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COURT OF APPEALS OF THE STATE OF WASHINGTON
DIVISION I

No. 66809-9-1

MICHAEL J. SAUTER,

Appellant,

v.

HOUSTON CASUALTY COMPANY,

Respondent.

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STATE OF WASHINGTON
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HOUSTON CASUALTY COMPANY'S RESPONSIVE BRIEF

Patrick M. Paulich, WSBA# 10951
Thorsrud Cane & Paulich
1325 Fourth Avenue, Suite 1300
Seattle, WA 98101
206.386.7755

and

Aidan M. McCormack
Sarah A. Kutner
Robert C. Santoro
DLA Piper US LLP
1251 Avenue of the Americas
New York, NY 10020
212.335.4500

Attorneys for Respondent

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Respondent Houston Casualty Company (“Houston Casualty”) respectfully submits this memorandum of law in opposition to Petitioner Michael J. Sauter’s (“Sauter”) appeal of the denial of his summary judgment motion by the court below. Houston Casualty respectfully requests, for the following reasons, that this Court deny Sauter’s appeal and uphold the trial court’s decision that there is no coverage under the Houston Casualty insurance contract for Sauter’s personal loan repayment obligation.

INTRODUCTION

The Trial Court correctly held that Sauter is not entitled to liability insurance monies to repay a loan of approximately \$2.8 million that Commerce Bank of Washington, N.A. (“Commerce Bank”) made to SJ Management LLC (“SJ Management”), and which Sauter and his wife, non-party Carol G. Sauter, personally guaranteed (the “Commerce Bank Matter”). Not surprisingly, the Trial Court held that a business liability insurance contract like the one at issue here does not provide insurance for one’s personal obligation to repay a loan. In essence, Sauter would like Houston Casualty to pay SJ Management’s line of credit — a corporate debt that was assumed by SJ Management and personally guaranteed by Sauter and his wife pursuant to a written guaranty agreement. There is no coverage because SJ Management suffers no financial detriment by

repaying Commerce Bank back the line of credit because those funds were borrowed. By issuing an insurance contract to SJ Management, Houston Casualty did not undertake the obligation to satisfy SJ Management's line of credit, nor to become SJ Management's business partner, nor a co-guarantor of Sauter and his wife's personal guarantee of SJ Management's loan obligations.

First, obtaining and personally guaranteeing a loan does not constitute a "Wrongful Act" under the Houston Casualty insurance contract. There was no *wrongful* act, error or omission. Sauter voluntarily guaranteed a loan with his significant personal assets. To hold that borrowing money is a "Wrongful Act" within the meaning of a liability insurance contract would be to espouse a shocking premise not accepted by a single Court in the entire country. Moreover, Sauter cannot commit a "Wrongful Act" while acting in his personal capacity, as he was when he personally guaranteed SJ Management's line of credit. For there to be a "Wrongful Act", Sauter must have been "acting in [his] capacity as: (a) [an Insured Person] on behalf of the Insured Organization"

Here, Commerce Bank seeks to recoup from Sauter the loan proceeds that SJ Management failed to repay on the basis that he and his wife (who is neither an insured, nor a party to this case) *personally* guaranteed the loan with *personal* assets, including some of the many

properties they hold *personal* title to. There is simply no insurable “Wrongful Act”. To hold differently would wreak havoc on the insurance industry by creating insurance for hundreds of thousands, if not millions, of simple, everyday loans where none was intended.

Second, any obligation to repay a loan does not constitute “Loss” under the Houston Casualty insurance contract. “Loss” under the insurance contract, and the law, requires compensation to another for damages one has caused and is legally obligated to repay. Here, there are no damages for which compensation is sought. Not surprisingly, Commerce Bank wants SJ Management to return money that SJ Management borrowed. Although not cited by Sauter, courts across the nation have held that the repayment of monies does not constitute “Loss” under D&O and other business liability insurance contracts, such as the one at issue here. Sauter has not cited a single case supporting the tortured reading of the contract language he seeks to impose.

Sauter bears the burden of proving entitlement to insurance coverage for each amount he has purportedly paid as a result of the Commerce Bank Matter. This is so not only because Sauter moved for summary judgment below, but also because it is Sauter’s burden, as the insured, to prove that this matter falls within the insuring agreement of the Houston Casualty insurance contract. He cannot do so. Indeed, it is quite

clear that Sauter's attempts to extract insurance monies so he can repay a debt he voluntarily and personally guaranteed are baseless. Accordingly, this Court should affirm the Trial Court's holding that there is no coverage under the Houston Casualty insurance contract.

ASSIGNMENTS OF ERROR

The Trial Court correctly denied Sauter's motion for partial summary judgment under Insuring Agreement A of the Houston Casualty insurance contract and granted Houston Casualty summary judgment. There was no error in the Trial Court's decision, and Houston Casualty respectfully requests that this Court affirm the holding that there is no coverage under the Houston Casualty insurance contract.

STATEMENT OF THE CASE

A. The Underlying Commerce Loan and Guaranty

On December 12, 2007, Commerce Bank agreed to extend a variable rate loan in the amount of \$1.75 million to SJ Management (the "2007 Loan").¹ On March 19, 2008, Commerce Bank agreed to extend a non-revolving line of credit to SJ Management in the amount of \$3.5 million (the "2008 Loan").² From the 2008 Loan proceeds, \$1.25 million was used to pay off the balance of the 2007 loan, and the

¹ CP 761.

² CP 768.

remaining \$2.25 million provided working capital for SJ Management.³ Sauter and his wife, Carol G. Sauter, personally secured the 2008 Loan by providing their personal assets as collateral. They provided \$500,000 in cash, to be held in escrow by Commerce Bank (the “Cash Collateral”), and seven personally held real properties by Deeds of Trust to the Commerce Bank.⁴ Sauter separately executed a Commercial Guaranty in connection with the 2008 Loan under which he personally guaranteed SJ Management’s debt.⁵ Indeed, the 2008 Loan was conditioned upon this security provided by Sauter and his wife.⁶ On April 10, 2009, Commerce Bank applied the Cash Collateral to SJ Management’s outstanding line of credit and extended the maturity date to May 31, 2009 because SJ Management failed to repay the loan by the original maturity date, March 31, 2009.⁷ The application of the Cash Collateral reduced the outstanding principal from \$3,298,266.37 to \$2,793,809.94.⁸

B. Commerce’s Demand for Repayment on the Loan

After the line of credit matured on May 31, 2009, Commerce Bank demanded payment on Sauter’s personal guaranty in the amount of

³ CP 766.

⁴ CP 768, CP 804.

⁵ CP 774-78.

⁶ CP 804.

⁷ CP 804.

⁸ CP 804.

\$2,824,466.61, plus \$329.82 *per diem* interest by letter dated July 20, 2009.⁹ Sauter, in turn, demanded indemnification from SJ Management under Section 4.2¹⁰ of the operating agreement, for the amount demanded by the bank, plus the Cash Collateral already applied to the line of credit (the “Indemnification Demand”).¹¹ In his letter, Sauter stated that

I entered into the Commercial Guaranty in my role as SJ’s CEO and did so to ensure that SJ could obtain the line of credit with Commerce Bank. I acted in good faith and placed my personal properties at risk to ensure that SJ would have funds available for operations from the line of credit.

Commerce Bank subsequently sent six Notices of Default to Sauter and his wife, Carol G. Sauter.¹² The Notices of Default, dated August 11, 2009, assert that Sauter and his wife executed Deeds of Trust on March 19, 2008 which encumbered real properties located at: (1) 4210 E. Garfield Street, Seattle, Washington; (2) 996 Mutiny Shore Drive, Freeland, Washington; (3) 1017 East Blaine Street, Seattle, Washington; (4) 816 Old Beach Road, Apt. 302, Freeland, Washington; (5) 1860 41st Avenue E., Seattle, Washington; and (6) 2015 42nd Avenue E., Seattle

⁹ CP 806-07.

¹⁰ It appears that Sauter meant to demand payment under Section 4.12, not 4.2.

¹¹ CP 809.

¹² CP 812-17; 819-24; 826-31; 833-38; 840-45; 847-52. Each Notice of Default references and incorporates the 2007 Loan documents, which Sauter refused to produce. *See* CP 571, CP 576.

Washington.¹³ The Notices of Default also assert that the Sauters failed to pay \$2,833,095.65 under the Deed of Trust and Commercial Guaranty dated December 12, 2007.¹⁴ The Notices stated that the failure to cure the default within 30 days could result in the sale of the encumbered properties at public auction.¹⁵

C. Claim History

On August 10, 2009, the Otto Law Group, counsel to SJ Management, sent a letter to Houston Casualty forwarding information regarding the Commerce Bank Matter.¹⁶ The letter attached a copy of Commerce Bank's July 20, 2009 letter and Sauter's indemnification demand to his own company, SJ Management, dated July 27, 2009.¹⁷ Houston Casualty acknowledged receipt of this correspondence by letter dated August 14, 2009.¹⁸ Houston Casualty then received another letter from the Otto Law Group dated August 18, 2009, attaching Notices of Default and acknowledged receipt of Houston Casualty's August 14, 2009 letter.¹⁹

¹³ CP 813; 820; 827; 834; 841; 848.

¹⁴ CP 813; 820; 827; 834; 841; 848.

¹⁵ CP 815; 821; 828; 835; 842; 849.

¹⁶ CP 704.

¹⁷ CP 706-07, CP 709.

¹⁸ CP 714-15.

¹⁹ CP 361-62.

In a September 24, 2009 letter, Houston Casualty's counsel responded to SJ Management counsel's request for a position.²⁰ The letter explained that, "based on the information obtained to date HC has determined that coverage is unavailable."²¹ Among other things, the letter explained Carol Sauter lacked insured status²²; repayment of a debt does not constitute "Loss"²³; Sauter executed the Commercial Guaranty in his personal capacity²⁴, and no "Wrongful Act" had been alleged.²⁵ The letter also explained that Houston Casualty's "investigation is continuing . . . [and] that a final determination of all the coverage issues raised by this matter may not be possible until the *Commerce Bank* matter has been fully resolved."²⁶

D. Litigation Procedural History

On February 19, 2010, Sauter alone commenced this action by filing a Summons and Complaint.²⁷ On June 29, 2010, Houston Casualty served its Answer in this action.²⁸ On August 27, 2010, Sauter filed his

²⁰ CP 854-64.

²¹ CP 854.

²² CP 859.

²³ CP 860.

²⁴ CP 861.

²⁵ CP 860-61.

²⁶ CP 855.

²⁷ CP 510-16.

²⁸ CP 527-32.

motion for partial summary judgment.

The Trial Court held oral argument on Sauter's motion for summary judgment on September 24, 2010 before the Honorable Judge Michael C. Hayden. Following argument, Judge Hayden denied Sauter's motion from the bench. Judge Hayden allowed Sauter additional time to submit a supplemental brief by way of which it could cite any decision from any court nationwide that held that a liability policy covers a repayment obligation of an ordinary loan. Sauter presumably did not find any such decisions, as he did not submit such a brief.

Accordingly, on February 11, 2011 Judge Hayden signed the parties' Joint Motion and Proposed Order For Entry of Judgment Based On The Court's September 24, 2010 Order.²⁹ Sauter now appeals from that Order. Houston Casualty respectfully requests that this Court affirm that Order.

E. The Houston Casualty Insurance Contract

Houston Casualty issued to SJ Management LLC insurance contract number H708-60250, with the policy period April 16, 2008 to July 27, 2009³⁰ (the "Houston Casualty insurance contract").³¹ The insurance contract includes the following provisions:

²⁹ CP 1121-24.

³⁰ CP 696. The policy period is quoted as amended by Endorsement No. 17.

³¹ CP 656-702.

DIVERSIFIED BUSINESS ORGANIZATION INSURANCE POLICY

In consideration of the payment of the premium, in reliance on the statements in the **Proposal** and subject to all of the provisions of this Policy, the Insurer and the **Insureds** agree as follows:

I. INSURING AGREEMENTS

COVERAGE A: 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**.

II. DEFINITIONS

A.³² **Claim** means:

- (1) any written demand for monetary damages or non-monetary relief against an **Insured** commenced by **Insured's** receipt of such demand;
- (2) any civil, judicial, administrative, regulatory or arbitration proceeding including but not limited to any investigation commenced by the United States Securities and Exchange Commission ("SEC") or similar state agency, initiated by the service of a complaint, formal order of investigation, target letter or other similar document or pleading initiated against any Insured for a Wrongful Act, including any appeal there from;
- (3) criminal proceedings commenced by the return of an indictment;
- (4) any judicial or administration proceeding, including any proceeding before the Equal Employment

³² CP 679-80. The definition of Claim is quoted as amended by Endorsement No. 4.

Opportunity Commission or any similar federal, state or local governmental body with jurisdiction over **Wrongful Employment Practices** initiated against any of the **Insureds** for **Wrongful Employment Practices**;

- (5) a written agreement to toll any applicable statute of limitations prior to the commencement of any judicial, administrative, regulatory or arbitration proceeding;
- (6) a proceeding brought by the Securities and Exchange Commission pursuant to a formal or informal order of investigation, or similar proceeding by a similar state agency, against the **Insured Organization** (referred to in this Policy as an “**SEC Investigation**”), provided that coverage with respect to such **Claim** is limited to the amount set forth at Item D. of the Declarations, which shall be a part of, and not in addition to, the Policy’s Limit of Liability;
- (7) Any Bump-up Claim.

* * *

F. Costs, Charges and Expenses mean reasonable and necessary legal fees and expenses (including expert fees) and cost of attachment or similar bonds incurred by the **Insureds** in defense of any **Claim**, but shall not include:

- (1) directors’ fees, salaries, wages, overhead or benefit expenses associated with directors, officers or employees of the Insured Organization; or
- (2) any amounts incurred in defense of any Claim for which any other insurer has a duty to defend.

* * *

M.³³ **Insured Persons** means any:

- (1) natural person who was, is, or shall become a duly appointed or elected director, officer, general partner, manager, trustee or equivalent executive of an **Insured Organization**. For purposes of Insuring Agreement Coverage F only (Employment Practices Liability Coverage), if purchased, the term **Insured Persons** also shall include **Employees** of the **Insured Organization**;
- (2) natural person **Employees** of an **Insured Organization**, but only with respect to **Securities Claims**;
- (3) natural persons serving on management committees, advisory boards, and similar committees formed pursuant to the **Insured Organization's** articles of incorporation, by-laws, operating agreement, partnership agreement or similar document; and
- (4) the functional equivalent to the positions identified in (1) above, in the event the **Insured Organization** is incorporated or domiciled outside the United States.

* * *

O.³⁴ **Loss** means damages, settlements and **Costs, Charges and Expenses** incurred by any of the **Insured Persons** under Insuring Agreement Coverage A, or B., the **Insured Organization** under Insuring Agreement Coverage C., or any **Insured** under Insuring Agreement Coverage G., including punitive damages where insurable, but shall not include:

- (1) that portion of any multiplied damages awarded which exceeds the amount multiplied;

³³ CP 682. The definition of Insured Persons is quoted as amended by Endorsement No. 6.

³⁴ CP 676-77. The definition of Loss is quoted as amended by Endorsement No. 3.

- (2) taxes, criminal or civil fines or penalties imposed by law;
- (3) matters deemed uninsurable under the law pursuant to which this Policy shall be construed;
- (4) with respect to Insuring Agreement Coverage D, **Costs, Charges and Expenses** incurred by any of the **Insureds** up to but not exceeding the Sublimit of Liability identified in Item D. of the Declarations relating to this Coverage Section; or
- (5) with respect to Insuring Agreement Coverage F only, **Loss** means damages, settlements, including front pay and back pay, and **Costs, Charges and Expenses** incurred by any of the **Insureds**, but shall not include:
 - (a) taxes, criminal or civil fines or penalties imposed by law; or
 - (b) matters deemed uninsurable under the law pursuant to which this Policy shall be construed.

* * *

Y. Wrongful Act means, as alleged in any **Claim**, any actual or alleged act, misstatement, error, omission, misleading statement, neglect, breach of duty or act by:

- (1) any of the **Insured Persons**, while acting in their capacity as:
 - (a) such on behalf of the **Insured Organization** or the functional equivalent of such on behalf of the **Insured Organization** in the event the **Insured Organization** is incorporated or domiciled outside the United States; and

- (b) a manager, director, officer, trustee, governor, executive director or similar position of any **Outside Entity** where such service is with the knowledge and consent of the **Insured Organization**; and
- (2) with respect to Insuring Clauses B, C and D of this Coverage Section only, the **Insured Organization**.
- (3)³⁵ with respect to Insuring Agreement Coverage G. only, any **Insured**

* * *

AA. Real Estate Activities means

- 1) Identification of, and arranging of financing for, the purchase of, or investment in, real estate properties on behalf of an **Insured Organization**;

* * *

ARGUMENT

I. SAUTER BEARS THE BURDEN OF PROVING ENTITLEMENT TO COVERAGE

Summary judgment motions are reviewed de novo. *TracFone Wireless, Inc. v. Washington Dept. of Revenue*, 170 Wn.2d 273, 280, 242 P.3d 810, 814 (2010). As the movant below, and the alleged insured, Sauter bears the burden of proving that the Commerce Bank Matter fits within the scope of the Insuring Clause of the Houston Casualty insurance

³⁵ CP 677. Section (3) of the definition of Wrongful Act was added by Endorsement No. 3.

contract, and is therefore an insured loss. *Safeco Ins. Co. v. Butler*, 118 Wn.2d 383, 395, 823 P.2d 499 (1992); *McDonald v. State Farm Fire & Cas. Co.*, 119 Wn.2d 724, 731, 837 P.2d 1000 (1992). This is particularly true in this instance, where Sauter seeks to demonstrate entitlement to indemnity for the loan repayment. The Houston Casualty insurance contract, it should be noted, is an indemnity-only insurance contract. It does not impose a duty to defend. Thus, as the alleged insured seeking indemnity coverage, Sauter has the burden of proving that his claim satisfies each element of the insuring agreement under the Houston Casualty insurance contract.

In an effort to shift his burden of proof, Sauter cites old and inapplicable case law. Contrary to Sauter's brief, insurance contracts are *not* automatically strictly construed against the insurer. *Shotwell v. Transamerica Title Ins. Co.* addressed whether an insurer could prove that an exclusion applied. 91 Wn.2d 161, 168 (1978).³⁶ But *Shotwell* is inapplicable because Houston Casualty has not argued that any exclusion applies here.

Likewise, Sauter cites *McCree v. Jennings*, 55 Wn.2d 725 (1960), another old decision that stated that the *ambiguous* language at issue there would be interpreted in the insured's favor. Words in an insurance

³⁶ App. Brief p. 22, n.50.

contract, including undefined terms, are simply to be given their “plain, ordinary, and popular” meaning. *Boeing Co. v. Aetna Cas. & Sur. Co.*, 113 Wn.2d 869, 877, 784 P.2d 507 (1990). Where, as here, policy language is clear and unambiguous, Washington Courts will enforce the insurance contract as written. *Allstate Ins. Co. v. Peasley*, 131 Wn.2d 420, 424 (1997).

II. PLAINTIFF HAS NOT DEMONSTRATED A “WRONGFUL ACT” WITHIN THE MEANING OF THE INSURANCE CONTRACT

The insuring clause of the Houston Casualty insurance contract requires a “Wrongful Act.” For there to be a “Wrongful Act” there must be an “actual or alleged act, misstatement, error, omission, misleading statement, neglect, breach of duty or act by: (1) any of the Insured Persons, while acting in their capacity as: (a) such on behalf of the Insured Organization”

A. Guaranteeing a Loan is Not a “Wrongful Act”

There plainly was no “Wrongful Act” by Sauter. He simply entered into an agreement, voluntarily, to secure a loan to his business with his personal assets. This is not an insurance “Wrongful Act”. “[A]n insured’s alleged or actual refusal to make payment under a contract does not give rise to a loss caused by a wrongful act.” *August Entertainment, Inc. v. Philadelphia Indemnity Insurance Company*, 146 Cal.App.4th 565

(Cal Ct. App. 2007). The *August* case addressed whether a D&O policy covers a breach of contract claim where an officer entered into a contract without stating that he was acting on behalf of the corporation. The corporation subsequently disputed liability under the contract, and suit was brought against the corporation and the officer. The D&O insurer denied the claim for a defense and the suit was settled for the contract price. The Court held that the

breach of the contractual obligation asserted in this case did not give rise to a loss caused by a wrongful act within the meaning of the policy. Rather, the corporation was **simply being required to pay an amount it voluntarily contracted to pay. To hold the insurer liable for the contract price would be tantamount to making it a business partner of the corporation and the officer, which was not the mutual intention of the insurer and the insured under the policy. . . . To hold otherwise would allow an insured to turn all of its legal liabilities into insured events by the intentional act of refusing to pay them.**

Id. at 568-69, 578.

Likewise, in *Oak Park Calabasas Condominium Assn. v. State Farm Fire & Cas. Co.*, 137 Cal. App. 4th 557 (Cal. Ct. App. 2006), a condominium association was sued for failing to pay a construction company bill, and sued its D&O insurer for coverage. In holding there was

no Wrongful Act and no coverage, the Court of Appeals explained:

it appears that if [the insured's] construction of the policy were correct, any condominium association could choose to enter a [contract], then decide not to pay the bill, thus shifting the obligation to its insurer. No rational insurer would wish to undertake such an insuring obligation.

Id. at 565. The court concluded that it would be impossible for an insurance company to calculate premiums to “guard against the risk that an [insured] would enter into multimillion-dollar [contracts], and then not pay for the [work].” *Id.*

The Court also recognized that the “concept of fortuity” required a decision in favor of the insurer. The Court noted that the insured entered into the contract voluntarily, and did not allege anything that was unanticipated from the standpoint of the insured. *Id.* The insured simply “chose not to pay all the money due and owed to [the construction company].”

Similarly, in *Newman v. XL Specialty Ins. Co.*, No. C-1-06-781, 2007 WL 2982751 (S.D. Ohio Sept. 24, 2007), a former employee obtained a default judgment in a suit against his ex-employer for failing to comply with an employment contract. The employee then brought an action for coverage against the employers insurer. The Court held that there was no “Wrongful Act” and therefore no coverage. It explained that

Federal Courts have consistently held that there is no Wrongful Act involved in a breach of contract claim as the claim, “arises out of the legal and voluntary action of creating a contract.” *Id.* at *4. The Court concluded:

[The insured] voluntarily entered into the employment contract [The insured] then voluntarily chose not to honor that contract. To interpret a liability insurance policy, that makes no mention of breach of contract, as covering breach of contract would have the effect of encouraging such irresponsible voluntary behavior. Companies could then use their liability insurance policy to support the breaking of contracts Unless the insurance policy explicitly states that it covers breach of contract actions, such an interpretation should not be read into the policy.

Id. at *6. See also *Republic Franklin Ins. Co. v. Albemarle Cnty. Sch. Bd.*, No. 10-cv-00007, 2010 WL 2950499 (W.D. Va. Jul. 23, 2010) (holding that the insured “cannot convert this pre-existing obligation to pay wages into a covered ‘wrongful act’ by simply failing or refusing to perform its statutory obligation to properly compensate its employees.”); *Noxubee Cnty. Sch. Dist. v. United Nat’l Ins. Co.*, 883 So. 2d 1159 (Miss. 2004) (the Mississippi Supreme Court held that the insured’s decision not to pay overtime compensation was not a “wrongful act” and that such a deliberate decision could not give rise to coverage under the policy);

Toombs NJ Inc. v. Aetna Cas. & Sur. Co., 404 Pa.Super. 471, 476 (1991) (finding that there is no indemnity for the simple voluntary breach of an agreement); *Pacific Ins. Co., Ltd. v. Eaton Vance Management*, 369 F.3d 584 (1st Cir. 2004) (“The insurance policy at issue . . . does not cover debts that are ‘incurred’ through a contractual obligation . . .”).

The voluntary guaranty of a loan is a common and legal practice by persons seeking to secure a loan. Sauter’s claim that his “Wrongful Act” is in failing to have SJ Management repay the loan is a red herring.³⁷ First, SJ Management failed to repay the loan — not Sauter. Second, Sauter’s decision not to repay using his personal assets is voluntary and not the result of fortuity. Third, Commerce Bank seeks to recoup the loan proceeds from Sauter due to his liability as a *personal* guarantor of the loan, not due to some claimed liability due to an error or omission by Sauter as an officer of SJ Management. The only basis on which Commerce Bank seeks repayment from Sauter was his execution of the loan documents. That is simply not a “Wrongful Act.”

B. There was No “Wrongful Act” Because Sauter Was Acting In His Personal Capacity

1. A Wrongful Act Must Be Committed In One’s Capacity Of Acting On Behalf Of The Insured Organization

³⁷ App. Br. at 40.

The insurance contract states at Section II.Y(1)(a) that a “Wrongful Act” is an “actual or alleged act, misstatement, error, omission, misleading statement, neglect, breach of duty or act by: (1) any of the Insured Persons, **while acting in their capacity as: (a) such on behalf of the Insured Organization. . . .**” (emphasis added).³⁸ Sauter conveniently omits this latter part of the definition of Wrongful Act from his brief and disingenuously claims that Houston Casualty conceded that he is an Insured Person.³⁹ Houston Casualty conceded no such thing, and in fact, explained both in its position letter⁴⁰ and in its brief below⁴¹ that Sauter is only an Insured Person when acting in his capacity as an officer of SJ Management. In fact, “Insured Person” is defined only with respect to such person’s relationship to the “Insured Organization” — SJ Management.⁴² Sauter may be an Insured Person in other situations, but when he and his wife together guaranteed the Commerce Bank loan with their personal properties, they were not Insured Persons because they were acting in their personal capacities. Thus, for this additional reason, there is no Wrongful Act.

³⁸ CP 662.

³⁹ App. Brief p. 25.

⁴⁰ CP 859.

⁴¹ CP 492-99.

⁴² CP 682.

Sauter argues that the inclusion of the word “any” in the definition of “Wrongful Act” prevents the definition from being narrowed under Washington law: a “Wrongful Act” must be “by: (1) any of the Insured Persons, while acting in their capacity as: (a) such on behalf of the Insured Organization”⁴³ Notably, Sauter himself does not cite Washington law, or any law, on which he purportedly relies. This is because not only is there no case law to support this illogical argument, there is also no grammar rule, definition or other authority that would support it either. Sauter completely ignores the latter half of the definition, which limits the scope of a Wrongful Act by a person’s capacity. It is true that “Wrongful Act” is defined, in the first instance, as any alleged act, error, omission, etc. But there is no reason, and indeed Sauter has not given any, why a “Wrongful Act” cannot be limited only to Insured Persons, and then only to those instances when those persons are acting in their capacity on behalf of SJ Management. The Houston Casualty insurance contract limits Wrongful Acts in clear, unambiguous terms, and the Court needs no assistance interpreting it.

If Sauter’s Guaranty of the loan to SJ Management is deemed to have been within his capacity as an Insured Person on behalf of SJ Management, then “capacity” part of the definition of “Wrongful Act”

⁴³ App. Br., p. 25.

would be rendered superfluous and the intent reflected by those words contravened. This runs contrary to Washington precedent. “In Washington, interpretation of an insurance contract is a matter of law, which requires the Court to consider the contract in its entirety and to give effect to each policy provision.” *Allstate Ins. Co. v. Peasley*, 131 Wn.2d 420, 423-24 (1997); *see also Public Employees Mut. Ins. Co. v. Sellen Constr. Co.*, 48 Wash. App. 792, 796 (1987) (holding that in construing a contract, the court should apply construction that will give each part of the instrument some effect).

Houston Casualty insured Sauter, as intended, only to the extent that he was acting in his capacity to act on behalf of SJ Management. His personal obligations, liabilities, actions, authority, and liabilities were not insured by Houston Casualty under the insurance contract. “In construing an insurance policy, the court ‘must give effect to language that clearly and unambiguously expresses the parties’ intent.’” *James F. O’Connell & Associates v. Transamerica Indem. Co.*, 61 Wash.App. 103, 109 (Wash. App. 1991) (citing *Greer v. Northwestern Nat’l Ins. Co.*, 109 Wash.2d 191, 197 (1987)). Had Houston Casualty intended the insurance contract to cover Sauter’s personal and marital assets and liabilities, it would have required that information on the application and an extensive investigation. Only SJ Management’s assets and liabilities were

investigated.⁴⁴ Further, Houston Casualty would have charged a substantial extra premium to provide coverage for Sauter's personal assets and liabilities. No extra premium was charged. Indeed, Sauter provided no notice to Houston Casualty of his personal guarantee of the loan — or indeed of the loan itself — until he made this claim. Thus, his claimed reasonable expectation that insurance would pay for his personal guarantee of a loan is baseless.⁴⁵

2. Sauter (And His Wife) Guaranteed The Loan In Their Personal Capacity

Sauter and his wife consciously placed a substantial amount of their cash and personally-owned real properties at risk to collateralize the 2007 and 2008 loans because SJ Management's assets were insufficient to collateralize those loans.⁴⁶ Without the personal guaranty and the personal assets as collateral, Commerce Bank would not have agreed to make the loans to SJ Management at all. But Houston Casualty did not agree to insure the Sauters' personal assets or liabilities. Thus, there is no insurance coverage under the Houston Casualty insurance contract for this personal liability.

If Sauter were acting in his capacity on behalf of SJ Management

⁴⁴ CP 697-702.

⁴⁵ CP 912.

⁴⁶ CP 804.

when he executed the Commercial Guaranty, he would not have had the authority to place his individual assets at risk, as they were not owned by SJ Management. The SJ Management operating agreement does not authorize such action, and in fact specifically limits its members' personal liability to their capital contributions.⁴⁷ Conversely, none of the other SJ Management members had the authority to place at risk any of their own or the other members' personal assets.⁴⁸ Although Sauter's entitlement to indemnification from SJ Management is irrelevant to the question of coverage, it is worth noting that SJ Management's members resolved "that the Company shall indemnify Michael Sauter for the **personal liability** incurred by him in connection with the Company's [Line of Credit] with Commerce [Bank]".⁴⁹

The Commercial Guaranty is signed "Michael J. Sauter".⁵⁰ When Sauter is acting in his capacity on behalf of SJ Management, he signs "Michael J. Sauter, Manager of SJ Management, LLC" — as he did on the Promissory Note⁵¹ and Business Loan Agreement.⁵² Thus, it is clear that Sauter did not execute the Commercial Guaranty in his capacity as

⁴⁷ CP 886, at §9.1.

⁴⁸ *Id.*

⁴⁹ CP 313 (emphasis added).

⁵⁰ CP 796.

⁵¹ CP 300.

⁵² CP 296.

Manager on behalf of SJ Management.

Sauter also fails to explain in which capacity his wife, Carol Sauter, was acting when she signed the loan documents. Surely he cannot argue that his wife was also acting on behalf of SJ Management. In fact, the Guaranty itself states that “[a]ny married person who signs this Guaranty hereby expressly agrees that recourse under this Guaranty may be had against both his or her separate property and community property.”⁵³ Plainly, they both signed in the same capacity — personally.

A Letter Agreement dated October 28, 2009, also irrefutably establishes that Sauter was acting in his individual capacity and not on behalf of SJ Management.⁵⁴ The Letter Agreement, between Commerce Bank, SJ Management and Sauter, states that it “addresses or otherwise revises certain payment terms in an effort to reach an mutually acceptable proposal for modifying both (i) Michael Sauter’s personal loan, loan no. 721816005, with a balance owed of \$747,043.16 as of August 21, 2009 (the “Personal Loan”) and (ii) S-J Management, LLC’s line of credit (*which is personally guaranteed by Sauter*), line of credit no. 721816016, with a balance owed of \$2,757,884.34, as of August 21, 2009”⁵⁵ The Letter Agreement further states that “Mr. Sauter has represented to

⁵³ CP 792, at ¶ 6 (titled “Obligations Of Married Persons”).

⁵⁴ CP 616-30.

⁵⁵ CP 616 (emphasis added).

Commerce Bank that he intends to enforce indemnification obligations against S-J Management, LLC and that S-J Management, LLC, will in turn, seek to secure the payment of indemnification obligations from S-J Management, LLC's insurance carrier."⁵⁶ It is apparent that Sauter planned all along to attempt to disguise his personal liability under the Guaranty as SJ Management's liability in an effort to have SJ Management's insurance repay the loan. The Trial Court, however, saw through Sauter's ruse, and this Court should too.

It is noteworthy that Sauter strategically omitted certain loan documents and claim correspondence with Houston Casualty from his moving papers below. There are a total of 25 loan documents that were executed in connection with the 2008 Loan at issue here.⁵⁷ However, Sauter only attached *four* of those documents to his summary judgment motion: the SJ Management LLC Resolution; the Promissory Note; the Business Loan Agreement; and the Commercial Guaranty. Further, Sauter only provided Houston Casualty with seven of those loan documents in

⁵⁶ CP 616.

⁵⁷ CP 768. The loan documents, as listed on the Notice of Final Agreement, include: (1) SJ Management LLC Resolution; (2) Promissory Note; (3) WA Assignment of Deposit Account; (4-10) Deeds of Trust for the Sauters' personal properties; (11-17) Hazardous Substances Agreements; (18-20) Flood Insurance Notices; (21) Agreement to Provide Insurance; (22) Business Loan Agreement; (23) Commercial Guaranty; (24) Disbursement Request and Authorization; and (25) Notice of Final Agreement.

discovery.⁵⁸ Not surprisingly, at least one of the documents omitted from the plaintiff's moving papers below (and produced two days before Houston Casualty's opposition was due) clearly distinguishes between Sauter in his capacity as an SJ Management officer and Sauter in his personal capacity. The Notice of Final Agreement, which was omitted from Sauter's motion papers below, shows four signatures on behalf of four separate parties: (1) Borrower: SJ Management, LLC, signed "Michael J. Sauter, Manager of SJ Management, LLC"; (2) Grantor: signed "Michael J. Sauter, Individually"; (3) Grantor: signed "Carol G. Sauter, Individually"; (4) Guarantor, signed "Michael J. Sauter, Individually".⁵⁹ These signatures unmistakably show the distinct capacities of the parties to the agreement, including Sauter's signature as guarantor in his individual capacity. The Agreement to Provide Insurance, which was also omitted from Sauter's motion papers below, is signed "Michael J. Sauter" and "Carol G. Sauter".⁶⁰ These documents were no doubt omitted because they further emphasize that Sauter was acting in his individual capacity — not on behalf of SJ Management.

The Commercial Guaranty at issue here also clearly distinguishes between the separate roles of the Borrower (SJ Management) and the

⁵⁸ CP 571-72.

⁵⁹ CP 769.

⁶⁰ CP 771.

Guarantor (Sauter). “Borrower” is defined as “SJ Management LLC and includes all co-signers and co-makers signing the Note and all their successors and assigns.” “Guarantor” is defined as “everyone signing this Guaranty, including without limitation Michael J. Sauter, and in each case, any signer’s successors and assigns.” The Commercial Guaranty is signed “Michael J. Sauter”.

The Commercial Guaranty states that it is:

secured by in addition to any other collateral, a Deed of Trust dated April 29, 2005 to a trustee in favor of Lender on real property located in KING County, State of Washington, a Deed of Trust dated September 2, 2005, to a trustee in favor of Lender on real property located in KING County, State of Washington, and Deed of Trust dated December 12, 2007, to a trustee in favor of Lender on real property located in KING County, State of Washington, all terms and conditions of which are hereby incorporated and made a part of this Guaranty.

These were Sauter’s (not SJ Management’s) assets. The Commercial Guaranty further states that the “Guarantor agrees that the Indebtedness . . . shall be superior to any claim that Guarantor may now have or hereafter acquire against Borrower, whether or not Borrower becomes insolvent.”⁶¹ Thus, the Commercial Guaranty itself clearly shows

⁶¹ CP 775, at ¶ 8 (titled “Subordination Of Borrower’s Debts To Guarantor”).

that SJ Management is borrowing monies, and Michael J. Sauter, as an individual in his personal capacity, is guaranteeing that loan and providing his personal properties as collateral by Deeds of Trust. The Commercial Guaranty even contemplates that Sauter may have a claim against SJ Management. Sauter was clearly acting in his individual capacity here.

Sauter next argues that the capacity element of a Wrongful Act is satisfied because he “executed the Guaranty because he was SJM’s CEO and Manager, and while acting in that role.” More accurately, SJ Management was one of Sauter’s many assets — he was its founder and majority owner.⁶² His position may well have influenced his *decision* to guarantee the loan with his personal properties, but he most certainly made that decision in his personal capacity. If Sauter was not acting in his personal capacity when he agreed to use the properties and cash that he and his wife held in their individual capacities, when does he *ever* act in his personal capacity?

Sauter was acting in his *personal* capacity when he purchased the properties he used as collateral with his wife. He likely declared those properties on his and his wife’s *personal* tax returns. Likewise, the Cash Collateral was Sauter and his wife’s *personal* income that was almost certainly declared, not on SJ Management’s tax returns, but on their

⁶² CP 277.

personal returns, and was likely stored in their *personal* bank accounts before being deposited in the Bank's escrow account. Sauter, of course, refused to produce these documents, despite Houston Casualty's request for them.⁶³ In fact, the Commercial Guaranty required submission of the Guarantor's personal tax return and personal financial statement.⁶⁴ That Sauter did not execute the Commercial Guaranty on behalf of SJ Management could not be any more apparent.

For all of these reasons, it is abundantly clear that by executing the Commercial Guaranty, Sauter committed no Wrongful Act and, in any event, incurred personal liability, not liability on behalf of SJ Management. Thus, there is no coverage for the Commerce Bank Matter under the Houston Casualty insurance contract.

III. PLAINTIFF CANNOT DEMONSTRATE A "LOSS" WITHIN THE MEANING OF THE INSURING CLAUSE OF THE HOUSTON CASUALTY INSURANCE CONTRACT

There is also no coverage for the Commerce Bank Matter because Sauter's contractual obligation to repay the Commerce Bank loan by honoring the Commercial Guaranty that he willingly executed is simply not a "Loss".⁶⁵ Sauter received valuable consideration in return for the risk

⁶³ CP 577-78.

⁶⁴ CP 795, at ¶7.

⁶⁵ The Houston Casualty insurance contract defines Loss at Section II.O as "damages, settlements and Costs, Charges and Expenses incurred by any of the Insured Persons

of his personal assets in the form of a loan of working capital to one of his assets, SJ Management. He has not incurred any “Loss” simply because Commerce Bank wants him to repay the loan for which he guaranteed repayment.

Sauter and Commerce Bank entered into a contract that required Sauter to repay the line of credit if SJ Management did not do so. Sauter is simply failing to perform under that contract. By applying the Sauters’ cash and some of their personal properties against the outstanding loan balance, Commerce Bank would simply be exercising its rights under the terms of Commercial Guaranty that the Sauters voluntarily agreed to. Houston Casualty did not insure SJ Management, or Sauter, for performance of their agreed contractual obligations. Thus, there is no coverage.

A. Repayment of a Loan Does not Qualify as “Loss”

Sauter actually argues that the costs he has incurred responding to Commerce Bank’s requests for repayment of the loan and his “partial periodic payments” made “in return for Commerce’s forbearance from further collection or foreclosure attempts” are Loss. This is not Loss under any reasonable interpretation of the policy language. SJ Management

under Insuring Agreement Coverage A” Further, “Loss” does not include (1) multiplied damages, (2) taxes, fines or penalties, and (3) “matters deemed uninsurable under the law pursuant to which this Policy shall be construed . . .”

borrowed money from Commerce Bank, and Sauter volunteered to personally guarantee the repayment of that money, and to collateralize the loan with his own cash and a few of his many commercial and private properties. How can Commerce Bank's exercise of its rights under this common loan agreement constitute Loss? Any payments made to Commerce Bank are not damages, nor settlements — they are payments that SJ Management and Sauter are contractually obligated to make. Indeed, Sauter repeatedly renegotiated and modified the Commerce Bank loan through various Letter Agreements, which specifically state in bold and capital letters that, “this agreement does not in any way constitute either a settlement negotiation or settlement agreement with respect to any of the obligations owed to Commerce Bank”⁶⁶

Terms in an insurance contract must be given their “plain, ordinary, and popular” meaning. *Boeing Co. v. Aetna Cas. & Sur. Co.*, 113 Wn.2d 869, 877, 784 P.2d 507 (1990). “Damages” is defined by Miriam Webster as “compensation in money imposed by law for loss or injury.” Law.com defines damages as “the amount of money which a plaintiff (the person suing) may be awarded in a lawsuit.” No compensation has been imposed on Sauter by law. Settlement is defined by Black's Law Dictionary as “An agreement ending a dispute or lawsuit.” Black's Law

⁶⁶ CP 616.

Dictionary (9th ed. 2009). Simply making partial payments on SJ Management's outstanding loan balance, or renegotiating the terms of their agreement is not a "settlement." Sauter is simply being asked to fulfill agreed terms on a loan.

B. Insurance does not Cover Loans, Debts or Other Voluntary Contractual Obligations

Business liability insurance is not intended to insure the obligation to repay funds, however they were obtained or used. Sauter neglects to mention that, although Washington Courts have not specifically addressed this issue, courts nationwide have held that D&O and similar business liability policies do not insure the obligation to repay monies since such obligations are not insurable "Loss." For example, in *Pan Pac. Retail Props., Inc. v. Gulf Ins. Co.* 471 F.3d 961, 966 (9th Cir. 2006), the Court noted that, "[i]t is well established that one may not insure against the risk of being ordered to return money" Similarly, in *Level 3 Commc'ns, Inc. v. Twin City Fire Ins. Co.* 272 F.3d 908, 910 (7th Cir. 2001), the 7th Circuit held that, "a 'loss' within the meaning of an insurance contract does not include the restoration of an ill-gotten gain." *Level 3* concerned a securities fraud suit. Level 3's insurer denied coverage for a judgment against Level 3 that ordered Level 3 to repay monies obtained in a shareholder transaction. Level 3 had to repay the difference in the stock

price back to the shareholders, and the court analogized Level 3's request for indemnity as if, "Level 3 had stolen cash from [the plaintiff] and had been forced to return it and were now asking the insurance company to pick up the tab." 272 F.3d at 911. Further, in *Local 705 Int'l Bhd. of Teamsters Health & Welfare Fund v. Five Star Managers*, the Illinois Court of Appeals held that, "[t]he plain and ordinary meaning of 'loss' cannot be ignored. [The Insured] 'simply cannot lose that to which it was not legally entitled.'" 316 Ill.App.3d 391, 396-97 (2000). Here, Sauter's repayment of funds is likewise not covered.

In *Reliance Grp. Holdings, Inc. v. Nat'l Union Fire Ins. Co.*, 188 A.D.2d 47, 55 (1st Dep't 1993), the Appellate Division held that "[i]t is well established that one may not insure against the risk of being ordered to return money or property" Reliance and its CEO were sued in connection with a purchase and sale of Walt Disney Productions corporate stock. Reliance purchased Disney stock at \$63.25 per share and then sold the stock back to Disney for \$77.50 per share, at a profit of approximately \$60 million. Disney shareholders sued and Reliance eventually settled for \$21.1 million. Reliance then sought indemnity from its D&O carrier. The central issue in the ensuing coverage dispute was whether Reliance sustained a "loss" as defined in the liability policy. Reliance "urged a construction of the policy that would cover *any* settlement, whether for

damages, or for restitution of property wrongfully acquired.” *Id.* The Court found Reliance’s argument unpersuasive, reasoning that if

by . . . fraud a corporation obtains title to stock worth \$60 million, . . . [t]he rightful owner sues . . . and the action is settled by a payment of \$20 million, which would undoubtedly constitute partial restitution to the rightful owner. [Here], the corporation could make . . . partial restitution . . . and then successfully make a claim against its D&O insurer for the full amount of the settlement.

Id. The same holds true here. SJ Management cannot borrow millions of dollars from Commerce Bank, fail to pay it back, and then seek coverage of the outstanding loan under its D&O policy.

There is no Washington case that holds that a D&O or similar policy can be used as a means of repaying an ordinary loan, and in fact courts around the country hold that they cannot. “It makes no sense to permit a dereliction in duty to transform an uninsured [contractual] liability into an insured event.” *Pacific Ins. Co., Ltd. v. Eaton Vance Management*, 369 F.3d 584 (1st Cir. 2004). “To allow indemnification . . . would have the effect of making the insurer a sort of silent business partner subject to great risk in the economic venture without any prospects of sharing in the economic benefit.” *Toombs NJ Inc. v. Aetna Cas. & Sur. Co.*, 404 Pa.Super. 471, 476 (1991). “The [insureds] were required to pay

their contractual obligation. This contractual obligation did not result from their wrongful act of refusing to satisfy it. To hold otherwise would allow an insured to turn all of its legal liabilities into insured events by the intentional act of refusing to pay them.” *Am. Cas. Co. of Reading, Pa. v. Hotel & Restaurant Employees and Bartenders Int’l Union Welfare Fund*, 113 Nev. 764, 770 (Nev. 1997). The Seventh Circuit has held that

Indeed, refusing to pay a debt upon erroneous advice of counsel would convert a contractual debt into damage arising from a negligent omission There is a well-recognized line of demarcation between negligent acts and breaches of contract. [The insureds] failure to make payments . . . was a breach of contract but its insurance policy covered only negligent acts. [The insurer] is thus not obligated under the policy.

Baylor Heating & Air Conditioning, Inc. v. Federated Mut. Ins. Co., 987 F.2d 415, 419 (7th Cir. 1993); *see also Cincinnati Ins. Co. v. Metropolitan Properties, Inc.*, 806 F.2d 1541 (11th Cir. 1986) (where insured argued that if it “forgot to pay its bills,” this would be negligent conduct and the insurer would be liable for coverage, the Court disagreed and held that there was no coverage, stating: “We do not agree . . . that any damages incurred by the insured through some ‘negligent’ action is coverable.”). This Court should similarly hold that there is no coverage for Sauter’s personal guaranty obligation to Commerce Bank.

C. There Is No Coverage Because There Is No Wrongful Act Resulting In Covered Loss, Not Because Of An Exclusion

In a misinterpretation — or an attempt at obfuscation — of Houston Casualty’s position, Sauter argues at great length that his contractual obligations are covered because there is no contractual obligations exclusion. That argument is without merit. The legion of decisions cited in this memorandum do not rest on exclusions. Rather, they recognize that there is no coverage because there is no Wrongful Act resulting in covered Loss as required by the insuring agreement. Sauter’s argument attempts to look to exclusions — or claimed lack of exclusions — as the basis for finding coverage. That approach runs entirely counter to a fundamental rule of insurance contract construction:

In interpreting an insurance contract, the court must first look to the grant of coverage in the insuring agreements to determine whether coverage exists. **“If coverage does not exist under the insuring agreement, the inquiry is at an end. There is no need to look to the exclusions because they cannot expand the basic coverage granted in the insuring agreement.”** If coverage does exist, the court must next determine whether the policy contains any exclusions from or limitations on that coverage.⁶⁷

⁶⁷ 1 Barry R. Ostrager & Thomas R. Newman, *Handbook on Insurance Coverage Disputes* § 1.01, at 4–5 (15th ed. 2010) (emphasis added) (citations omitted) (quoting *Stanford Ranch, Inc. v. Maryland Cas. Co.*, 89 F.3d 618, 627 (9th Cir. 1996)); see also *Sony Computer Entm’t Am. Inc. v. American Home Assur. Co.*, 532 F.3d 1007, 1017 (9th Cir. 2008); *Diamaco, Inc. v. Aetna Cas. & Surety Co.*, 97 Wn. App. 335, 341, 983 P.2d

Here, Sauter has failed to carry **his** burden — not Houston Casualty’s — of showing, in the first instance, that a loan repayment obligation falls within the Insuring Agreement. *Diamaco, Inc. v. Aetna Cas. & Sur. Co.*, 97 Wash. App. 335, 337, 983 P.2d 707 (1999).

Sauter also claims that his contractual obligations are insurable under Washington law.⁶⁸ But, as the Court below recognized, none of the cases he cites address the situation here. *Fluke Corp. v. Hartford Accident and Indem. Co.*, 145 Wn. 2d 137, 34 P.3d 809 (2001) simply held that where an insurance policy had an “explicit promise” to insure for “damages because of . . . injury . . . arising out of . . . [m]alicious prosecution,” there was no public policy barring coverage for a jury verdict finding liability for that tortious (not contractual) liability. *Id.* at 143.

Sauter states that “in arguing that contractual liability damages

707, 711 (1999) (“Having determined that the loss here falls within the insuring clause, we now turn to the second question: whether an exclusion applied to bar coverage.”); *Twin City Fire Ins. Co. v. Ennen*, 2000 WL 558525 (E.D. Cal. 2000) (same); and *Ray v. Valley Forge Ins. Co.*, 77 Cal. App. 4th 1039, 1048 (2000), which held:

Insurance policy exclusions do not create coverage. If the insuring clause does not cover a claimed loss, then there is no coverage. In such a circumstance, there is no need to consider policy exclusions because exclusions serve to limit coverage granted by an insuring clause and thus apply only to hazards covered by the insuring clause. An exclusion cannot act as an additional grant or extension of coverage.

⁶⁸ App. Br. at 33-34.

should be excluded under Washington law,” Houston Casualty relied entirely on inapposite non-Washington decisions.” Besides the fact that Houston Casualty did not make that argument, it is Sauter who failed to cite Washington law — or any law at all, for that matter — to support his argument that he has sustained Loss under the Houston Casualty insurance contract. The fact that the Washington Courts have not yet addressed whether repayment of a loan is Loss under an insurance policy (likely because it is an absurd argument that no insured has yet bothered to make), does not yield the illogical conclusion that it is therefore covered. The Washington Supreme Court has held that “[w]hen resolving a question of first impression concerning the scope of article I, section 7, we may consider well-reasoned precedents from federal courts and sister jurisdictions.” *York v. Wahkiakum School Dist. No. 200*, 163 Wn. 2d 297, 330-331, 178 P.3d 995, 1013 (2008) (citing *State v. Chenoweth*, 160 Wn.2d 454, 470-71, 158 P.3d 595 (2007); *State v. Murray*, 110 Wn. 2d 706, 709, 757 P.2d 487 (1988)). “Although not binding on this court, such precedents may provide persuasive authority and analysis.” *Id.*; see also *City of Seattle v. Mighty Movers, Inc.*, 152 Wn. 2d 343, 356, 96 P.3d 979 (2004). Where, as here, there is no Washington precedent on a certain point of law, the Court is called upon to set the relevant precedent, for which it may consider relevant precedents from other jurisdictions. Here,

this Court's sister jurisdictions have repeatedly held that loan repayment is not Loss under an insurance policy, and in fact, none have held the opposite.

Sauter's complete reliance on the unpublished trial court decision *Virginia Mason Med. Ctr. v Executive Risk*, 2007 WL 3473683 (W.D. Wash. 2007) is utterly misplaced. That case concerned a claim for insurance for the settlement of class action lawsuits seeking "compensatory damages for injury . . . caused by [the] deceptive act or practice" of wrongful facility changes, plus attorney fees. *Id.* at *1. In *Virginia Mason*, there was no dispute that there was a "Wrongful Act." Rather, the insurer argued that the settlement was not "Loss" because it was restitutionary in nature. The *Virginia Mason* Court found that argument unavailing. Although the Court recognized that "Washington Courts have not addressed whether an insurer can provide coverage for the risk of being forced to return money that was wrongfully obtained," that was simply not the issue. Rather, the plaintiffs' sought compensation for harms caused by the violation of a statute. The resulting damages were not restitutionary in nature, but rather "calculated by determining the individual harm suffered by each plaintiff." *Id.* at *3. The Court, therefore, rejected the attempt to characterize the settlement as a return of monies. *Id.*

Indeed, although Sauter fails to mention it, when the Ninth Circuit affirmed *Virginia Mason*, it explained that the settlement was “a compromise of asserted damages arising from the plaintiffs’ non-disclosure claim [under the Washington Consumer Protection Act] in the underlying action, rather than a disgorgement of unlawful gains.” *Virginia Mason Medical Center v. Executive Risk Indem. Inc.*, 331 Fed. Appx. 473, 474 (9th Cir. 2009). That claim is incomparable with the Commerce Bank Matter at issue. Here, we are only concerned with a simple request for repayment of a lawful loan. The funds are due because of a contractual obligation, not because of any Wrongful Act resulting in Loss.

Under existing Washington law, the obligation to repay a loan should not be considered covered “Loss.” As the trial court recognized, if Sauter’s repayment obligation was deemed to constitute Loss under the insurance contract, it would mean that anyone who executed a similar guaranty could escape their personal liability on which the underlying loans were based and shift it to insurers who never contemplated that liability. “Long standing case law establishes that liability insurance policies do not cover breach of contract claims, because a contractual duty is not a liability imposed by law but is rather a voluntarily undertaken

obligation.”⁶⁹ This is both logical and good policy because to hold otherwise would encourage bad behavior by debtors. “[A] debtor ought not to be able to borrow funds, neglect or choose not to repay the debt, and then shift the repayment obligation to an insurer.”⁷⁰ “Federal courts have held that the definition of loss does not include expenditures or damages required by a voluntarily undertaken contractual obligation as the loss is not legally obligated, but contractually obligated.” *Newman v. XL Specialty Ins. Co.*, 2007 WL 2982751, *4 (S.D. Ohio 2007) (citing *Baylor Heating & Air Conditioning, Inc. v. Federated Mutual Insurance Co.*, 987 F.2d 415 (7th Cir. 1993) and *Cincinnati Ins. Co. v. Metro. Prop., Inc.*, 806 F.2d 1541 (11th Cir. 1986)). “It is well established that one may not insure against the risk of being ordered to return money or property that has been wrongfully acquired. Such orders do not award ‘damages’ as that term is used in insurance policies.” *Reliance Grp. Holdings, Inc. v. Nat’l Union Fire Ins. Co. of Pittsburgh, Pa.*, 188 A.D.2d 47, 55 (1st Dep’t 1993). Instead, the “only reasonable construction of ‘damages, judgments [and] settlements’ as used in the policy requires, in order to constitute a covered ‘loss,’ that there must have been an ordered or actual payment of damages

⁶⁹ See Kevin M. LaCroix, *D&O Insurance: The Contract Exclusion*, THE D&O DIARY (March 16, 2009), <http://www.dandodiary.com/2009/03/articles/d-o-insurance/do-insurance-the-contract-exclusion/>.

⁷⁰ *Id.*

by the director or officer, either in satisfaction of a judgment, or by way of settlement of an action.” *Id.* at 54.

CONCLUSION

For the foregoing reasons, Houston Casualty respectfully requests that this Court deny Sauter’s appeal and uphold the trial court’s decision that there is no coverage under the Houston Casualty insurance contract for Sauter’s personal obligation to repay the Commerce Bank loan.

Respectfully submitted this 15th day of July, 2011.



Patrick M. Paulich, WSBA #10951
Thorsrud Cane & Paulich
1325 Fourth Avenue, Suite 1300
Seattle, WA 98101
206.386.7755

and

FOR Aidan M. McCormack
Sarah A. Kutner
Robert C. Santoro
DLA Piper US LLP
1251 Avenue of the Americas
New York, NY 10020
212.335.4500

Attorneys for Respondent

DECLARATION OF SERVICE

I, Mary Lou Hanshaw, declare under penalty of perjury under the laws of the State of Washington that I am now and at all times mentioned herein, a resident of the State of Washington, over the age of eighteen years, not a party to or interested in the above-entitled action, and competent to be a witness herein.

On July 15, 2011, I caused to be served in the manner noted copies of the foregoing upon designated counsel:

Marco J. Magnano, Jr.
Bradley W. Hoff
Jason R. Donovan
Foster Pepper PLLC
1111 Third Avenue, Suite 3400
Seattle, WA 98101-3299

Attorneys for Michael J. Sauter
Via Email and Messenger

Executed at Seattle, Washington this 15th day of July, 2011.

A handwritten signature in black ink that reads "Mary Lou Hanshaw". The signature is written in a cursive style with a large initial "M" and a long, sweeping underline.