1 Witkin, Summary of Cal. Law (9th ed. 1987) Contracts, § 695, p. 628.)" (*Sy First Family Limited Partnership v. Cheung* (1999) 70 Cal.App.4th 1334, 1342; *Estate of Petersen* (1994) 28 Cal.App.4th 1742, 1753-1754, fn. 4.)

"[P]articular expressions may, by trade usage, acquire a different meaning in reference to the subject matter of a contract. If both parties are engaged in that trade, the parties to the contract are deemed to have used them according to their different and peculiar sense as shown by such trade usage and parol evidence is admissible to establish the trade usage even though the words in their ordinary or legal meaning are entirely unambiguous. [Citation.]" (*Hayter Trucking, Inc. v. Shell Western E&P, Inc.* (1993) 18 Cal.App.4th 1, 15.)

Bearing these principles in mind, we now examine the Trust Agreement, considering the whole agreement, ascertaining the mutual intent of the parties and considering whether terms should be construed according to their ordinary and popular meaning or whether a special meaning was ascribed to them.

3. *Plain Language*

We first review the plain language of the Trust Agreement.

First and foremost, we note that there is nothing in the Agreement which specifically provides for the distribution of interest income. There is no mention of interest made in the definition of Distribution Proceeds. Many other terms are identified, and the Trust Agreement is long (43 pages) and detailed.

Next, Distribution Proceeds are clearly delineated by fixed amount. FLH's right to distribution is clearly limited to amounts between $30 million and $102 million. The distribution scheme does not say $30 million "plus interest" or $30 million "including proceeds therefrom."

FLH's argument that interest income necessarily has to be distributed stems from its premise that all Trust Assets must be distributed. It argues that there is nowhere else for interest income to be placed once all the Trust Assets are marshaled in a single "pot," and thus must be distributed. This premise is faulty because the Trust Agreement does not define Distribution Proceeds and Trust Assets as interchangeable terms. Trust Assets consist of Litigation Claims, Non-Litigation Trust Assets, Third Party Claims and Related Litigation Claims and "*any other property or funds acquired from time to time by the Trustee with*

respect thereto." (Art. II, italics added.)[5] This clause would seem to be the only one in the Agreement which would encompass interest and investment income.

The definition of Distribution Proceeds does not include this phrase. Distribution Proceeds include a percentage of Litigation Claims, Non-Litigation Trust Assets, Third Party Claims and Related Litigation Claims less administrative expenses. FLH's premise that all Trust Assets must be distributed is not supported by the plain language of the Agreement since the definition of Trust Assets provides that Trust Assets that are not distributed would go to pay administrative expenses, and would not be left unaccounted for, as urged by FLH.

Moreover, the Agreement states that the Trust terminates when "all of the Trust Assets have been liquidated . . . and all Distribution Proceeds distributed." (Art. IX, § 9.1.1.) Clearly, the two funds are not interchangeable and are to be treated separately.

C. *Intent of the Parties*

Each of the parties submitted their different interpretations of the intent of the Trust Agreement.

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[5] Trust Assets are defined as: "the Non-Litigation Trust Assets and Litigation Claims transferred to the trust pursuant to Article I of this Trust Agreements, the Pension GIC Third Party Claims assigned by the holders thereof to the trust, the CQRA Third Party Claims assigned by the holders thereof to the trust and the Muni GIC Third Party Claims assigned by the holders thereof to the trust . . . and 25% of any proceeds (after subtracting therefrom any reasonable costs, expenses and fees, including contingent fees, incurred by the Conservator in connection with the Related Litigation Claims) of the Related Litigation Claims (which are required to be transferred to the Trustee pursuant to Section 3.3), together with any additions thereto and changes therein, and any other property or funds acquired from time to time by the Trustee with respect thereto." (Art. II.)

In the superior court, FLH submitted declarations about the intent of the nature and operation of the Trust. Objections to those declarations were made, but the Court did not rule on any of them.

The Agreement states only that the purpose of the Trust is to liquidate the assets and distribute them.

The indenture trustees and policyholders argued that the main intent of the Trust is to benefit the policyholders, and thus no terms should be imputed which would increase FLH's distribution at the expense of the policyholders.

The superior court found that since the Agreement provided for annual distributions, interest income was not contemplated at the time the contract was signed. We do not agree with the trial court's position that the accrual of interest on trust assets was not contemplated. Article VI, section 6.1 (c) of the Trust Agreement specifically allows the Trustee to invest trust funds, albeit with maturities of less than one year. A significant amount of interest, especially on such large amounts as are involved in the Trust would still accrue in a one-year period. We feel instead, that interest income was contemplated, and considered a Trust Asset, as "funds acquired from time to time by the Trustee."

It does not follow, however, that the interest had to be distributed as part of the Distribution Proceeds, for that would clearly be to imply terms not used in the Agreement.

FLH also contends that since the Agreement contemplates the receipt of non-cash items as Trust Assets, there should be a mechanism for taking interest income or appreciation of value into account. The Commissioner argues, and we agree, that this does not compel an interpretation of the distribution scheme to include interest income, as any appreciation realized in the liquidation of these assets would become a Trust Asset, and not necessarily part of the Distribution Proceeds.

D. *Ambiguous Terms*

FLH also contends that interest could be subsumed under the portion of the definition of Distribution Proceeds that includes "aggregate proceeds."

In its motion, FLH referred to the California Commercial Code in support of its interpretation of the term "proceeds." The Commissioner argued that the Commercial Code did not apply because the parties did not mention it in the Trust Agreement, and that the definition was inapplicable in this situation since it did not involve a sale or other disposition of collateral or proceeds. The parties then were asked to provide supplemental briefing on whether interest income was included as "proceeds of proceeds."

The superior court reasoned that since the Commercial Code definition of "proceeds" had changed since 1992, after case law had indicated that there was some confusion over whether interest income was included under that definition, it could not conclude that the parties intended the Commercial Code definition of proceeds be used.

Then, in its opening brief, FLH argued that no reference to the Commercial Code was necessary.

We reach the same conclusion as the superior court: that the parties did not mean for the term "proceeds" to be defined in connection with the Commercial Code. But we reach this conclusion for different reasons. There was nothing presented to the superior court which would compel a conclusion that the parties or the particular transaction or industry required a special or technical meaning be ascribed to the words "proceeds."

Reviewing the plain language of the Agreement, we find that the terms "proceeds" or "aggregate proceeds" are not defined. "Aggregate proceeds" is only used in context with the various types of litigations claims of FEC. Since the litigation claims are always referred to in plural, and the specific claims were

not collected, and thus not quantifiable, at the time the Agreement was executed, we can only conclude that this term means those funds which are received as a result of the prosecution of the many litigation claims of FEC, which were ongoing at the time the Trust was created, and the term does not include interest earned on the claims.

E. *Subsequent Conduct*

FLH argues that the Trustee's decision to distribute interest income in 1997 is compelling proof that the Trust Agreement should be read to include interest income in the Distribution Proceeds. We agree that in some cases, prior transactions may be used as evidence of intent. (*California C.P. Growers v. Williams* (1938) 11 Cal.2d 221, 228; *1880 Corp. v. Atlas Corp.* (1969) 1 Cal.App.3d 326, 335.) In this case, however, the conduct which FLH seeks to use to prove intent occurred well after the Trust Agreement was signed, and appears to have occurred because the Trust Agreement's requirement of annual distributions was not met.

The Commissioner and the indenture trustees argue that the 1997 distribution resulted in an overpayment to FLH because the accrued interest on the Distribution Proceeds was not distributed in proportion to FLH's share of Tier Two Distribution Proceeds. The superior court found, and we agree, that the issue of overpayment should be resolved in another proceeding.

F. *Conclusion*

We conclude, after reviewing the entire Trust Agreement, the intent of the parties as clearly stated therein, and ordinary and plain meaning of the words used therein and the lack of any evidence that any other meaning was intended,

that interest income was not to be distributed, but to be considered as part of the Trust Assets.

DISPOSITION

The judgment (order denying motion to compel) is affirmed. Respondents shall recover costs on appeal.

NOT TO BE PUBLISHED

HASTINGS, J.

We concur:

VOGEL (C.S.), P.J.

EPSTEIN, J.