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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,

Petitioner,

v.

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

Respondent.

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DIVISION I

POLICYHOLDER'S OPENING BRIEF

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TABLE OF CONTENTS

	<i>Page</i>
A. SUMMARY OF ARGUMENT	1
B. ASSIGNMENTS OF ERROR.....	4
1. Assignments Of Error.....	4
2. Issues Pertaining To Assignment Of Error.....	6
C. STATEMENT OF THE CASE	8
1. SJM’s Business and Management.	9
2. SJM’s Line of Credit from Commerce.....	9
3. Commerce’s “Claim” Against Sauter.....	11
4. The Houston Casualty Policy.	13
5. Houston Casualty’s Coverage Denial.....	17
6. Procedural History.....	18
D. ARGUMENT	19
1. Standard of Review.	19
2. Summary Judgment Standard.....	20
3. Washington Insurance Policy Interpretation Law.	20
4. Commerce’s “Claim” Against Sauter Triggers Coverage Under The Houston Casualty Policy.	23
a. Commerce’s “Claim” Satisfies Coverage A’s Insuring Clause.	23
b. Houston Casualty’s Purported Denial Grounds Are Inapplicable.	27
(1) Sauter Has Sustained Covered “Loss” Resulting From Commerce’s “Claim”.....	29
(a) The Houston Casualty Policy Merely Excludes “Loss” Deemed Uninsurable As A Matter Of Washington Law; Contractual Liability Is Not Deemed Uninsurable As A Matter Of Washington Law.....	29

(b)	Houston Casualty Consciously Chose Not To Include A Contractual Liability Exclusion Under Coverage A	36
(2)	Commerce’s “Claim” Alleges A “Wrongful Act” By Sauter	39
(a)	Commerce’s “Claim” Arises Out Of Sauter’s Alleged Act, Neglect, and/or Breach of Duty – i.e., a “Wrongful Act”	39
(b)	Commerce’s “Claim” Is Based On Alleged Conduct By Sauter In His Role As SJM’s CEO And Manager – i.e., as an “Insured Person”	46
E.	CONCLUSION	49

TABLE OF AUTHORITIES

CASES	Page(s)
<i>Am. Cas. Co. of Reading, PA v. Hotel & Restaurant Emp'ees and Bartenders Int'l Union Welfare Fund</i> , 113 Nev. 764 (Nev. 1997)	30
<i>American National Fire Ins. v. B&L Trucking</i> , 134 Wn.2d 413, 951 P.2d 250 (1998).....	21, 38, 41
<i>August Ent't, Inc. v. Phila. Indem. Ins. Co.</i> , 146 Cal.App. 4 th 565 (Cal. App. 2007)	30
<i>Avanade, Inc. v. City of Seattle</i> , 151 Wn. App. 290, 211 P.3d 476 (2009).....	19
<i>Baylor Heating & Air Conditioning, Inc. v. Federated Mut. Ins. Co.</i> , 987 F.2d 415 (7 th Cir. 1993)	30
<i>Boeing Co. v. Aetna Cas. & Sur. Co.</i> , 113 Wn.2d 869, 784 P.2d 507 (1990).....	passim
<i>Cincinnati Ins. Co. v. Metropolitan Props., Inc.</i> , 806 F.2d 1541 (11 th Cir. 2007)	30
<i>Dickson v. United States Fid. & Guar. Co.</i> , 77 Wn.2d 785, 466 P.2d 515 (1970).....	22
<i>Emter v. Columbia Health Services</i> , 63 Wn.App. 378, 819 P.2d 390 (1991), <i>review denied</i> , 119 Wn.2d 1005 (1992).....	21
<i>Fluke Corp. v. Hartford Acc. & Indem. Co.</i> , 145 Wn.2d 137, 34 P.3d 908 (2001).....	passim
<i>Kaplan v. Northwestern Mut. Life Ins. Co.</i> , 115 Wn.App. 791, 65 P.3d 16 (2003).....	22
<i>Lallas v. Skagit County</i> , 167 Wn.2d 861, 225 P.3d 910 (2009).....	19

<i>Larsen v. United Pacific Ins.</i> , 44 Wn.App. 529, 723 P.2d 8 (1986).....	21
<i>Level 3 Comm'ns., Inc. v. Twin City Fire Ins. Co.</i> , 272 F.3d 908 (7 th Cir. 2001).....	30
<i>Local 705 Int'l Bhd. Of Teamsters Health & Welfare Fund v. Five Star Mgrs.</i> , 316 Ill.App.3d 391 (Ill. App. 2000).....	30
<i>McCree v. Jennings</i> , 55 Wn.2d 725, 349 P.2d 1071 (1960).....	22
<i>McDonald v. State Farm Fire & Cas. Co.</i> , 119 Wn.2d 724, 837 P.2d 1000 (1992).....	20
<i>Med. Mut. Ins. Co. v. Indian Harbor Ins. Co.</i> , 587 F. Supp. 2d 288 (D.Me. 2008).....	48
<i>Newman v. XL Specialty Ins. Co.</i> , 2007 WL 2982751 (S.D. Ohio 2007).....	30
<i>Odessa School District v. Ins. Co. of America</i> , 57 Wn.App. 893, 791 P.2d 237 (1990).....	22
<i>Olympic Steamship Co. v. Centennial Ins. Co.</i> , 117 Wn.2d 37, 811 P.2d 763 (1991).....	50
<i>Pacific Ins. Co. v. Eaton Vance Mgmt.</i> , 369 F.3d 584 (1 st Cir. 2004).....	30
<i>Panorama Village Condominium Owners Association v. Allstate Ins. Co.</i> , 114 Wn.2d 130, 26 P.3d 910 (2001).....	21, 36, 41
<i>Pan Pac. Retail Props., Inc. v. Gulf Ins. Co.</i> , 471 F.3d 961 (9 th Cir. 2006).....	30
<i>Phil Schroeder Inc. v. Royal Globe Ins. Co.</i> , 99 Wn.2d 65, 659 P.2d 509 (1983).....	22
<i>P.U.D. No. 1 v. International Insurance Co.</i> , 124 Wn.2d 789, 881 P.2d 1020 (1994).....	21, 31

<i>Ratliffe v. ISLIC</i> , 194 Ill. App. 3d 18, 550 N.E.2d 1052 (1990).....	46
<i>Reliance Grp. Holdings, Inc. v. Nat’l Union Fire Ins. Co.</i> , 188 A.D.2d 47 (1 st Dep’t 1993)	30
<i>Roller v. Stonewall Ins. Co.</i> , 115 Wn.2d 679, 801 P.2d 207 (1990).....	20
<i>Shotwell v. Transamerica Title Insurance Co.</i> , 91 Wn.2d 161, 599 P.2d 208 (1978).....	22
<i>Telecable of Seattle, Inc. v. City of Seattle</i> , 164 Wn.2d 35, 186 P.3d 1032 (2008).....	19
<i>Toombs NJ Inc. v. Aetna Cas. & Sur. Co.</i> , 404 Pa. Super. 471 (Pa. Super. 1991).....	30
<i>TracFone Wireless, Inc. v. Wash. Dept. of Revenue</i> , 170 Wn.2d 273, 242 P.3d 810 (2010).....	19
<i>Virginia Mason Med. Ctr. v. Executive Risk Indem., Inc.</i> , 2007 WL 3473683 (W.D. Wash. 2007).....	31, 35
<i>Willing v. Community Association Underwriters Of America, Inc.</i> , 2007 WL 1991038 (W.D. Wash. 2007).....	38
<i>Wilson v. Steinbach</i> , 98 Wn.2d 434, 656 P.2d 1030 (1982).....	20

STATUTES

CR 56(c)	20
RCW 25.15.040.....	26

OTHER AUTHORITIES

<u>The Great Recession’s Stranglehold</u> , Robert J. Samuelson, Editorial	9, 11, 45
<u>Webster’s Third New International Dictionary</u> 571 (1971)).	24

A. SUMMARY OF ARGUMENT

This case involves an insurance coverage dispute between an insurance company, Defendant / Respondent Houston Casualty Company (“Houston Casualty”), and its policyholder, Plaintiff / Appellant Michael J. Sauter (“Sauter”). Because the facts in this case are not in dispute, this case can and should be resolved by this Court as a matter of law.

Houston Casualty issued a D&O-type policy insuring SJ-Management, LLC’s (“SJM”) directors and officers, including Sauter, against third-party “Claims” seeking to impose “Loss” for “Wrongful Acts” allegedly committed by such directors and officers. The terms “Claims,” “Loss,” and “Wrongful Act” are specifically defined in the Houston Casualty Policy, and must be interpreted and applied according to the plain language of those definitions.

Houston Casualty does not dispute that Sauter is an insured under the Houston Casualty Policy. Nor does Commerce dispute that Commerce Bank (“Commerce”) has asserted a “Claim” against Sauter, as that term is defined under the Houston Casualty Policy.

In the summary judgment proceedings below, Houston Casualty argued that the Houston Casualty Policy did not cover Commerce’s “Claim” against Sauter for three main reasons, each of which is invalid for the reasons explained below.

First, Houston Casualty argued that Sauter’s contractual guaranty liability to Commerce does not constitute “Loss” as that term is defined in the Houston Casualty Policy. Specifically, Houston Casualty argued that Sauter’s liability falls within that “Loss” definition’s exception for “matters deemed uninsurable under the law pursuant to which this Policy shall be construed.” But there is no dispute that contractual liability **is not deemed uninsurable under governing Washington law.** To the contrary, governing Washington law expressly recognizes that an insurer seeking to avoid coverage for particular losses or liabilities must state that clearly and expressly in its policy, and may not seek the refuge of unwritten notions of “public policy” or “uninsurability.” *Fluke Corp. v. Hartford Acc. & Indem. Co.*, 145 Wn.2d 137, 34 P.3d 908 (2001). Houston Casualty chose to exclude “contractual liability” under two coverages in the Houston Casualty Policy and other under policies it has issued over the years, but chose not to do so under Coverage A at issue below and on appeal. Thus, Houston Casualty’s “Loss” argument is factually and legally invalid.

Second, Houston Casualty argued that Sauter’s alleged breach of his duty to Commerce under his guaranty is not a “Wrongful Act” under the Houston Casualty’s definition of that term. But there is no dispute that the Houston Casualty Policy expressly defines “Wrongful Act” broadly to include “any actual or alleged ... neglect, breach of duty or act” (emphasis

added) and does not exclude or except an alleged breach of contractual duty. Consistent with this broad policy definition, Houston Casualty publicly proclaims that its D&O policies cover directors and officers for breach of duty claims brought by creditors. Thus, Houston Casualty's primary "Wrongful Act" argument is factually and legally invalid.

Third, Houston Casualty argued that even if an insured's breach of a contractual duty constitutes a "Wrongful Act," Commerce's "Claim" against Sauter does not satisfy the "Wrongful Act" definition's "official capacity" requirement because it seeks to impose only personal liability upon Sauter. There is no dispute that Sauter executed his guaranty in his role as SJM's CEO and Manager, and that he was unable to pay Commerce pursuant to that guaranty because SJM was financially unable to provide Sauter with the indemnification to which it agreed he was entitled. Thus, Sauter both executed and allegedly breached his guaranty in his "official capacity." Sauter's exposure to personal liability to Commerce under his guaranty does not undermine or negate coverage, as the Houston Casualty Policy – as with all D&O policies – is specifically designed to protect directors and officers from such personal liability. Thus, Houston Casualty's secondary "Wrongful Act" argument is factually and legally invalid.

Because Houston Casualty's arguments are unsupported by the plain language of the Houston Casualty policy, the facts surrounding Commerce's "Claim" against Sauter, or governing Washington law, Houston Casualty is left to argue that policies like the Houston Casualty Policy should not be interpreted as covering "Claims" like the one Commerce has made against Sauter. But Washington law repeatedly and expressly holds that such unexpressed notions of what should and should not be insured under a given policy are irrelevant to policy interpretation, especially when such notions directly conflict with the plain language of the policy at issue.

Thus, this Court should reverse the trial court and declare that Commerce's "Claim" against Sauter is covered under Coverage A of the Houston Casualty Policy.

B. ASSIGNMENTS OF ERROR

1. Assignments Of Error.

Sauter assigns error to the following findings in the trial court's September 24, 2010 Order Denying Plaintiff's Motion For Partial Summary Judgment And Granting Houston Casualty's Cross-Motion For Summary Judgment (CP 1118-20):

[IT IS] ORDERED, ADJUDGED and DECREED that Plaintiff Sauter's Motion for Partial Summary Judgment Re: Existence of Coverage Under "Coverage A" is DENIED.

IT IS FURTHER ORDERED, ADJUDGED and DECREED that Defendant Houston Casualty's Cross Motion for Summary Judgment is GRANTED and the court hereby declares that Houston Casualty does not owe a coverage obligation or a duty to indemnify Michael Sauter under Coverage A of the Houston Casualty policy at issue for the Commerce claim against Sauter.

Sauter also assigns error to the following Order in the trial court's Order For Entry Of Judgment Based On The Court's September 24, 2010 Order (CP 1121-24) to the extent it is based upon or incorporates the trial Court's above-referenced September 24, 2010 summary judgment Order:

The Order of this Court issued on September 24, 2010 resolves all issues in controversy in this action between the parties, and shall become final and appealable as of the the date of entry of Final Judgment, pursuant to Washington Civil Rule 58. The Clerk is directed to enter Final Judgment on the docket....

Finally, Sauter assigns error to the following rulings in the Judgment Summary (CP 1126-27) also entered based on the trial court's above-referenced Orders to the extent they are based upon or incorporate the trial Court's above-referenced September 24, 2010 summary judgment Order:

Defendant Houston Casualty does not owe plaintiff Michael Sauter a coverage obligation under Coverage A of the Houston Casualty policy at issue for the Commerce Bank claim against Sauter, as set forth in the Order of this Court issued on September 24, 2010.

* * *

[T]his Court's September 24, 2010 Order resolves all issues in controversy in this action between the parties. Therefore, Final Judgment is hereby entered effective the date set forth below, from which date the time for filing a notice of appeal shall begin to run pursuant to Washington Rule of Appellate Procedure 5.2.

Sauter assigns error to those findings and rulings on the ground that they are based upon an interpretation of the Houston Casualty Policy that is erroneous as a matter of Washington law.

2. Issues Pertaining To Assignment Of Error.

Sauter executed a commercial guaranty securing a loan that non-party Commerce extended to Sauter's company SJM. After SJM failed to repay that loan to Commerce and Sauter failed to pay Commerce pursuant to his contractual guaranty, Commerce made a claim against Sauter for breach of his contractual duty to pay Commerce under that guaranty. The general issue on appeal is whether, under Washington law, Coverage A of the Houston Casualty Policy covers Sauter for the claim Commerce made against him.

The specific disputed policy interpretation issues on appeal are:

a. Commerce alleged that Sauter breached his duty to pay Commerce after SJM defaulted on its loan. Coverage A covers an insured person's "Loss" but defines covered "Loss" to exclude "matters deemed uninsurable under the law pursuant to which this policy shall be

construed.” An insured’s contractual liability is not deemed uninsurable under Washington law.¹ Is Sauter’s alleged contractual liability to Commerce deemed uninsurable as a matter of Washington law, such that it falls outside of the definition of insured “Loss”?

b. Coverage A of the Houston Casualty policy covers “Claims” for “Wrongful Acts,” and defines “Wrongful Act” to include “any ... breach of duty” by an “Insured Person.”² (Emphasis added.) The Houston Casualty Policy does not contain any language limiting coverage to only certain types of “breach of duty.” Commerce alleged that Sauter breached his duty to pay Commerce after SJM defaulted on its loan. May the “Wrongful Act” definition in the Houston Casualty Policy be reasonably interpreted to include Sauter’s alleged breach of his duty to pay Commerce?

c. Coverages C and G contain an exclusion barring coverage for “Claims” based upon the “liability of others assumed by the Insured

¹ Washington law applies to this Washington State court dispute over whether the Houston Casualty Policy provides coverage because: (1) Sauter is a Washington resident; (2) the Houston Casualty Policy was issued to SJM, a Washington Limited Liability Company with a “principal address” in Seattle, Washington; (3) the Houston Casualty Policy was procured by a Washington broker, Alliance Insurance, Inc.; and (4) Houston Casualty is a resident of and transacts business in King County, Washington. In the summary judgment proceedings below, there was no dispute that Washington law governs the interpretation of the Houston Casualty Policy.

² In the summary judgment proceedings below, there was no dispute that Commerce had asserted a “Claim” against Sauter, and that Sauter is an “Insured Person” under the Houston Casualty Policy, as those terms are defined in the Houston Casualty Policy. Thus, those coverage requirements are not at issue on appeal.

under any contract or agreement.” Coverage A does not contain such a “contractual liability” exclusion. Must Coverage A’s “Wrongful Act” and “Loss” definitions be interpreted as containing a “contractual liability” exclusion like the one Houston Casualty expressly included under Coverages C and G but omitted from Coverage A?

d. Coverage A covers “Claims” for “Wrongful Acts” allegedly committed in one’s role as an “Insured Person.” Commerce conditioned its loan to SJM upon SJM obtaining and furnishing a Commercial Guaranty from Sauter. SJM obtained that guaranty from Sauter because he was SJM’s CEO and Manager. Sauter provided that guaranty because he was SJM’s CEO and Manager, and breached that guaranty because SJM was unable to provide the indemnification to which SJM agreed Sauter was entitled. May the capacity requirement in the “Wrongful Act” definition be reasonably interpreted as including Sauter’s breach of the duty he assumed under his guaranty to pay Commerce after SJM defaulted on its loan?

C. STATEMENT OF THE CASE

The following facts relevant to this insurance coverage dispute are undisputed, as confirmed by the parties’ summary judgment briefing below.

1. SJM's Business and Management.

Sauter has been the CEO and Manager of SJM since its creation in 2001.³ SJM's primary business is rental property (apartment) management.⁴ SJM does not own or develop properties for sale or rental.⁵

As SJM's Manager and CEO, Sauter has the "exclusive right and power to manage, operate and control [SJM] and to take all actions and make all decisions as appropriate to carry on [SJM's] business and affairs."⁶

2. SJM's Line of Credit from Commerce.

In March 2008, shortly before the Great Recession struck with full force,⁷ SJM secured a \$3.3 million business line of credit from Commerce.⁸ Acting in his role as SJM's CEO and Manager, Sauter signed the Business Loan Agreement and Promissory Note for that business line of credit on behalf of SJM.⁹

³ CP 151, 255 (definition of "Manager").

⁴ CP 151.

⁵ *Id.*

⁶ CP 256.

⁷ "Great Recession" is a commonly used label for the worldwide economic downturn that commenced around 2008 and by most every estimation continues to this day. *See, e.g., Robert J. Samuelson, Editorial, The Great Recession's Stranglehold, WASH. Post, July 12, 2010, at A15* ("The Great Recession (as it is widely called) has changed America psychologically, politically, economically and socially.").

⁸ CP 152.

⁹ *Id.*

The Business Loan Agreement between SJM and Commerce expressly required SJM to obtain from Sauter and furnish to Commerce an unlimited guaranty “on Lender’s forms”:¹⁰

AFFIRMATIVE COVENANTS. Borrower [SJM] covenants and agrees with Lender [Commerce] that, so long as this Agreement remains in effect, Borrower [SJM] will:

...

Guaranties. Prior to disbursement of any Loan proceeds, furnish executed guaranties of the Loans in favor of Lender, executed by the guarantor named below, on Lender’s forms, and in the amount and under the conditions set forth in those guaranties.

<u>Name of Guarantor</u>	<u>Amount</u>
MICHAEL J. SAUTER	Unlimited

Pursuant to that requirement, SJM requested that Sauter execute Commerce’s form “Commercial Guaranty.”¹¹ Indeed, that Commercial Guaranty expressly stated that Sauter executed it at SJM’s request.¹² As SJM’s CEO and Manager, Sauter had the duty, right and power to obtain the required guaranty on SJM’s behalf.¹³ Sauter exercised that duty, right and power as CEO and Manager of SJM by executing that Commercial

¹⁰ CP 290-96.

¹¹ CP 301-06.

¹² *Id.*

¹³ CP 152.

Guaranty, which was then furnished by SJM to Commerce as required.¹⁴ Sauter only executed that Commercial Guaranty because he was SJM's CEO and Manager; he would not have executed that guaranty acting in any other role.¹⁵

Based on his in-depth understanding of SJM's business and financial prospects, Sauter was confident that SJM would be able to repay Commerce in full, and that he would not be called upon to make payment pursuant to that guaranty.¹⁶

3. Commerce's "Claim" Against Sauter.

Unfortunately, the Great Recession decimated SJM's business. For example, occupancy rates at the eleven properties operated and managed by SJM decreased by nearly ten percent and property values dropped forty to fifty-five percent.¹⁷ As a result, the owners of those properties were unable to satisfy their own financial (loan repayment and operational) obligations.¹⁸ Moreover, because of the substantial downturn in property valuations in the Southwestern United States region (Arizona and Nevada) where those properties were located, property owners were generally unable to refinance their property loans before or as they became

¹⁴ *Id.*

¹⁵ *Id.*

¹⁶ *Id.*

¹⁷ *Id.*

¹⁸ *CP 152.*

due.¹⁹ As a result, beginning in 2008, each of the eleven properties SJM managed were sent into receivership controlled by the property lenders.²⁰ Those receiverships eliminated those revenue sources, rendering SJM unable to make required payments to Commerce.²¹

On July 20, 2009, Commerce informed Sauter of SJM's failure to make required payments and demanded that Sauter pay Commerce the full \$2,824,466.61 of SJM's indebtedness by August 3, 2009.²²

On July 27, 2009, Sauter demanded that SJM indemnify him against Commerce's demand on the Commercial Guaranty.²³ SJM's members granted that demand by unanimous consent, confirming that Sauter had executed that guaranty "in connection with his role as Manager of the Company."²⁴ But for the same reason SJM was unable to repay Commerce – lack of funds – SJM was unable to indemnify Sauter.²⁵

Without the indemnification to which he was entitled from SJM, Sauter was unable to pay Commerce as Commerce had demanded.²⁶ As a

¹⁹ *Id.*

²⁰ *Id.*

²¹ *Id.*

²² CP 307-09.

²³ CP 310-11.

²⁴ CP 312-15.

²⁵ CP 153.

²⁶ *Id.*

result, Sauter failed to satisfy his alleged duty to repay Commerce pursuant to the Commercial Guaranty.²⁷

Around August 11, 2009, Commerce followed up its prior demand to Sauter by issuing six separate notices demanding that Sauter make payment by a specified date or face foreclosure upon Sauter's properties that secured his guaranty obligations.²⁸

Since Houston Casualty's initial coverage denial, Sauter has paid more than \$30,000 defending against Commerce's "Claims" and paid nearly \$250,000 to Commerce in an attempt to prevent Commerce from commencing formal foreclosure or other legal proceedings against him and all of his pledged properties.²⁹

4. The Houston Casualty Policy.

Houston Casualty sold SJM separate but essentially identical claims-made "Diversified Business Organization Insurance Polic[ies]" for the periods April 16, 2008 through July 27, 2009 and July 27, 2009 through July 27, 2010 (collectively, the "Houston Casualty Policy").³⁰

Houston Casualty publicly acknowledges – indeed, proclaims – that the directors' and officers' insurance policies it issues – such as the

²⁷ *Id.*

²⁸ *CP 316-52.*

²⁹ *CP 154.*

³⁰ *CP 155-247.*

Houston Casualty Policy – protect officers’ personal assets and liability against damages resulting from creditors’ breach of duty claims.³¹

Today directors and officers owe a duty to a number of parties including the company, creditors, shareholders, employees, individuals, and the public. Breach of duty claims followed by judgments, settlements, and lawsuits can result in disqualification, penalties, damages, and in some cases, loss of assets.

D&O GIVES CORPORATE LEADERS PEACE OF MIND
Directors and Officers Liability Insurance (D&O) covers the personal assets and liability of past, present and future directors and officers. This coverage provides peace of mind, protecting them from wrongful acts or decisions made in their capacity as leaders and decision makers.

³¹ CP 958.

Houston Casualty provides those promised protections through the following coverages, among others:³²

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 .
COVERAGE B:	The Insurer shall pay on behalf of the Insured Organization, Loss which the Insured Organization is required or permitted to pay as indemnification to any of the Insured Persons resulting from any Claim first made against the Insured Person during the Policy Period for a Wrongful Act .
COVERAGE C:	The Insurer shall pay on behalf of the Insured Organization, Loss resulting from any Claim first made against the Insured Organization during the Policy Period for a Wrongful Act .
	* * *
COVERAGE G:	The Insurer shall pay on behalf of the Insureds Loss arising from a Claim first made during the Policy Period arising from a Wrongful Act in the performance of Real Estate Activities .

The Houston Casualty Policy defines “Insured Persons” to include:³³

M.	Insured Persons mean 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 Practice Liability Coverage), if purchased, the term Insured Persons also shall include Employees of the Insured Organization ;

³² CP 157, 204. (All terms appearing in **bold** in boxed quotes in this Section actually appear in bold in the original Houston Casualty Policy.)

³³ CP 159-60, 181, 206, 228.

The Houston Casualty Policy defines “Loss” to include:³⁴

- O. 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 Insurance 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;
 - (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;

The Houston Casualty Policy defines “Wrongful Act” to include:³⁵

- 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; . . .

³⁴ CP 160, 177, 207, 224.

³⁵ CP 161-62, 208-09.

Coverage A of the Houston Casualty Policy contains the following exclusion:³⁶

IV. EXCLUSIONS

The Insurer shall not be liable to make any payment in connection with any **Claim**:

* * *

E. brought about or contributed to by any dishonest, fraudulent or criminal act or omission committed with the intent to deceive, or any personal profit or advantage gained by any of the Insureds to which they were not legally entitled, if such dishonest, fraudulent or criminal act or personal profit or advantage is established by judgment or other final adjudication adverse to the Insureds;

Coverages C and G of the Houston Casualty Policy, but not Coverage A at issue in the summary judgment cross-motions below or on appeal here, contain the following exclusion:³⁷

IV. EXCLUSIONS

The Insurer shall not be liable to make any payment in connection with any **Claim** made against the **Insured Organization** under the Insuring Agreement Coverage C or any Insured under Insuring Agreement Coverage G:

A.1. based upon, arising out of, directly or indirectly resulting from, in consequence of, or in any way involving, liability of others assumed by the **Insured** under any contract or agreement, either oral or written, except to the extent the **Insured** would have been liable in the absence of such contract or agreement;

5. Houston Casualty's Coverage Denial.

In August 2009, Sauter tendered Commerce's "Claim" to Houston Casualty and requested coverage for that "Claim."³⁸

³⁶ CP 164, 211.

By letter dated September 24, 2009, Houston Casualty denied coverage for Commerce's "Claim" on the purported grounds that: (1) Commerce's "Claim" was uninsurable as a matter of law, and thus could not give rise to "Loss" covered under the Houston Casualty Policy; (2) Commerce's "Claim" for breach of Sauter's duty under his guaranty was not the result of a "Wrongful Act", as required for coverage under the Houston Casualty Policy; (3) any such "Wrongful Act" was not committed by Sauter in his role as an "Insured Person," as required for coverage under the Houston Casualty Policy; and (4) Commerce's "Claim" was barred under Coverage C and Coverage G due to an exclusion for "contractual liability" under those coverages.³⁹ Houston Casualty also asserted that the "personal profit" exclusion may bar coverage for Commerce's "Claim."⁴⁰

6. Procedural History.

February 2010: Sauter filed his Complaint For Declaratory Relief And Damages against Houston Casualty.⁴¹

August & September 2010: Both parties requested summary judgment interpreting the Coverage A policy language at issue.⁴²

³⁷ CP 166, 173, 213, 220.

³⁸ CP 353- 362.

³⁹ CP 363-74.

⁴⁰ *Id.*

⁴¹ CP 1-5.

September 2010: Trial court interpreted Coverage A of the Houston Casualty Policy in Houston Casualty's favor – denying Sauter's summary judgment cross-motion seeking a declaration that Coverage A covered Michael Sauter for Commerce's "Claim" against him and granting Houston Casualty's cross-motion seeking a declaration of no coverage.⁴³

March 2011: Sauter timely filed his Notice Of Appeal To Court of Appeals, Division I.⁴⁴

D. ARGUMENT

1. Standard of Review.

A trial court's ruling on summary judgment cross-motions is reviewed de novo. *Telecable of Seattle, Inc. v. City of Seattle*, 164 Wn.2d 35, 41, 186 P.3d 1032 (2008) (conducting de novo review of trial court's ruling on summary judgment cross motions); *Avanade, Inc. v. City of Seattle*, 151 Wn. App. 290, 297, 211 P.3d 476, 479 (2009) (same).

As such, a Court of Appeals reviewing such a ruling engages in the same inquiry as the trial court. *TracFone Wireless, Inc. v. Wash. Dept. of Revenue*, 170 Wn.2d 273, 280-281, 242 P.3d 810, (2010); *Lallas v. Skagit County*, 167 Wn.2d 861, 864, 225 P.3d 910 (2009).

⁴² CP 119-47,479-506.

⁴³ CP 1118-20.

⁴⁴ CP 1129-30.

2. Summary Judgment Standard.

Summary judgment is appropriate if there is no genuine issue of material fact and the moving party is entitled to judgment as a matter of law. CR 56(c); *Wilson v. Steinbach*, 98 Wn.2d 434, 437, 656 P.2d 1030 (1982). Insurance policy interpretation is a matter of law for a court to decide. *McDonald v. State Farm Fire & Cas. Co.*, 119 Wn.2d 724, 730, 837 P.2d 1000 (1992). Summary judgment is therefore appropriate here because (1) there is no dispute about the relevant facts and (2) coverage depends solely on the language of the Houston Casualty Policy. *See Roller v. Stonewall Ins. Co.*, 115 Wn.2d 679, 682, 801 P.2d 207 (1990).

3. Washington Insurance Policy Interpretation Law.

Because the interpretation of insurance policy language presents a question of law, this section begins with a summary of what that law is.

First, Washington law requires that insurance policies be interpreted as they would be by an average purchaser of insurance, not an

expert or scholar.⁴⁵ That means a policy must be interpreted according to its plain language, in a manner that gives meaning to each policy term.⁴⁶

Second, Washington law holds that undefined terms in an insurance policy must be given an ordinary English dictionary meaning.⁴⁷ “In this state, legal technical meanings have never trumped the common perception of the common man.”⁴⁸

Third, Washington law does not allow an insurance company to “interpret” its policy language so as to effectively insert new language or limitations.⁴⁹

⁴⁵ *Panorama Village Condominium Owners Association v. Allstate Ins. Co.*, 114 Wn.2d 130, 139, 26 P.3d 910, 915 (2001) (“[O]ur construction of an insurance contract must be a fair, reasonable, and sensible construction as would be given to the contract by the average person purchasing insurance. The proper inquiry is not whether a learned judge or scholar can, with study, comprehend the meaning of an insurance contract but instead whether the insurance policy contract would be meaningful to the layman.”) (citations and quotations omitted).

⁴⁶ *P.U.D. No. 1 v. International Insurance Co.*, 124 Wn.2d 789, 797, 881 P.2d 1020 (1994) (“The interpretation of insurance policies is a question of law, and in construing the language of an insurance policy, a court must construe the entire contract together so as to give force and effect to each clause.”) (citations omitted).

⁴⁷ *Panorama Village*, 114 Wn.2d at 139 (“Undefined terms in an insurance contract must be given their plain, ordinary, and popular meaning; and to determine the ordinary meaning of an undefined term, our courts look to standard English language dictionaries.”) (citations and quotations omitted).

⁴⁸ *Boeing Company v. Aetna Casualty And Surety Company*, 113 Wn.2d 869, 881, 784 P.2d 507 (1990).

⁴⁹ *American National Fire Ins. v. B&L Trucking*, 134 Wn.2d 413, 430, 951 P.2d 250 (1998) (“We will not add language to the policy that the insurer did not include.”); see also, *Emter v. Columbia Health Services*, 63 Wn.App. 378, 382-83 819 P.2d 390, 391 (1991), review denied, 119 Wn.2d 1005 (1992) (Washington law does not even allow the insurer to insert commas it had omitted); *Larsen v. United Pacific Ins.*, 44 Wn.App. 529, 532, 723 P.2d 8 (1986) (per Utter, J.) (finding coverage and noting that language in another insurance provision used by the insurer showed the insurer knew how to clearly exclude coverage for the loss at issue if it had wanted to, yet insurer failed to use that policy language in the provision at issue).

Fourth, Washington law requires an insurance policy to be construed strictly against the insurance company.⁵⁰ Washington law accordingly requires the wording in a policy to “be liberally construed to provide coverage whenever possible,”⁵¹ and mandates that “any doubts, ambiguities and uncertainties arising out of the language used in the policy must be resolved in [the policyholder’s] favor.”⁵² Washington law applies this pro-coverage mandate with even more force to language in an insurance policy that purports to limit the scope of coverage.⁵³

Fifth, Washington law dictates that when the wording of a policy is fairly susceptible to more than one interpretation, the interpretation most favorable to the policyholder must be employed – even if that is not the interpretation the insurance company says it intended.⁵⁴

⁵⁰ E.g., *Shotwell v. Transamerica Title Insurance Co.*, 91 Wn.2d 161, 167-68, 599 P.2d 208 (1978); *McCree v. Jennings*, 55 Wn.2d 725, 349 P.2d 1071, 1072 (1960).

⁵¹ *Odessa School District v. Ins. Co. of America*, 57 Wn.App. 893, 897, 791 P.2d 237 (1990).

⁵² *Phil Schroeder Inc. v. Royal Globe Ins. Co.*, 99 Wn.2d 65, 69, 659 P.2d 509, 511 (1983) (underline added).

⁵³ *Shotwell*, 91 Wn.2d at 167-68 (the rule that any doubts, ambiguities and uncertainties arising out of the language used in the policy must be resolved in [the insured’s] favor “applies with added force in the case of exceptions and limitations to a policy’s coverage”) (emphasis added); accord, e.g., *Dickson v. United States Fid. & Guar. Co.*, 77 Wn.2d 785, 789, 466 P.2d 515, 518 (1970) (provisions excluding coverage “are to be construed most strongly against the company writing the policy, and in favor of the insured”).

⁵⁴ *Shotwell*, 91 Wn.2d at 167-68 (“Where a provision of a policy of insurance is capable of two meanings, or is fairly susceptible of two constructions, the meaning and construction most favorable to the insured must be employed, even though the insurer may have intended otherwise.”) (underline added); accord, *Kaplan v. Northwestern Mut. Life Ins. Co.*, 115 Wn.App. 791, 804, 65 P.3d 16, 23 (2003) (“A clause in a policy is ambiguous when, on its face, it is fairly susceptible to two different interpretations, both of which are reasonable. ... When an ambiguity in the policy exists, a meaning and

In light of the settled Washington insurance law and facts set forth above, Sauter is entitled to reversal of the trial court’s summary judgment ruling, and entry of summary judgment in Sauter’s favor, unless Houston Casualty can prove that the only reasonable way to interpret and apply each relevant provision of the Houston Casualty Policy is as barring coverage for Commerce’s “Claim” against Sauter. As explained below, Houston Casualty has not and cannot meet that substantial burden.

4. Commerce’s “Claim” Against Sauter Triggers Coverage Under The Houston Casualty Policy.

a. Commerce’s “Claim” Satisfies Coverage A’s Insuring Clause.

The insuring clause of Houston Casualty Policy Coverage A expressly provides:⁵⁵

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 this insuring clause is satisfied here.

Sauter is an “Insured Person” because he was and is SJM’s CEO and Manager, and thus a “duly appointed or elected . . . officer . . . manager, or equivalent executive of an Insured Organization” falling within the plain language of the Houston Casualty Policy’s “Insured

construction most favorable to the insured must be applied, even though the insurer may

Person” definition.⁵⁶ Houston Casualty has already acknowledged that Sauter is an “Insured Person” under the Houston Casualty Policy.⁵⁷

Commerce asserted a “Claim” against Sauter because Commerce sent Sauter multiple written demands that Sauter pay, pursuant to his Commercial Guaranty, the amounts SJM owed to Commerce.⁵⁸ Such a demand constitutes a “written demand for monetary damages” falling within the plain language of the Houston Casualty Policy’s “Claim” definition.⁵⁹ Houston Casualty has not disputed that Commerce’s payment demand constituted a “Claim” under the Houston Casualty Policy.⁶⁰

Commerce’s “Claim” was first asserted against Sauter during the period of the Houston Casualty Policy. Sauter received Commerce’s initial written demand for payment around July 20, 2009.⁶¹ Sauter received a follow-up payment demand based upon the same purported facts and circumstances around August 11, 2009.⁶² Both demands were

have intended another meaning.”) (citations omitted).

⁵⁵ CP 157, 204 (**bold typeface in original**).

⁵⁶ CP 151, 159-60, 181, 206-07, 228.

⁵⁷ CP 369.

⁵⁸ CP 307-09, 316-52.

⁵⁹ See *Boeing*, 113 Wn.2d 869 (rejecting insurer’s request for narrow interpretation of undefined policy term “damages” in favor of broad interpretation consistent with the understanding of an average purchaser of insurance – e.g., “the estimated reparation in money for detriment or injury sustained”) (quoting *Webster’s Third New International Dictionary* 571 (1971)). CP 158, 179, 205, 226.

⁶⁰ CP 363-74.

⁶¹ CP 307-09.

⁶² CP 316-52.

received while the Houston Casualty Policy was in effect.⁶³ Houston Casualty has not disputed that Commerce’s “Claim” was first asserted against Sauter during the Houston Casualty Policy period.

Commerce’s “Claim” is for a “Wrongful Act” by Sauter. The Houston Casualty Policy defines “Wrongful Act” extremely broadly, to include “any ... alleged act, ... error, omission, ... neglect, breach of duty or act...” by an “Insured Person.”⁶⁴ Commerce’s “Claim” alleges that Sauter is liable for, among other things, his act of executing a Commercial Guaranty regarding that indebtedness, and his breach and neglect of the duties he assumed by the act of executing that guaranty.⁶⁵ In order to give meaning to Houston Casualty’s inclusion of the express policy term “any,” as required by Washington insurance law, the term “Wrongful Act” cannot be interpreted as being internally or implicitly narrowed – e.g., as automatically inapplicable to contractual breaches as Houston Casualty contends. Thus, Sauter’s alleged acts, neglects, and breaches fall squarely within the plain language of the Houston Casualty Policy’s “Wrongful Act” definition.

The “capacity” element of the “Wrongful Act” definition is also satisfied by the undisputed facts. Sauter executed the Commercial

⁶³ CP 151, 156, 203 (policy declarations).

⁶⁴ CP 161-62, 208-09.

⁶⁵ CP 307-09, 316-52.

Guaranty because he was SJM's CEO and Manager, and while acting in that role. This is confirmed by the SJM members' unanimous agreement that Sauter executed that guaranty "in connection with his role as Manager of the company."⁶⁶ (Indeed, that alleged breach occurred because SJM was financially unable to provide the indemnification to which SJM's members agreed Sauter was entitled.⁶⁷) Commerce therefore alleges a breach of duty or act by Sauter while acting in that role. This falls within the exact language Houston Casualty chose to use in the "capacity" element of the "Wrongful Act" definition. And the Houston Casualty Policy expressly covers "Claims" alleging such a "Wrongful Act."

Finally, Commerce's "Claim" has imposed and will continue to impose "Loss" upon Sauter because that "Claim" has forced Sauter to incur costs defending against that "Claim" and making partial periodic payments in return for Commerce's forbearance from further collection or foreclosure attempts.⁶⁸ Whether Sauter's payments are characterized as "damages" or partial "settlements" – both of which would be reasonable

⁶⁶ CP 312-15. SJM's members therefore agreed that Sauter was entitled to indemnification under SJM's LLC agreement and Washington's indemnification statute. *See* RCW 25.15.040 (permitting limited liability company agreements to contain provisions that "Eliminate or limit the personal liability of a member or manager to the limited liability company or its members for monetary damages for conduct as a member or manager....").

⁶⁷ CP 153, 312-15.

⁶⁸ CP 154, 375-88.

interpretations – they fall within the plain language of the Houston Casualty’s “Loss” definition.⁶⁹

Thus, Commerce’s “Claim” against Sauter satisfies all requirements of Coverage A’s insuring clause.

b. Houston Casualty’s Purported Denial Grounds Are Inapplicable.

As set forth above, Houston Casualty denied coverage responsibility for Commerce’s “Claim” against Sauter, contending that: (1) Commerce’s “Claim” is legally uninsurable, and thus not a covered “Loss,” because it arises out of Sauter’s alleged breach of his contractual duties; (2) Commerce’s “Claim” is not for a “Wrongful Act,” and thus does not trigger coverage, because it arises out of Sauter’s alleged breach of his contractual duties; (3) Commerce’s “Claim” is not for a “Wrongful Act” committed in Sauter’s capacity as an “Insured Person,” and thus does not trigger coverage, because Sauter neither executed nor allegedly breached his duties under the Commercial Guaranty in his role as CEO or Manager of SJM; (4) coverage for Commerce’s “Claim” may be barred under the “personal profit” exclusion if Sauter is adjudicated to have

⁶⁹ *Washington law requires that “damages” be interpreted broadly, consistent with how it would be interpreted by the layman, as opposed to the way in which an insurance adjuster, judge, lawyer or scholar could conceivably interpret that term. See Boeing, 113 Wn.2d at 881.*

retained possession of the loan proceeds SJM received from Commerce;⁷⁰ and (5) coverage for Commerce's "Claim" is barred under the "contractual liability" exclusion in Coverages C and G because Commerce's "Claim" arises out of Sauter's alleged breach of his contractual duty to satisfy SJM's indebtedness.⁷¹ As explained below, each of these denial grounds is invalid and inapplicable here.

⁷⁰ Sauter's summary judgment briefing below specified three reasons why the "personal profit" exclusion did not apply to bar coverage for Houston Casualty's "Claim." First, Commerce's "Claim" does not even allege that Sauter acted deceptively or fraudulently. Second, Commerce paid the line of credit proceeds to SJM, not Sauter. Both Sauter and SJM's managers have confirmed that Sauter did not obtain any personal profit from those proceeds. CP 152, 313. And third, there has not been a final adjudication, as is required for that exclusion to apply. For each of the foregoing reasons, the "personal profit" exclusion does not apply to bar coverage for Commerce's claim against Sauter. Houston Casualty's summary judgment briefing did not invoke the "personal profit" exclusion. As such, that purported denial ground has been abandoned/withdrawn and is not at issue on appeal.

⁷¹ CP 363-74. Because the parties' summary judgment cross-motions, and the trial court's ruling on those motions, solely involved Coverage A of the Houston Casualty Policy, this Coverage C and G issue is not at issue on appeal. (As explained below, that Coverage C and G "contractual liability" exclusion is nonetheless relevant here because it shows that Houston Casualty knew how to expressly bar coverage for contractual liability when it wanted to, but chose not to do so under Coverage A at issue on summary judgment below and on appeal.)

(1) Sauter Has Sustained Covered “Loss” Resulting From Commerce’s “Claim”.

(a) The Houston Casualty Policy Merely Excludes “Loss” Deemed Uninsurable As A Matter Of Washington Law; Contractual Liability Is Not Deemed Uninsurable As A Matter Of Washington Law.

The Houston Casualty Policy defines “Loss” to include “damages, settlements and Costs, Charges and Expenses incurred by any of the Insured Persons under Insuring Agreement Coverage A....”⁷² That definition expressly excludes “matters deemed uninsurable under the law pursuant to which this Policy shall be construed.”⁷³

Houston Casualty relies on the exclusion for “matters deemed uninsurable under the law” to deny coverage for Commerce’s “Claim”. Specifically, Houston Casualty contends that any “Loss” incurred by Sauter as a result of Commerce’s “Claim” is merely a contractual liability that Houston Casualty wants to be uninsurable as a matter of law.⁷⁴ Notably, even though that exclusion expressly references applicable insurance law (which is Washington law here), Houston Casualty has not cited and cannot cite a single citation or reference to Washington law declaring contractual liability claims to be uninsurable as a matter of law.

⁷² CP 160, 177, 207, 224.

⁷³ CP 160, 177, 207, 224.

That is undoubtedly because contractual liability claims are not deemed uninsurable under Washington law. The absence of Washington law declaring contractual liability to be uninsurable as a matter of law is fatal to Houston Casualty's uninsurability argument.

Unable to cite any Washington law declaring contractual liability claims to be uninsurable as a matter of law, Houston Casualty's summary judgment briefing below relied entirely upon inapposite non-Washington decisions in arguing that contractual liability damages should be excluded under Washington law.⁷⁵ But such Non-Washington decisions are irrelevant here because Houston Casualty chose to draft its "Loss" exclusion to apply only to matters deemed insurable under applicable state law – here, Washington law. Relying upon or citing non-Washington decisions holding that contractual liability claims are uninsurable as a

⁷⁴ CP 370.

⁷⁵ CP 493 (citing *August Ent't, Inc. v. Phila. Indem. Ins. Co.*, 146 Cal.App.4th 565 (Cal. App. 2007) (applying California law); CP 501-04 (citing *Pan Pac. Retail Props., Inc. v. Gulf Ins. Co.*, 471 F.3d 961 (9th Cir. 2006) (applying California law); *Level 3 Comm'ns., Inc. v. Twin City Fire Ins. Co.*, 272 F.3d 908 (7th Cir. 2001) (applying Illinois law); *Local 705 Int'l Bhd. Of Teamsters Health & Welfare Fund v. Five Star Mgrs.*, 316 Ill.App.3d 391 (Ill. App. 2000) (applying Illinois law); *Reliance Grp. Holdings, Inc. v. Nat'l Union Fire Ins. Co.*, 188 A.D.2d 47 (1st Dep't 1993) (applying New York law); *Pacific Ins. Co. v. Eaton Vance Mgmt.*, 369 F.3d 584 (1st Cir. 2004) (applying Massachusetts law); *Toombs NJ Inc. v. Aetna Cas. & Sur. Co.*, 404 Pa. Super. 471 (Pa. Super. 1991) (applying Pennsylvania law); *Am. Cas. Co. of Reading, PA v. Hotel & Restaurant Emp'ees and Bartenders Int'l Union Welfare Fund*, 113 Nev. 764 (Nev. 1997) (applying Nevada law); *Baylor Heating & Air Conditioning, Inc. v. Federated Mut. Ins. Co.*, 987 F.2d 415 (7th Cir. 1993) (applying Indiana law); *Cincinnati Ins. Co. v. Metropolitan Props., Inc.*, 806 F.2d 1541 (11th Cir. 2007) (applying Alabama law); *Newman v. XL Specialty Ins. Co.*, 2007 WL 2982751 (S.D. Ohio 2007) (applying Ohio law)).

matter of law, when Washington law is silent on the issue, would render superfluous the “Loss” exclusion’s express reference to “matters deemed uninsurable under the law pursuant to which this Policy shall be construed.”⁷⁶ Such an interpretation is therefore impermissible under Washington insurance law summarized above.⁷⁷

In addition, the non-Washington *Pan Pacific, Level 3, Local 705*, and *Reliance Group* decisions Houston Casualty cited at the trial court level are factually inapposite because they merely discuss whether or not restitutionary ill-gotten gains damages are insurable – under other states’ laws, no less. Those cases are also factually inapposite because it is undisputed that Sauter did not receive the 2008 loan proceeds and thus could not have obtained ill-gotten gains.

More importantly, although those non-Washington decisions cited by Houston Casualty do not involve the particular contractual liability coverage issue involved here, even those decisions directly conflict with the Western District of Washington’s *Virginia Mason* decision (discussed below) recognizing that such claims are not uninsurable as a matter of law.

⁷⁶ See CP 160, 177, 207, 224. (Emphasis added.)

⁷⁷ See, e.g., *P.U.D. No. 1*, 124 Wn.2d at 797 (“The interpretation of insurance policies is a question of law, and in construing the language of an insurance policy, a court must construe the entire contract together so as to give force and effect to *each* clause.”) (citations omitted) (emphasis added).

Finally, the non-Washington *Eaton Vance*, *Toombs*, *American Casualty*, *Baylor Heating*, and *Metropolitan Properties* decisions Houston Casualty cited at the trial court level are inapposite because they do not even involve a D&O policy or the repayment of a business loan.

In fact, Washington’s highest court has expressly held that “uninsurability” must be determined based on the plain language an insurer chooses to include in its insurance policy, rather than some unexpressed notion of what an insurer thinks should or should not be insurable as a matter of public policy. *Fluke*, 145 Wn.2d 137, 144-47.

Fluke involved a liability insurer’s denial of coverage for punitive damages awarded against its policyholder on a malicious prosecution claim.⁷⁸ The insurer attempted to invoke California insurance law, which precludes coverage for intentional acts such as malicious prosecution, as well as punitive damages.⁷⁹ But the Washington Supreme Court joined the trial court and court of appeals in applying Washington law.⁸⁰

The Court first rejected the insurer’s argument that its policy’s express coverage for malicious prosecution claims should be invalidated on public policy grounds – specifically, because malicious prosecution is an intentional act that should not be insurable – on the ground that

⁷⁸ *Id.* at 140.

⁷⁹ *Id.* at 141.

⁸⁰ *Id.*

Washington courts had never overridden an express grant of coverage on public policy grounds.⁸¹ The court stated:⁸²

[t]he paramount public policy here is the commitment to upholding the plain language of [insurance] contracts.

The Court acknowledged that public policy had twice been applied to expand coverage by invalidating policy exclusions, but only when express statutory language establishing the public policy grounds justified such policy invalidation.⁸³ But the Court concluded that in the case before it, the insurer had identified “no public policy expressed in Washington statutes or case law that would justify overriding the policy’s explicit coverage for malicious prosecution.”⁸⁴

Importantly, the Court noted in a footnote the absence of any “public policy that acts as a blanket prohibition against [insurance coverage for] *all* so-called intentional torts.”⁸⁵ Similarly, there is no declared Washington public policy acting as a blanket prohibition against insurance coverage for contractual liability claims. So under *Fluke*, one

⁸¹ *Id.* at 144.

⁸² *Id.* at 147.

⁸³ *Id.* at 144.

⁸⁴ *Id.* at 145.

⁸⁵ *Id.* at 147 n. 5 (quoting Peter J. Kalis, Thomas M. Reiter & James R. Segerdahl, *Policyholder’s Guide to the Law of Insurance Coverage* §6.02 (Supp.2001) (brackets and italics in original)).

should not be applied in the absence of an express policy exclusion to that effect.

The *Fluke* Court next addressed the insurer's argument coverage for punitive damages should be precluded as a matter of public policy. The Court quickly rejected that argument because "this state has articulated no such public policy, either by statute or judicial decision."⁸⁶ The Court specifically acknowledged that Washington law differed from California law in that respect, but properly concluded that the absence of Washington law precluding coverage for punitive damages dispositively established that a liability policy could provide coverage for such damages unless expressly excluded.⁸⁷

Similarly, Houston Casualty has not cited any Washington statute or judicial decision supporting its argument that there should be an unwritten blanket prohibition against D&O coverage for contractual liability claims. Given the Houston Casualty Policy's express invocation of Washington law in its insurability exclusion, the absence of any such Washington law is fatal to Houston Casualty's argument.

The federal district court here in Seattle recently followed the *Fluke* court's rationale and mandate in rejecting the notion that a third-party claim seeking the return of money by an insured should be

automatically uninsurable. See *Virginia Mason Med. Ctr. v. Executive Risk Indem., Inc.*, 2007 WL 3473683 at *4 (W.D. Wash. 2007) (unreported decision):

Washington courts have not addressed whether an insurer can provide 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. *Fluke Corp. v. Hartford Accident & Indem. Co.*, 145 Wash.2d 137, 144, 34 P.3d 809 (Wash.2001). In *Fluke*, the Court found that insurance coverage for the intentional tort of malicious prosecution is not contrary to public policy and neither is coverage for punitive damages. *Id.* at 144, 34 P.3d 809. The Washington Supreme Court has distinctly acknowledged an “absence of public policy in the construction of insurance contracts.” *Boeing v. Aetna*, 113 Wash.2d 869, 876 n. 1, 784 P.2d 507 (2001) (“Washington courts rarely invoke public policy to override express terms of an insurance policy.”). In *Fluke*, the Court indicated that public policy must be clearly expressed in a state statute or judicial decision before it can override an insurance policy’s explicit coverage. *Id.* at 145, 784 P.2d 507) (“The paramount public policy here is the commitment to upholding the plain language of contracts.”).

(Emphasis added.)

⁸⁶ *Id.* at 148.

⁸⁷ *Id.* at 148-9.

The same result is mandated in this case. Houston Casualty is unable to cite to any Washington statute or judicial decision declaring that such claims are uninsurable. Absent such a Washington statute or judicial decision, Houston Casualty cannot rely upon the “uninsurability” exclusion to justify its coverage denial.

**(b) Houston Casualty Consciously
Chose Not To Include A
Contractual Liability Exclusion
Under Coverage A.**

Because contractual liability is not deemed uninsurable under Washington law, coverage must be determined based on the language Houston Casualty chose to include in Coverage A of the Houston Casualty Policy. Houston Casualty’s denial ground is equally flawed under the plain language of the Houston Casualty Policy, as Coverage A does not contain a “contractual liability” exclusion of any kind.

As repeatedly acknowledged by the Washington Supreme Court, the insurance industry “knows how to protect itself and it knows how to write exclusions and conditions.”⁸⁸ Houston Casualty has repeatedly demonstrated that it knows exactly how to draft an “contractual liability” exclusion when it wants to include one in its policy. Houston Casualty drafted a “contractual liability” exclusion for Coverages C and G (which were not at issue in the summary judgment cross-motions at the trial court

level, and thus not at issue on appeal),⁸⁹ and also has been issuing insurance with a similar breach of contract exclusion dating back many years:⁹⁰

Unless otherwise specifically stated or provided for in CONDITION (D)(2) or elsewhere in this Policy, the Insurer will not be liable to make any payment of Loss in connection with a Claim:

(P) for any actual or alleged breach of contract or agreement; provided that this EXCLUSION (P) will not apply to any Claim for an Employment Practices Wrongful Act.

Thus, had Houston Casualty wanted to exclude contractual liability “Claims” under Coverage A (which is at issue here), it could have drafted such an exclusion in Coverage A. But Houston Casualty chose not to do so. Thus, Washington law prohibits Houston Casualty from skirting its coverage obligations by now “interpreting” the uninsurability exclusion in its policy’s “Loss” definition as having the same effect as a “contractual liability” exclusion.

⁸⁸ *Panorama Village*, 114 Wn.2d 130 at 141 (citing *Boeing*, 113 Wn.2d at 887).

⁸⁹ CP 166, 177, 213, 224.

⁹⁰ As early as 2002, Houston was issuing Directors, Officers and Organization Liability Insurance Policies that excluded coverage for “Loss in connection with a Claim... arising out of any actual or alleged breach of contract or agreement”. In 2004, Houston even limited the exclusion and broadened coverage by rewriting the exclusion to only exclude coverage for “Loss in connection with a Claim... for any actual or alleged breach of contract or agreement”. CP 395, 458.

Courts in Washington have repeatedly rejected attempts by insurers to have their policies interpreted as containing an exclusion the insurers could have included, but chose not to include, in their policies. For example, in *Willing v. Community Association Underwriters Of America, Inc.*, 2007 WL 1991038 (W.D. Wash. 2007) (unreported decision), the insurance carrier argued that a general liability policy's "owned property exclusion" should be applied to bar coverage for third-party claims for damage to property not legally owned by the named insured, but over which the named insured had allegedly exercised "incidents of ownership." Western District of Washington Judge Lasnik rejected that argument and held that the policyholders were entitled to coverage, stating:

if defendant had intended to exclude coverage based on "incidents of ownership" in the property or exercising any type of control over it, they could have done so. In fact, [insurer] sold the Association a policy after the relevant time period underwritten by a different company [] that included just such an exclusion.

Willing, 2007 WL 1991038 at *5. See also *B&L Trucking*, 134 Wn.2d at 430 ("We will not add language to the policy that the insurer did not include.").

Here, it was not even a “different company” than Houston Casualty that demonstrated how an insurer could include in its later policies the type of “contractual liability” exclusion that Houston Casualty now seeks to “interpret” into the Houston Casualty Policy. Rather, it was Houston Casualty itself that included such an exclusion in its own prior policies and in Coverages C and G of the Houston Casualty Policy. Thus, Houston Casualty cannot now invoke that exclusion under a coverage that does not even contain such an exclusion.

Because neither Washington law nor Coverage A bars coverage for contractual liability claims, Houston Casualty cannot validly disclaim coverage on the ground that Commerce’s “Claim” against Sauter is based upon Sauter’s purported contractual liability to Commerce.⁹¹

**(2) Commerce’s “Claim” Alleges A
“Wrongful Act” By Sauter.**

**(a) Commerce’s “Claim” Arises Out
Of Sauter’s Alleged Act, Neglect,
and/or Breach of Duty – i.e., a
“Wrongful Act”.**

The Houston Casualty Policy broadly defines “Wrongful Act” as “any actual or alleged act, misstatement, error, omission, misleading

⁹¹ *Houston Casualty has also previously argued that Sauter’s undisputed payments to Commerce and his counsel due to Commerce’s “Claim” are not “Loss” because they do not result from a suit or judgment. CP 500-01. But this argument fails because Coverage A is triggered by a “Claim,” defined as both a “written demand for monetary damages” and a formal legal proceeding like a suit.⁹¹ Thus, Sauter’s payments are “Loss” even without a suit.*

statement, neglect, breach of duty or act” by an “Insured Person.”⁹² There is no dispute that Commerce’s “Claim” is for breach of Sauter’s duty under the guaranty he executed. Specifically, Commerce’s “Claim” is based upon Sauter’s alleged act of executing the Commercial Guaranty and his subsequent neglect and/or breach of the duty to repay Commerce that he purportedly assumed by executing that guaranty. Thus, that “Claim” falls within the plain (and broad) language of the “Wrongful Act” definition.

Houston Casualty nonetheless argues that Commerce’s “Claim” is not the result of a “Wrongful Act” because the “Wrongful Act” definition’s express reference to a “breach of duty” by an insured should not be interpreted as including a breach of a contractual duty by an insured. Put another way, Houston Casualty contends that the Houston Casualty Policy’s express definition of “Wrongful Act” should be judicially amended, under the guise of interpretation, so that the express coverage for a “breach of duty” by an insured actually covers only a “breach of non-contractual duty” by an insured. This argument should be rejected as violating several prime tenets of Washington insurance law, including the requirement that a policy be interpreted according to its plain language, without effectively inserting new language or limitations, and as

⁹² CP 161-62, 208-09 (*emphasis added*).

it would be by an average purchaser of insurance, rather than an expert or scholar.⁹³

Houston Casualty's argument that "breach of duty" in the "Wrongful Act" definition should be interpreted to read "breach of non-contractual duty" also directly contravenes the Washington Supreme Court's reasoning and decision in *Boeing*.

In *Boeing*, the Court resoundingly rejected an attempt by a collective of major liability insurers to avoid coverage for their insureds' substantial environmental response (CERCLA) costs. The insurers' primary argument against coverage was that such environmental response costs were not the types of "damages" intended to be covered by the liability policies issued by those insurers.⁹⁴ Specifically, the insurers argued that the "damages" expressly covered by their respective policies were intended to be monetary compensation for injuries, but not monetary equitable remedies such as the type of environmental response/cleanup costs incurred by their insured under CERCLA.⁹⁵

As referenced in Sauter's summary judgment briefing below, the Court's decision began with an acknowledgement that although that case presented a "grave question of policy," the Court's task was to "construe

⁹³ See, e.g., *Panorama Village, P.U.D. No. 1, and B&L Trucking*, each cited *supra*.

⁹⁴ *Boeing*, 113 Wn.2d at 876.

⁹⁵ *Id.*

the terms of the policies under Washington law [because] Washington courts rarely invoke public policy to override express terms of an insurance policy.”⁹⁶ The Court then recited the various rules of policy interpretation that it was required to follow under Washington law – including the requirements that an insurance policy must be construed according to its plain language and in a way that gives meaning to each and every policy provision – as summarized in Section D.3 above.⁹⁷

The Court noted that the “linchpin” of the insurers’ argument was that the undefined policy term “as damages” appearing in the policies’ general insuring clause should be given a legal, technical meaning – specifically, as meaning “as compensatory damages.” The Court rejected the insurers’ argument because the limitation proffered by the insurers simply was not communicated in the actual policy language. In fact, the Court specifically pointed out that the term “as damages” upon which the insurers based their limited interpretation appeared in the policies’ general coverage provisions, not in an exclusion where an average purchaser of insurance might expect to find limitations on coverage.⁹⁸ The Court stated:⁹⁹

⁹⁶ *Id.* at 876 n.1.

⁹⁷ *Id.* at 876-77.

⁹⁸ *Id.* at 877.

⁹⁹ *Id.*

The subject clause, “as damages”, is sandwiched into the general coverage provisions of policyholders’ insurance contracts. This is an odd place to look for exclusions of coverage. Furthermore, there is nothing more in the contracts. Under the title “Exclusions”, there is nothing in the enumerated exclusionary provision about “damages.”

The Court later added:¹⁰⁰

[I]nsurers are in effect trying to write out of the CGL policy a concept that is expressly stated – that damages paid as a consequence of property damage caused by an occurrence are covered by the policy – and to write into the policy a condition that is not there – that such sums are covered only if they have been imposed pursuant to a “legal,” as opposed to “equitable” basis for liability.

The Court concluded that in the absence of plain language in the policy supporting the kind of “parsing” between covered and uncovered “damages” the insurers were advocating, the Court would not impose such a “parsed” interpretation under the guise of policy interpretation.¹⁰¹

Boeing is directly analogous (and controlling) here:

- Both cases involved the interpretation of a term appearing in the subject policy’s insuring clause: in *Boeing*, the term “as damages”; here, the term “Wrongful Act,” and thus the definition of that term.
- Just as the policies in *Boeing* generally covered the insureds’ liability for “damages” without specifying any

¹⁰⁰ *Id.* at 880-81.

¹⁰¹ *Id.* at 882.

limitation on that term, the Houston Casualty Policy covers the insured's liability for "any ... breach of duty" – a term appearing in the "wrongful act" definition – without specifying any limitation on that term.

- Just as the insurers in *Boeing* asked the Court to interpret "as damages" as limited to "as compensatory damages," Houston Casualty argues that "any...breach of duty" should be interpreted as limited to "any...breach of non-contractual duty."
- Just as the policies in *Boeing* did not contain an exclusion barring coverage for non-compensatory damages, Coverage A of the Houston Casualty Policy does not contain an exclusion barring coverage for breach of a contractual duty.¹⁰²

Thus, just as the Court in *Boeing* refused to "interpret" a "non-compensatory damages" exclusion into the policies' insuring clause, this Court should refuse to "interpret" a "contractual liability" exclusion into Coverage A's insuring clause.

In addition to being factually analogous, *Boeing* and this matter are similar in that they derive increased significance from their direct connection to and impact upon pressing "current" issues.

The *Boeing* litigation and appeals occurred in the late 1980's and early 1990's, in the context of a significant environmental protection movement. The Washington Supreme Court rejected the insurers' chorus

¹⁰² *Importantly, as noted above, Coverages C & G in the Houston Casualty Policy, as well as other Houston Casualty policies, do contain such a "contractual liability" exclusion, which makes the absence of such a limiting exclusion in Coverage A at issue here even more notable and, frankly, dispositive.*

of arguments about what should/should not be covered by general liability policies and instead respected and enforced the plain language of the general liability policies issued by the insurers. That decision undoubtedly had a monumental and sweeping effect on liability insurers and the claims and liabilities they were obligated to cover, and ultimately caused many insurers to significantly revise the plain language of their policies to clearly and expressly bar coverage for environmental liabilities those insurers did not want to insure.

This particular matter does not involve the number of insurers or substantial dollars that *Boeing* did, but has great importance after Great Recession and widespread loan defaults of the past few years – that is, the existence of D&O coverage for personal liability under guaranties executed by corporate officers or directors. As in *Boeing*, the plain language of the Houston Casualty Policy does not match what Houston Casualty argues should/should not be covered by that policy. But Houston Casualty authored that policy, and must provide coverage consistent with that policy’s plain language without regard for unwritten or unstated notions of purported public policy or what should be covered if Houston Casualty had its way. The plain language of that policy provides coverage for Commerce’s breach of duty “Claim” against Sauter.

(b) Commerce’s “Claim” Is Based On Alleged Conduct By Sauter In His Role As SJM’s CEO And Manager – i.e., as an “Insured Person”.

There is no dispute that Sauter is an “Insured Person” under the Houston Casualty Policy.¹⁰³ But Houston Casualty nonetheless contends that Commerce’s “Claim” is not covered because it was asserted against Sauter “in his individual capacity rather than in his capacity as an Insured Person” because “[Sauter] did not execute the personal guarantees in his capacity as Manager or CEO of S-J Management.”¹⁰⁴ This contention is legally and factually meritless.¹⁰⁵

As Sections C.2 and D.4.a above explain, Sauter executed the Commercial Guaranty required by Commerce because he was SJM’s CEO and Manager, and while acting in that role.¹⁰⁶ In fact, SJM’s members all agreed that Sauter executed that guaranty in his role as SJM’s Manager.¹⁰⁷

In addition, the Business Loan Agreement and SJM’s governance and structure confirm that Sauter executed the Commercial Guaranty in

¹⁰³ CP 369 (“Mr. Sauter, as Manager and CEO of S-J Management, is an Insured Person.”).

¹⁰⁴ CP 371.

¹⁰⁵ To the extent that Houston Casualty argues that Sauter’s “Wrongful Act” must have committed solely in his insured capacity, it should be noted that the definition of “Wrongful Act” is not limited to acts solely in that capacity. Houston Casualty knows how to include “solely” in its policy – e.g., the Spousal Extension (CP 163) – and Washington law prohibits adding that new term by “interpretation.” Thus, coverage exists for acts in dual capacities. See, e.g., *Ratliffe v. ISLIC*, 194 Ill. App. 3d 18, 550 N.E.2d 1052 (1990).

¹⁰⁶ CP 152.

his role as SJM's CEO and Manager: the Business Loan Agreement executed by Commerce and SJM (through Sauter) expressly required that SJM obtain an executed Commercial Guaranty from Sauter;¹⁰⁸ SJM satisfied that requirement by requesting that Sauter execute that guaranty;¹⁰⁹ and that guaranty expressly stated that it was requested by SJM, not Commerce.¹¹⁰

Similarly, Commerce alleged that Sauter neglected and breached the duty he assumed by executing the guaranty in his role as SJM's CEO and Manager.¹¹¹ Importantly, Sauter's inability to pay Commerce resulted from SJM's financial inability to provide Sauter with the indemnification to which SJM's members unanimously agreed Sauter was entitled because he had executed the guaranty in his role as SJM's CEO and Manager.¹¹² These undisputed facts satisfy the "capacity" element of the Houston Casualty Policy's "Wrongful Act" definition.¹¹³

¹⁰⁷ CP 312-15.

¹⁰⁸ CP 290-96.

¹⁰⁹ CP 301-06.

¹¹⁰ Id.

¹¹¹ CP 153.

¹¹² Id.

¹¹³ *Houston Casualty has also argued that Sauter's "Wrongful Act" must have been as SJM's legal/binding representative. But Standard English language dictionaries define "behalf" as "support" or "interest." CP 1000. HC's Opposition admits Commerce would not have made the loan to SJM without Sauter's guaranty and assets as collateral. CP 494. Thus, Sauter's guaranty was "on behalf of" SJM within the "Wrongful Act" definition.*

Unable to dispute the foregoing facts, Houston Casualty's summary judgment briefing at the trial court level merely argued that Sauter faces personal liability for his acts, and thus those acts could not have been taken in his official/corporate capacity as required by the "Wrongful Act" definition. This argument distorts plain policy language and ignores the reality that D&O insurance is purchased and maintained for the specific purpose of protecting individual directors and officers from personal liability for their official/corporate acts. *See, e.g., Med. Mut. Ins. Co. v. Indian Harbor Ins. Co.*, 587 F. Supp. 2d 288 (D.Me. 2008) ("the purpose of a Directors and Officers policy [is] to give those persons insurance to protect them from personal liability.")

Houston Casualty's argument also contradicts Houston Casualty's own public declarations about the benefits of purchasing D&O insurance from Houston Casualty. As noted above, Houston Casualty's promotional literature expressly states:

Directors' and Officers Liability Insurance (D&O) covers the personal assets and liability of . . . officers and senior management.

CP 958 (emphasis added).

Houston Casualty's capacity argument is therefore without merit.

E. CONCLUSION

The only way to interpret the plain language of the Houston Casualty Policy in accordance with Washington policy interpretation law is as providing coverage for Commerce's "Claim" against Sauter. At a minimum, that interpretation favoring coverage is a reasonable one.

Conversely, because Houston Casualty's proffered interpretation of that policy violates various tenets of Washington policy interpretation, that proffered interpretation is not reasonable and must be rejected. However, at the very most, Houston Casualty's proffered interpretation provides an alternate reasonable interpretation, which creates an ambiguity that must be resolved in favor of coverage.

For the foregoing reasons, plaintiff/appellant Sauter respectfully requests that this Court reverse the trial court's ruling that Houston Casualty has no coverage obligations for Commerce's "Claim" against Sauter under Coverage A of the Houston Casualty Policy, vacate the trial court's resulting Judgment, and direct the trial court to enter partial summary judgment in Sauter's favor, declaring that:

(1) Sauter's "Loss" resulting from Commerce's "Claim" is not uninsurable as a matter of Washington law, and thus falls within the definition of "Loss" in the Houston Casualty Policy;

(2) Commerce's "Claim" alleges an act, omission, neglect, or breach of duty or act by Sauter which falls within the definition of "Wrongful Act" in the Houston Casualty Policy;

(3) Commerce's "Claim" alleges such a "Wrongful Act" by Sauter in his capacity as an "Insured Person" under the Houston Casualty Policy;

(4) Commerce's "Claim" against Sauter is covered under Coverage A of the Houston Casualty Policy; and

(5) Sauter is entitled to an award of his reasonable attorney fees in this matter, both at the trial court level and on this appeal, pursuant to *Olympic Steamship*.¹¹⁴

RESPECTFULLY SUBMITTED this 31st day of May, 2011.

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¹¹⁴ *Olympic Steamship Co. v. Centennial Ins. Co.*, 117 Wn.2d 37, 53, 811 P.2d 763 (1991) ("an award of fees is required in any legal action where the insurer compels the insured to assume the burden of legal action [] to obtain the full benefit of his insurance contract....").

DECLARATION OF SERVICE

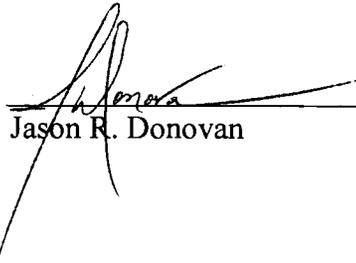
I, Jason R. Donovan, declare under penalty of perjury under the laws of the State of Washington that I am now and at all times mentioned herein, a resident of the State of Washington, over the age of eighteen years, not a party to or interested in the above-entitled action, and competent to be a witness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

On May 31, 2011, I caused to be served in the manner noted copies of the foregoing upon designated counsel:

Patrick M. Paulich
Thorsrud Cane & Paulich
1300 Puget Sound Plaza
1325 4th Avenue
Seattle, WA 98101-2509

- Via U.S. Mail
- Via Facsimile
- Via Messenger
- Via Email

DATED in Seattle, Washington on this 31st day of May, 2011.



Jason R. Donovan

FILED
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STATE OF WASHINGTON
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