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No. 66809-9-1  
(King County No. 10-2-07756-1 SEA)

COURT OF APPEALS OF THE STATE OF WASHINGTON,  
DIVISION I

MICHAEL J. SAUTER, an individual,  
Appellant,

v.

HOUSTON CASUALTY COMPANY, a foreign, non-admitted insurer  
doing business in Washington,

Respondent.

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DIVISION I  
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**POLICYHOLDER SAUTER'S REPLY BRIEF**

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## **I. SUMMARY OF REPLY ARGUMENT**

Whether by design or due to a fundamental misunderstanding of the issues raised by and addressed in Sauter's Opening Brief, Houston Casualty's Opposition Brief repeatedly misrepresents the history of this coverage litigation, the issues raised by Sauter's appeal, and Sauter's positions concerning those issues. This Reply Brief is necessarily devoted to correcting Houston Casualty's array of misrepresentations and to clarifying what this appeal is about and why Washington insurance law necessitates reversal of the trial court's summary judgment ruling.

This appeal involves a dispute over whether the D&O policy Houston Casualty issued to insure Sauter provides coverage for third-party Commerce Bank's claim that Sauter neglected or breached his duties under a commercial guaranty he executed in conjunction with a loan Commerce Bank made to Sauter's company, SJM. Sauter contends that claim is covered. Houston Casualty contends it is not.

Sauter has incurred defense costs and made certain payments to Commerce Bank in response to Commerce Bank's "Claim." Sauter risks further liability to Commerce Bank, including possible foreclosure upon various properties securing Sauter's guaranty or a suit for money damages. This declaratory judgment action addresses Sauter's right to coverage for his past payments and for any future payments or liability.

Both parties filed summary judgment motions concerning the existence of coverage for Commerce Bank's claim under "Coverage A" of the Houston Casualty Policy. Houston Casualty repeatedly asserts that only Sauter filed a summary judgment motion below, and argues that Sauter therefore bears a higher burden on appeal than Houston Casualty.<sup>1</sup> But the record readily confirm that Houston Casualty filed its own summary judgment cross-motion.<sup>2</sup>

On September 24, 2010, trial court Judge Michael C. Hayden heard oral argument on both parties' summary judgment motions. At the conclusion of that oral argument, Judge Hayden announced his ruling and promptly signed an Order denying Sauter's motion and granting Houston Casualty's motion.<sup>3</sup> Houston Casualty falsely contends that Judge Hayden invited and waited for additional briefing from Sauter before signing that Order.<sup>4</sup> But that Order itself confirms that is false.<sup>5</sup>

This appeal involves a purely legal policy interpretation issue. As noted above, both parties' confirmed the absence of any disputed factual

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<sup>1</sup> See, e.g., *Opp. Br.* at pp. 3, 8-9.

<sup>2</sup> CP 479-480.

<sup>3</sup> CP 1141-42.

<sup>4</sup> *Opp. Br.* at p. 9.

<sup>5</sup> *Houston Casualty's Opposition Brief* contains a verbatim restatement of its prior accusation that Sauter refused to produce all the 2008 loan documents at issue here. *Opp. Br.* at pp. 27-28; compare CP 496-498. But as Sauter pointed out when that accusation was first lodged, Sauter produced all loan documents to Houston Casualty. CP 915. Houston Casualty's restatement of a demonstrably false accusation reveals that Houston Casualty's primary tactic on appeal is to malign Sauter.

issues by filing summary judgment cross-motions on that legal issue. Thus, Houston Casualty's repeated statements about Sauter bearing some type of factual "burden of proof" on appeal are misplaced.<sup>6</sup>

Sauter's Opening Brief set forth the rules of policy interpretation applicable here. Those rules include the requirement that a policy be interpreted as a whole pursuant to its plain language, and the prohibition against effectively adding language to a policy under the guise of interpreting that policy's plain language.

Washington law also requires that an insurance policy's plain language "be liberally construed to provide coverage whenever possible."<sup>7</sup> Houston Casualty inaccurately contends that rule of liberal construction applies only to the interpretation of policy exclusions. The Washington Supreme Court has confirmed that the rule of liberal construction applies equally to inclusionary coverage provisions, such as an Insuring Clause.<sup>8</sup>

Finally, settled Washington law requires a court to adopt a reasonable interpretation of a policy provision under which coverage exists even if that policy provision is subject to a different interpretation under which coverage would not exist. Thus, the trial court's summary

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<sup>6</sup> *See, e.g., Opp. Br. at pp. 3, 15.*

<sup>7</sup> *Odessa Sch. Dist. v. Ins. Co. of America*, 57 Wn. App. 893, 791 P.2d 237 (1990).

<sup>8</sup> *See State Farm Mut. Auto. Ins. Co. v. Ruiz*, 134 Wn.2d 713, 952 P.2d 157 (1998) ("As a general principle, courts must liberally construe inclusionary clauses in insurance policies in favor of coverage. . . .").

judgment Order must be reversed unless the relevant provisions of the Houston Casualty Policy can only be reasonably interpreted as barring coverage for Commerce Bank's claim against Sauter.

The only way to interpret the plain language of the Houston Casualty Policy in accordance with Washington's interpretation rules is as providing coverage for Commerce Bank's claim under Coverage A.

Coverage A's insuring clause provides:<sup>9</sup>

The Insurer shall pay on behalf of the **Insured Persons Loss** resulting from any **Claim** first made against the **Insured Persons** during the **Policy Period** for a **Wrongful Act**.

Each requirement is satisfied here.

**"Insured Person."** Sauter is an "Insured Person" under the Houston Casualty Policy because he is undisputedly a "duly appointed or elected . . . officer . . . manager, or equivalent executive of an Insured Organization [SJM]." Indeed, Houston Casualty has repeatedly acknowledged that Sauter is an "Insured Person."<sup>10</sup> Houston Casualty's newfound attempt to add an unstated "capacity" requirement to that definition is simply unsupported by policy language.

**"Claim."** Commerce Bank made multiple written demands that Sauter pay Commerce Bank certain contractual damages or face

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<sup>9</sup> CP 157.

<sup>10</sup> See, e.g., CP 369.

foreclosure upon his personal properties.<sup>11</sup> Such a “written demand for monetary damages or non-monetary relief” constitutes a “Claim” under the Houston Casualty Policy. Houston Casualty has never disputed that Commerce Bank’s demand is a “Claim.”

**“Wrongful Act.”** Commerce Bank’s “Claim” is for Sauter’s neglect or breach his duties under his commercial guaranty. The Houston Casualty Policy broadly defines “Wrongful Act” to include “any . . . alleged act, . . . neglect, breach of duty or act” committed in one’s capacity as an “Insured Person.” (Emphasis added.) Sauter’s neglect or breach of his contractual duty falls squarely within that definition.

Moreover, there is no dispute that Sauter executed that commercial guaranty because he was SJM’s CEO and Manager, and breached his duty under that commercial guaranty because SJM was unable to provide him with the indemnification to which its board agreed he was entitled because he had executed that guaranty on behalf of SJM. Thus, the “Wrongful Act” definition’s “capacity” requirement is satisfied as well.

**“Loss.”** Commerce Bank’s “Claim” seeks to impose “Loss” upon Sauter. The Houston Casualty Policy defines “Loss” to include “damages, settlements, and ‘Costs, Charges and Expenses’ incurred by any “Insured Person.” Houston Casualty’s acknowledgement that a “Claim” has been

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<sup>11</sup> CP 316-352.

made against Sauter also confirms that that “Claim” is for “Loss.” Dictionary definitions cited by both parties confirm that interpretation. Houston Casualty does not even dispute that Sauter has incurred defense costs falling within the definition of “Costs, Charges and Expenses.”

Now that Houston Casualty has properly acknowledged that the “Loss” definition’s exception for “matters deemed uninsurable under [governing] law” is inapplicable here,<sup>12</sup> the parties agree that the Houston Casualty Policy’s “Loss” definition is satisfied by any “damages, settlements, or ‘Costs, Charges and Expenses’” incurred by Sauter. Because that is the case, the “Loss” definition is satisfied.

**No Exclusions Apply.** Finally, Houston Casualty now admits that there are no policy exclusions that apply to bar coverage for Commerce Bank’s claim against Sauter.

The Houston Casualty Policy therefore requires Houston Casualty to provide coverage for Commerce Bank’s “Claim” against Sauter.

Unable to change the foregoing, Houston Casualty tries to avoid its express coverage obligations by warning this Court of the “havoc” that would purportedly result from this Court’s enforcement those obligations. But *Boeing v. Aetna* confirms that the proper interpretation of an insurance policy is not affected by the magnitude of the coverage obligations that

might be created by judicial adoption of that interpretation, and that sophisticated insurers like Houston Casualty can avoid unwanted coverage obligations by drafting their policies to clearly and unambiguously eliminate the potential for such coverage. Indeed, Houston Casualty demonstrated it knew how to avoid coverage for its insured's contractual liability by including a contractual liability exclusion elsewhere in the Houston Casualty Policy. But it chose not to do so here.

The real danger created by this appeal is found in Houston Casualty's argument that Commerce Bank's "Claim" does not allege a "Wrongful Act" in Sauter's corporate capacity because Commerce Bank's "Claim" seeks to impose personal liability upon Sauter. D&O policies are specifically intended to protect directors and officers against personal liability arising out of their acts on behalf of the corporation. If an insurer could escape its express coverage obligations by arguing that a corporate officer could never have personal liability arising out an act committed in a corporate capacity, D&O coverage would never protect an officer from personal liability. Although Houston Casualty would undoubtedly desire that result, it would turn D&O insurance entirely on its head.

## II. ARGUMENT

"Coverage A" of Houston Casualty's D&O policy expressly covers

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<sup>12</sup> *Opp. Br. at 39-40.*

“Loss” sustained by an officer, director, or manager of the “Insured Organization.” Other coverages not at issue here provide coverage for different types of “Loss” sustained by the “Insured Organization.”

Coverage A’s insuring clause expressly provides:

The Insurer shall pay on behalf of the **Insured Persons Loss** resulting from any **Claim** first made against the **Insured Persons** during the **Policy Period** for a **Wrongful Act**.

Each element of Coverage A’s insuring clause is satisfied here.<sup>13</sup>

**A. Sauter Is An “Insured Person.”**

Houston Casualty now denies that Sauter is an “Insured Person” under the Houston Casualty Policy, because Sauter was not “acting in his capacity as an officer of SJ Management” with respect to the commercial guaranty Commerce Bank alleges he breached.<sup>14</sup>

Notably, Houston Casualty previously admitted that “Mr. Sauter, as a Manager and CEO of S-J Management, is an **Insured Person**.”<sup>15</sup> This underscores the significant irony of Houston Casualty’s false assertion that Sauter “disingenuously claims that Houston Casualty conceded that he is an Insured Person.”<sup>16</sup>

Houston Casualty’s original admission of Sauter’s “Insured

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<sup>13</sup> *Houston Casualty has never denied that Commerce’s written demands for monetary damages constitute a “Claim” under the Houston Casualty Policy. See, e.g., CP 366.*

<sup>14</sup> *Opp. Br. at p. 21.*

<sup>15</sup> *CP 369.*

Person” status was correct. The Houston Casualty Policy defines “Insured Person” as any “natural person who was, is, or shall become a duly appointed or elected director, officer, . . . manager, . . . or equivalent executive of an Insured Organization.”<sup>17</sup> There is no dispute that Sauter is the CEO and Manager of SJM.<sup>18</sup> Nor is there any dispute that SJM is an “Insured Organization.”<sup>19</sup>

The “Insured Person” definition simply does not contain any type of “capacity” requirement. Thus, Sauter is an “Insured Person” under the plain and unambiguous language of the Houston Casualty Policy.

**B. Commerce’s “Claim” Alleges a “Wrongful Act” by Sauter.**

Sauter’s Opening Brief expressly set forth the following language from the Houston Casualty Policy’s “Wrongful Act” definition:<sup>20</sup>

<p><b>Y. Wrongful Act</b> means, as alleged in any <b>Claim</b>, any actual or alleged act, misstatement, error, omission, misleading statement, neglect, breach of duty or act by:</p> <p>(1) any of the <b>Insured Persons</b>, while acting in their capacity as:</p> <p>(a) such on behalf of the <b>Insured Organization</b> or the functional equivalent of such on behalf of the <b>Insured Organization</b> in the event the <b>Insured Organization</b> is incorporated or domiciled outside the United States; . . .</p>
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Yet Houston Casualty’s Opposition Brief falsely accuses Sauter

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<sup>16</sup> *Opp. Br. at 21.*

<sup>17</sup> *CP 159.*

<sup>18</sup> *CP 150.*

<sup>19</sup> *CP 156, 159.*

<sup>20</sup> *Opening Brief at 16.*

(again) of “conveniently omit[ting] this latter [capacity] part of the definition of Wrongful Act from his brief . . . .”<sup>21</sup>

**1. Sauter’s Alleged Breach of His Commercial Guaranty is a “Wrongful Act.”**

Sauter’s summary judgment briefing below and Opening Brief both confirmed that Sauter’s alleged “Wrongful Act” was the neglect or breach of his duties under the commercial guaranty he executed to satisfy a condition of Commerce Bank’s loan to SJM.<sup>22</sup> That alleged neglect or breach of contractual duty by Sauter falls squarely within the plain language of the Houston Casualty Policy’s “Wrongful Act” definition – specifically, that definition’s express reference to “any . . . neglect [or] breach of duty” by an “Insured Person” such as Sauter.<sup>23</sup>

Houston Casualty argues that a breach of contractual duty such as Sauter’s can never be a “Wrongful Act” under a D&O policy. That argument essentially asks this Court to judicially revise its policy’s express coverage for “any . . . neglect [or] breach of duty” to mean “any . . . neglect [or] breach of non-contractual duty.”

Such an interpretation would effectively convert the Houston

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<sup>21</sup> *Opp. Br. at pp. 21, 22.*

<sup>22</sup> *CP 136; Opening Brief at p. 25.*

<sup>23</sup> *Houston Casualty’s Opposition Brief attempts to escape the significance of the word “any” used in the “Wrongful Act” definition by mischaracterizing Sauter’s argument concerning the significance of that word as relating to that definition’s capacity requirement. Opp. Br. at 22. Sauter has never made that argument.*

Casualty Policy's "Wrongful Act" definition into a contractual liability exclusion. Such an interpretation would violate Washington insurance law's prohibition against adding policy language under the guise of interpretation, especially when it would limit the coverage afforded under the subject policy's plain language.<sup>24</sup>

The foregoing prohibition applies with even greater force when the added language would bar coverage the issuing insurer showed it knew how to bar when it really wanted to by including an express exclusion for such coverage elsewhere in the same policy, or even in a separate policy.<sup>25</sup> Houston Casualty showed it knew how to exclude coverage for contractual liability by including an express exclusion to that effect in Houston Casualty Policy Coverages C and G and entirely separate policies.<sup>26</sup>

Houston Casualty does not dispute the foregoing. Instead, it argues those other exclusions are irrelevant because this appeal solely concerns the interpretation of Coverage A's insuring clause.<sup>27</sup> That argument is misplaced because under *Larsen*, Houston Casualty's use of those exclusions elsewhere prevents Coverage A's insuring clause from being interpreted the same as those separate exclusions.

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<sup>24</sup> See, e.g., *American Nat'l Fire Ins. Co. v. B&L Trucking*, 134 Wn.2d 413, 430, 951 P.2d 250 (1998).

<sup>25</sup> *Larsen v. United Pacific Ins. Co.*, 44 Wn. App. 529, 532, 723 P.2d 8 (1986).

<sup>26</sup> *Opp. Br. at pp. 36-39.*

<sup>27</sup> *Opp. Br. at pp. 38-39.*

Similarly, the judicial policy revision sought by Houston Casualty violates *Boeing*'s prohibition against interpreting a general coverage provision term like an insuring clause as having an exclusionary effect.<sup>28</sup>

Not surprisingly, Houston Casualty fails to discuss or address this controlling aspect of the *Boeing v. Aetna* decision. Instead, Houston Casualty's primary tactic is to avoid this straightforward application of plain policy language by repeatedly mischaracterizing the "Wrongful Act" upon which Commerce Bank's "Claim" against Sauter is based. For example:

- Houston Casualty asserts that Sauter's alleged "Wrongful Act" was "obtaining and personally guaranteeing a loan."<sup>29</sup>
- Houston Casualty asserts that Sauter's alleged "Wrongful Act" was "enter[ing] into an agreement, voluntarily, to secure a loan to his business with his personal assets."<sup>30</sup>
- Houston Casualty asserts that Sauter contends that "his 'Wrongful Act' is in failing to have SJ Management repay the loan."<sup>31</sup>

The shifting nature of the foregoing mischaracterizations by Houston Casualty exposes those mischaracterizations as a tactic intended to confuse the issues on appeal.

None of the non-Washington decisions relied upon by Houston

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<sup>28</sup> *Boeing*, 113 Wn.2d at 877.

<sup>29</sup> *Opp. Br.* at p.2.

<sup>30</sup> *Opp. Br.* at 16.

<sup>31</sup> *Opp. Br.* at 20.

Casualty supports the argument that the Houston Casualty Policy's express coverage for "any . . . neglect [or] breach of duty" cannot be interpreted as satisfied by Commerce Bank's "Claim" for Sauter's neglect or breach of his duty under his commercial guaranty. To begin with, none of those decisions can constitute even persuasive authority because Houston Casualty does not even discuss the "wrongful act" definition being interpreted or applied in any of those non-Washington decisions.<sup>32</sup>

Moreover, even Houston Casualty's own discussion of those non-Washington decisions confirms that those decisions are factually distinguishable. To begin with, the *August Entertainment*, *Oak Park*, *Newman*, *Republic Franklin*, *Noxubee*, *Toombs*, and *Eaton Vance* decisions involved an alleged breach of contract by a corporate insured after it had received the benefits of that contract. None of those decisions involved an alleged breach by a party, like Sauter here, who did not receive any of the benefits of that contract. As such, those courts' collective objection to a party obtaining the benefits of a contract and then shifting its own contractual obligations to its insurer do not apply here.

Similarly, those decisions involved an insured's deliberate decision not to satisfy its contractual obligations. Conversely, the undisputed facts

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<sup>32</sup> *See Opp. Br. at pp. 16-20. Nor does Houston Casualty discuss whether or not the issuers of those policies had expressly excluded coverage for contractual liability elsewhere.*

here confirm that Sauter did not deliberately refuse to satisfy his duty under his commercial guaranty. Rather, Sauter was unable to satisfy his duty because SJM was financially unable to provide Sauter with the indemnification to which its directors unanimously agreed he was entitled.<sup>33</sup> Thus, those courts' collective objection to allowing insureds to intentionally "walk away" from their contractual obligations and have their insurers satisfy those obligations do not apply here.

Houston Casualty specifically cites *Oak Park* as supporting its "Wrongful Act" argument because "Sauter's decision not to repay using his personal assets is voluntary and not the result of a fortuity."<sup>34</sup> But Washington's fortuity doctrine actually supports Sauter's right to coverage here. The Washington Supreme Court has described that doctrine as:

In Washington, we call the fortuity principle the known risk principle and first enunciated it in *Public Util. Dist. No. 1 v. International Ins. Co.*, 124 Wash.2d 789, 805, 881 P.2d 1020 (1994): "The known risk defense is premised on the principle that an insured cannot collect on an insurance claim for a loss that the insured subjectively knew would occur at the time the insurance was purchased...."<sup>35</sup>

Houston Casualty does not and cannot argue that Sauter

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<sup>33</sup> CP 312-15, 153.

<sup>34</sup> *Opp. Br.* at p. 18.

<sup>35</sup> *Aluminum Co. of America ("Alcoa") v. Aetna Cas. & Sur. Co.*, 140 Wn.2d 517, 556, 998 P.2d 856 (2000); see also *Frank Coluccio Const. Co., Inc. v. King County*, 136 Wn.App. 751, 150 P.3d 1147 (2007) ("in deciding whether a loss was fortuitous, a court should examine the parties' perception of risk at the time the policy was issued", noting that "ordinarily, a loss which could not reasonably be foreseen by the parties at the time of the policy was issued is fortuitous.").

subjectively knew before the Houston Casualty insurance inception that Commerce Bank would assert a “Claim” against him in July 2009.<sup>36</sup> In fact, the record here confirms that Sauter had no knowledge or expectation at the time the Houston Casualty insurance inception that an unprecedented economic crisis was coming, that that crisis would hit the Southwestern U.S. real estate market with particular force, and that as a result SJM would be unable to repay the loan it obtained from Commerce Bank.<sup>37</sup> Consequently, Sauter neither knew nor expected that Commerce Bank would assert a “Claim” against him.

In Washington, “[f]ortuity is, in effect, an exclusion and it logically should be the burden of the insurer to plead and prove the exclusion.”<sup>38</sup> Houston Casualty has not set forth any facts supporting its argument that the fortuity exclusion precludes coverage, and even concedes that “Houston Casualty has not argued that any exclusion applies

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<sup>36</sup> Neither does Houston Casualty argue that Sauter knew prior to April 18, 2008 that there was a substantial probability that Commerce would assert a Claim against him, as required for the fortuity principle to apply. See *PUD No. 1 of Klickitat County v. Int'l Ins. Co.*, 124 Wn.2d 789, 881 P.2d 1020 (1994) (affirming trial court instruction requiring that “insureds know that there was a substantial probability” that a Claim would be asserted against them for the fortuity / known-loss principle to apply.).

<sup>37</sup> See CP 152 (“At the time I executed the Commercial Guaranty on behalf of SJM, I believed I had an in-depth understanding of SJM’s business and financial prospects. I was confident that SJM would be able to repay Commerce in full and did not expect that I would ever be required to make personal payments to satisfy SJM’s indebtedness to Commerce.”).

<sup>38</sup> *Alcoa*, 140 Wn.2d 517, 562, 998 P.2d 856 (2000).

here.”<sup>39</sup> Houston Casualty’s fortuity argument is therefore invalid.

**2. Sauter’s Alleged “Wrongful Act” Was Committed in His Capacity As CEO and Manager of SJM.**

The record here confirms that Commerce Bank’s “Claim” is for a “Wrongful Act” committed in Sauter’s capacity as an “Insured Person.”<sup>40</sup> Indeed, Houston Casualty has admitted that Commerce Bank would not have loaned to SJM without Sauter’s guaranty and assets as collateral.<sup>41</sup>

Unable to dispute any of those facts, Houston Casualty merely argues (at great length) that Sauter’s “Wrongful Act” could not have been committed in his corporate capacity because he faces only personal liability for that “Wrongful Act.”<sup>42</sup>

Houston Casualty’s argument contravenes the widely recognized purpose for directors and officers insurance.<sup>43</sup> The *Medical Mut. Ins. Co. of Maine v. Indian Harbor Ins. Co.* decision cited in Sauter’s Opening Brief relied heavily upon one of the most respected insurance law

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<sup>39</sup> *Opp. Br. at p. 15.*

<sup>40</sup> *Opening Brief at pp. 46-47.*

<sup>41</sup> *CP 494.*

<sup>42</sup> *Opp. Br. at 24-31. Houston Casualty falsely alleges that Carol Sauter also executed the commercial guaranty. Opp. Br. at p. 26. In truth, Mrs. Sauter did not sign the guaranty. CP 306. Mrs. Sauter was merely a “grantor” on the Deeds of Trust in case of default and/or foreclosure, because the properties securing Mr. Sauter’s guaranty were marital/community property. Houston Casualty’s “Wrongful Act” argument is actually undermined by the fact that SJM could make Mr. Sauter, but not Mrs. Sauter, provide a guaranty, because Mr. Sauter had an official role with SJM, but Mrs. Sauter did not.*

<sup>43</sup> *Opening Brief at p.48.*

commentators in describing that purpose.<sup>44</sup>

This outcome is consistent with the purpose of a Directors and Officers policy, to give those persons insurance coverage to protect them from personal liability. 9A Lee R. Russ & Thomas F. Segalla, *Couch on Insurance* §131:30 (3d ed. 1995) (“[A]n explosion in litigation against corporate officers and directors made liability coverage a necessity, and corporations wanted to be able to provide such coverage for their officials so that the top candidates for office would not be discouraged by the threat of litigation.”).

And as Sauter’s Opening Brief also notes, Houston Casualty’s argument also contradicts Houston Casualty’s own representations to the public about the benefits of Houston Casualty’s D&O policies.<sup>45</sup>

In short, D&O insurance exists to protect directors and officers from personal liability for corporate acts. That is why Coverage A protects solely against the liability of “Insured Persons,” but not the “Insured Organization.” Houston Casualty’s capacity argument, if accepted, would negate D&O insurance by ensuring that the capacity requirement is never satisfied whenever a third-party claim seeks to impose personal liability upon a corporate director or officer. Houston Casualty’s argument should be rejected.

**C. Commerce’s “Claim” Seeks to Impose “Loss” Upon Sauter.**

The Houston Casualty Policy defines “Loss” as “damages,

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<sup>44</sup> 587 F.Supp.2d at 291.

<sup>45</sup> Opening Brief at p.48.

settlements and ‘Costs, Charges and Expenses’ incurred by any of the ‘Insured Persons’ under Insuring Agreement Coverage A . . . .”<sup>46</sup>

The “Loss” definition has an exception for “matters deemed uninsurable under the law pursuant to which this Policy shall be construed.”<sup>47</sup> Houston Casualty has repeatedly argued that Sauter’s contractual liability was not “Loss” because such liability is not (or at least should not be) legally insurable.<sup>48</sup> Thus, Sauter has repeatedly explained that contractual liability has not been deemed uninsurable under Washington law, and thus Houston Casualty’s uninsurability argument violated Washington’s rules of policy interpretation.<sup>49</sup>

Houston Casualty finally admits that the “matters uninsurable” exception to the “Loss” definition does not apply here. Thus, both parties now agree that Coverage A’s “Loss” requirement is satisfied as long as Commerce Bank’s “Claim” seeks to impose “damages, settlements, [or] ‘Costs, Charges and Expenses’” upon Sauter.

**1. Houston Casualty Admits that Commerce Bank’s “Claim” Seeks to Impose “Damages” upon Sauter.**

The Houston Casualty Policy defines “Loss” to include the

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<sup>46</sup> *Opening Brief at p.16.*

<sup>47</sup> *Opening Brief at p.29.*

<sup>48</sup> *See, e.g., Opp. Br. at 500, 505.*

<sup>49</sup> *Opening Brief at pp.29-32 (citing Fluke Corp. v. Hartford Acc. & Indem. Co., 145 Wn.2d 137, 144-47, 34 P.3d 908 (2001) as confirming that Washington courts determine “insurability” based upon the plain language an insurer chooses to include in its policy, rather than unexpressed notions of what should be covered).*

undefined term “damages.” As explained above, Houston Casualty has never disputed that Commerce Bank has asserted a “Claim” against Sauter. The Houston Casualty Policy defines “Claim” to include a “written demand for monetary damages.”<sup>50</sup> Thus, Houston Casualty necessarily admits that Commerce Bank seeks “damages” from Sauter. This admission confirms that the “Loss” requirement is satisfied here.

Houston Casualty’s acknowledgement makes sense. One standard English dictionary defines “damages” as “the estimated reparation in money for detriment or injury sustained.”<sup>51</sup> Commerce Bank’s “Claim” seeks contractual damages, interest, attorney fees and reconveyance fees – or foreclosure upon Sauter’s properties in lieu of such payment – as reparation for the detriment or injury Commerce Bank sustained as a result of Sauter’s breach of his commercial guaranty.<sup>52</sup> And of course, Commerce Bank retains the right to pursue additional payments from Sauter, for which Houston Casualty has also denied any coverage responsibility. Commerce Bank’s “Claim” therefore seeks such “Loss.”<sup>53</sup>

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<sup>50</sup> CP 158.

<sup>51</sup> Webster’s Third New International Dictionary (1993).

<sup>52</sup> CP 127, 154; Opening Brief at p. 13.

<sup>53</sup> Even if Sauter’s past and potential payments to Commerce Bank were not “damages,” it is reasonable to interpret those payments as “settlements” falling within the “Loss” definition. Houston Casualty argues that partial periodic payments made by Sauter are not “settlements” because the periodic partial payments did not fully resolve the Commerce’s Claim against Sauter. Opp. Br. at pp. 33-34. Houston Casualty’s technical argument violates the requirement that a policy be interpreted as it would be by an

**2. Commerce Bank’s “Claim” Falls Within Dictionary Definitions of “Damages” Offered by Houston Casualty.**

Houston Casualty cites two “damages” definitions that apply to Commerce Bank’s “Claim” against Sauter:<sup>54</sup>

- Miriam Webster defines “damages” to mean “compensation in money imposed by law for loss or injury.”<sup>55</sup> Commerce Bank’s “Claim” clearly alleges that Sauter is legally obligated to compensate Commerce Bank for its loss resulting from Sauter’s breach of the duty he assumed under his commercial guaranty.
- “Law.com” – while not a standard English dictionary consulted by Washington courts but rather a dictionary containing technical/legal definitions not necessarily consistent with Washington’s “average purchaser of insurance” interpretation rule – defines “damages” as “the amount of money which a plaintiff (the person suing) may be awarded in a lawsuit.” Commerce Bank’s “Claim” clearly demands that Sauter pay amounts that may be awarded to Commerce Bank in a lawsuit against Sauter.

Sauter has made periodic payments which fall within both of these dictionary definitions. And as noted above, Commerce Bank retains the right to pursue additional payments from Sauter due to his breach of his duty under his commercial guaranty. Such payments are “Loss” to Sauter.

With respect to the foregoing definitions, Houston Casualty merely offers the conclusory and ambiguous assertion that “No compensation has been imposed on Sauter by law.” Houston Casualty appears to be arguing

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*average purchaser of insurance — that is, as encompassing any agreement that fully or partially resolves a dispute or lawsuit.*

<sup>54</sup> *Opp. Br. at p.33.*

that Sauter cannot have “damages” satisfying the “Loss” definition unless such “damages” are awarded against Sauter at the end of a lawsuit.

Such a definition of “damages” is impermissible here because the Houston Casualty Policy expressly covers a “written demand for monetary damages” that does not involve a formal civil proceeding. Interpreting “damages” as requiring such an award of money damages in a lawsuit would impermissibly negate that express coverage. Similarly, interpreting “damages” to include only money damages awarded against the insured ignores that the Houston Casualty Policy’s “Claim” definition expressly includes coverage for a “written demand for . . . non-monetary relief”<sup>56</sup> Commerce Bank’s “Claim” expressly asserted Commerce Bank’s purported right and intent to foreclose upon Sauter’s properties if Sauter did not pay the amount demanded.<sup>57</sup> Thus, the defense costs, partial settlement payment, and property losses sustained as a result of such a “Claim” are covered “Loss.”

**3. Commerce Bank’s “Claim” Imposes “Costs, Charges and Expenses” upon Sauter.**

The Houston Casualty Policy also defines “Loss” to include “Costs, Charges and Expenses,” which means “legal fees and expenses . . .

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<sup>55</sup> *Id.*

<sup>56</sup> *CP 158 (emphasis added).*

<sup>57</sup> *CP 317-352.*

incurred by the Insureds in defense of any Claim . . . .”<sup>58</sup> The record here confirms that Sauter has paid fees for the defense against Commerce Bank’s “Claim.” Houston Casualty has never disputed this fact. This further confirms that the “Loss” definition is satisfied here.

**4. Houston Casualty’s Math-Based “Loss” Argument and Related Authority Are Inapplicable Here.**

Houston Casualty eventually abandons the Houston Casualty Policy’s plain language and argues that Sauter could not have a covered “Loss” because Commerce Bank merely seeks to have him repay a loan. Houston Casualty seeks to support this argument by citing to various non-Washington decisions – specifically, the *Pan Pacific*, *Level 3*, *Local 705*, and *Reliance Group Holdings* decisions – generally holding that the an obligation to repay moneys previously received as “ill-gotten gains” is not insurable “Loss.” Notably, Houston Casualty does not even attempt to discuss whether or not those decisions involved a “Loss” definition similar to the one Washington law requires this Court to enforce as written.<sup>59</sup>

Those non-Washington decisions do not actually support Houston Casualty’s argument. Those decisions merely reflect what amounts to a mathematical reality that an insured that is sued for money it improperly

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<sup>58</sup> CP 158.

<sup>59</sup> The *Eaton Vance*, *Toombs*, *American Casualty*, *Baylor Heating*, *Metropolitan Props.*, and *Newman* decisions also relied upon by Houston Casualty are inapposite because they involve neither a D&O policy nor a demand for repayment of a business loan.

received does not sustain “Loss,” but rather “breaks even” financially.

That reality does not exist here. It is undisputed that Sauter did not receive any of the proceeds of Commerce Bank’s loan to SJM.<sup>60</sup> Thus, Sauter cannot be required to return or repay funds to Commerce Bank. Indeed, Sauter would end up substantially “worse off” – by up to \$3 million – as a result of Commerce Bank’s “Claim.”

Even if decisions concerning the existence of coverage for “ill-gotten gains” claims were relevant here, a court in Washington has already ruled that under Washington law, such claims would be covered unless an express exclusion unambiguously applied to bar such coverage.<sup>61</sup>

In *Virginia Mason*, the plaintiff class sued to recover facility charges they were billed for services provided at Virginia Mason’s downtown clinic when Virginia Mason’s clinics did not include such charges.<sup>62</sup> Virginia Mason agreed to repay its downtown clinic facility charges to each class member, then sought coverage for that settlement.<sup>63</sup>

Insurer Executive Risk argued that the settlement was not “Loss” because “Loss” does not include “payments that are purely restitutionary, i.e., a pure refund of funds that were not properly obtained, whether

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<sup>60</sup> CP 152.

<sup>61</sup> See *Virginia Mason Medical Center v. Executive Risk Indemnity, Inc.*, 2007 WL 3473683 (W.D. Wash. 2007).

<sup>62</sup> *Virginia Mason*, 2007 WL 3473683 at \*1.

<sup>63</sup> *Virginia Mason*, 2007 WL 3473683 at \*1.

through intentional or negligent conduct – like [Virginia Mason’s] return of undisclosed hospital facilities charges to member of the *Gibsons* class.”<sup>64</sup> Judge Pechman properly rejected that argument, stating:

Executive Risk’s argument is unconvincing. The Court’s construction of a contract cannot “lead to an absurd conclusion, or render the policy nonsensical or ineffective.” *Morgan v. Prudential Ins. Co.*, 86 Wash.2d 432, 434-435, 545 P.2d 1193 (Wash.1976) (internal citation omitted). Disallowing coverage for the *Gibson* settlement on the grounds that the funds were wrongfully gained would render nonsensical the Policy’s explicit coverage for settlements resulting from a wrongful act. Instead, when construed as a whole, the plain language of the Policy indicates that the *Gibson* settlement is a covered “loss.”<sup>65</sup>

Houston Casualty claims that reliance upon Judge Pechman’s ruling is misplaced because Virginia Mason’s claim concerned compensatory damages, as opposed to restitutionary damages.<sup>66</sup> But Judge Pechman characterized such a distinction was misplaced.<sup>67</sup>

Executive Risk also argued that the settlement was uninsurable as a matter of Washington law. Judge Pechman also rejected that argument:<sup>68</sup>

Washington courts have not addressed whether an insurer can provided coverage for the risk of being forced to return money that was wrongfully obtained, but the Washington Supreme Court has held that entities may insure against liability for their own wrongful conduct.

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<sup>64</sup> *Virginia Mason*, 2007 WL 3473683 at \*3.

<sup>65</sup> *Virginia Mason*, 2007 WL 3473683 at \*3.

<sup>66</sup> *Opp. Br.* at p. 41.

<sup>67</sup> *Virginia Mason*, 2007 WL 3473683 at \*3; *affirmed*, 331 Fed.Appx. 473 (9<sup>th</sup> Cir. 2009).

<sup>68</sup> *Virginia Mason*, 2007 WL 3473683 at \*4.

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Executive Risk has not supplied any Washington statutes or case law expressing public policy against such coverage. Because the Washington Supreme Court has indicated that vague public policy arguments should not limit the express language in a policy, the Court finds that the coverage defined in Executive Risk's Policy is insurable under Washington law.

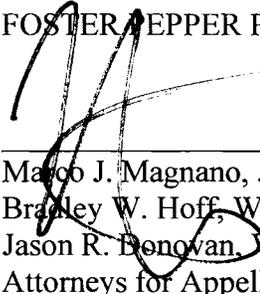
*Virginia Mason* is therefore fatal to Houston Casualty's argument that Commerce Bank's "Claim" does not seek to impose "Loss."

### **III. CONCLUSION**

Sauter respectfully requests that this Court reverse the trial court's summary judgment Order, vacate the resulting Judgment, and direct the trial court to enter partial summary judgment as requested by Sauter.

RESPECTFULLY SUBMITTED this 31st day of August, 2011.

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