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253 Kan. 198, *; 855 P.2d 77, **;
1993 Kan. LEXIS 102, ***; 8 I.E.R. Cas. (BNA) 988

MGM Inc., and John Mash, Appellees/Cross-Appellants, v. Liberty Mutual Insurance Company,
Appellant/Cross-Appellee

No. 67,067

Supreme Court of Kansas

253 Kan. 198; 855 P.2d 77; 1993 Kan. LEXIS 102; 8 I.E.R. Cas. (BNA) 988

June 16, 1993, Opinion Filed

PRIOR HISTORY: [***1]

Review of the judgment of the Court of Appeals in 17 Kan. App. 2d 492, 839 P.2d 537 (1992). Appeal from Sedgwick District Court, C. Robert Bell, Judge.

DISPOSITION: Judgment of the Court of Appeals reversing the district court is affirmed. Judgment of the district court is reversed; cross-appeal is dismissed.

CASE SUMMARY


PROCEDURAL POSTURE: Appellee insureds filed an action in the district court, seeking a determination that the comprehensive general liability insurance policy in question afforded coverage for and a duty to defend against lawsuits filed by employees and former employees of the insureds. The district court ruled in favor of the insured, and the Court of Appeals (Kansas) affirmed. Appellant insurer sought review of the district court's ruling.


OVERVIEW: The insured's president became concerned over telephone charges for unauthorized long distance calls originating from the manager's office at the insured's restaurant. Because he wanted to find out which employee or employees were making these calls, he purchased and installed two telephone-recording devices in the office ceiling. The employees were not advised of the installations. Every few days the insured's president would listen to the tapes. Some employees filed actions against the insured for invasion of privacy, and the insured sought coverage under its policy with the insurer, but coverage was denied. The insured claimed that coverage existed and that the insurer's duty to defend had been breached. The insurer contended there was no coverage because coverage was specifically excluded as the conduct arose out of a wilful violation of penal statutes. The court agreed, holding that the wilful violation of a penal statute exclusion was controlling on the duty to defend issue and, if reached on the coverage issue, it would have been applicable therein to deny coverage. Thus, there was no duty to defend the lawsuits, and the district court erred awarding damages to the insureds.


OUTCOME: The court affirmed the judgment of the court of appeals, which reversed the judgment of the district court.

CORE TERMS: coverage, duty to defend, lawsuits, insured, personal injury, recording, advertising injury, telephone, conversation, intentionally, settlement, manager, utterance, insurer, intercept, consequential damages, wilful violation, former employees, contacted, recorded, willful, uncontroverted, cross-appealed, intercepted, disclosure, purposeful, right of privacy, penal statute, giving rise, cross-appeal


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HN1 ♦ The duty to defend arises whenever there is a "potential of liability" under the policy. The insurer determines if there is a potential of liability under the policy by examining the allegations in the complaint and considering any facts brought to its attention or which it could reasonably discover. Where a petition alleges an act that is clearly not covered, for example, that the defendant acted willfully and intentionally, a declaratory judgment would then be proper to determine the issue of coverage, since there would be no "potential of liability" under the policy for intentional acts. Where the complaint alleges both a negligent and intentional act, these alleged facts give rise to the potential for liability and the duty to defend arises. [More Like This Headnote](#) | [Shepardize: Restrict By Headnote](#)

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HN2 ♦ [Kan. Stat. Ann. § 21-3201\(2\)](#) provides: (2) Willful conduct is conduct that is purposeful and intentional and not accidental. As used in this code, the terms "knowing," "intentional," "purposeful," and "on purpose" are included within the term "willful." [More Like This Headnote](#) | [Shepardize: Restrict By Headnote](#)


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HN3 ♦ [Kan. Stat. Ann. § 21-4002](#) provides: (1) Breach of privacy is knowingly and without lawful authority: (a) Intercepting, without the consent of the sender or receiver, a message by telephone, telegraph, letter or other means of private communication. [More Like This Headnote](#) | [Shepardize: Restrict By Headnote](#)

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[Criminal Law & Procedure](#) > [Criminal Offenses](#) > [Miscellaneous Offenses](#) > [Illegal Eavesdropping](#) > [Elements](#) 

HN4 ♦ [18 U.S.C.S. § 2511](#) provides: (1) Except as otherwise specifically provided in this chapter any person who (a) intentionally intercepts, endeavors to intercept, or procures any other person to intercept or endeavor to intercept, any wire, oral, or electronic communication; shall be punished as provided in subsection (4) or shall be subject to suit as provided in subsection (5). [More Like This Headnote](#)

[Insurance Law](#) > [General Liability Insurance](#) > [Obligations](#) > [Defense](#) 

HN5 ♦ The wilful violation of a penal statute exclusion is controlling on the duty to defend issue and, if reached on the coverage issue, it would have been applicable therein to

deny coverage. [More Like This Headnote](#) | [Shepardize: Restrict By Headnote](#)

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SYLLABUS: SYLLABUS BY THE COURT

1. INSURANCE -- *Insurer's Duty to Defend Insured*. An insurer's duty to defend arises whenever there is a potential of liability under the policy.

2. INSURANCE -- *Insurer's Duty to Defend Insured -- Insurer Had No Duty under Facts to Defend Insureds for Breach of Privacy Actions Brought by Insureds' Employees*. In an action by insureds under a comprehensive general liability insurance policy seeking a determination that the policy provided coverage for and a duty to defend against lawsuits filed against the insureds by their employees based upon breach of privacy, the record is examined and it is *held*: The district court erred in holding that: (1) there was coverage under the policy; (2) the insurer breached its duty to defend; and (3) the insureds were entitled to judgment for the amount of the settlement *****2** of the underlying lawsuits and attorney fees incurred.

COUNSEL: Lynn D. Preheim, of Morrison & Hecker, of Wichita, argued the cause and was on the brief for appellant/cross-appellee.

James R. Schaefer, of Wichita, argued the cause and was on the briefs for appellees/cross-appellants.

JUDGES: The opinion of the court was delivered by McFarland, J. Holmes, C.J., and Davis, J., not participating. Marla J. Luckert and Terry L. Bullock, district judges, assigned. n1

n1 REPORTER'S NOTE: Judge Luckert and Judge Bullock were appointed to hear case No. 67,067 vice Chief Justice Holmes and Justice Davis pursuant to the authority vested in the Supreme Court by article 3, § 6(f) of the Kansas Constitution.

OPINION BY: McFARLAND

OPINION: ***198** ****77** This is an action by insureds against the defendant insurance company seeking: (1) a determination that the comprehensive general liability insurance policy in question afforded coverage for and a duty to defend against lawsuits filed by employees and former employees of insureds; (2) a judgment reimbursing the insureds for monies paid out in settlement of said lawsuits and satisfying the balance of said settlement; and (3) payment of the insureds' attorney fees *****3** arising from defense of said actions and the prosecution of the action herein as well as certain consequential damages arising from the insurer's breach of the insurance contract. The defendant insurance company appealed from the judgment of the district court finding there was ****78** coverage and a duty to defend and ordering the insurance company ***199** to pay the settlement and the requested attorney fees. The insureds cross-appealed from the refusal of the district court to consider or allow the requested consequential damages. The Court of Appeals reversed the district court's judgment against the insurance company, holding there was no coverage or duty to defend relative to said lawsuits. *MGM, Inc. v. Liberty Mut. Ins. Co.*, 17 Kan. App. 2d 492, 839 P.2d 537 (1992). The matter is before us on petition for review.

The facts may be summarized as follows.

MGM, Inc., (MGM), is a Kansas corporation that owned and operated a Western Sizzlin Steak House, on Rock Road in Wichita, at all pertinent times herein. Defendant John Mash was the

president of MGM. Telephone service at the restaurant consisted of a pay phone located in [***4] a frequently used area and two nonpay telephones located in the manager's office. The office was kept locked in the manager's absence. No other employee worked in the office. In January 1988, Mash became concerned over telephone charges for unauthorized long distance calls originating from the manager's office. He wanted to find out which employee or employees were making these calls. On January 27, 1988, Mash purchased and installed two telephone recording devices in the office ceiling. The employees were not advised of the installations. The devices would activate when the respective telephone receiver was picked up and would disconnect when the receiver was returned to its cradle.

Every few days Mash would listen to the tapes and rewind them for rerecording. On February 19, 1988, a plumber repairing a hot water pipe discovered the recording devices. That same day, Mash removed the devices.

On May 19, 1988, Mash was contacted by an attorney who advised that she represented two MGM employees, that the use of the recording devices was a criminal offense, that lawsuits were being considered based upon invasion of privacy, and that the matter could be resolved by paying each [***5] client \$ 10,000.

That same day Mash called defendant Liberty Mutual Insurance Company (Liberty Mutual), relayed the facts of his visit from the employees' attorney and asked if MGM's liability insurance policy issued by Liberty Mutual would provide coverage in this situation. [*200] The individual Mash talked to was Viola Schuckman, a claims supervisor. Bill Smith, claims manager, was absent at the time. The conversation lasted about 30 minutes. Schuckman told Mash that she did not think there was coverage as the conduct giving rise to the claims was an illegal act, but that she would check the policy and get back with him. She also advised that if suit were filed, the company would evaluate the allegation for coverage. Mash then contacted his own attorney, James Schaefer, and relayed the events which had occurred. On advice of Schaefer, Mash told Schuckman to contact Schaefer with the company's response to the coverage matter. On May 20, 1988, Schuckman contacted Schaefer. She advised him that she did not think there was coverage for a criminal act, but that "if any lawsuits were filed, he should submit the lawsuits to us so we could review the allegations and make a [***6] determination at that point whether there was any coverage." Subsequently, Schuckman conferred with the claims manager as to what had transpired up to that point, and he concurred with Schuckman's initial belief that there was no coverage. Six petitions were filed on June 14, 1988, and Schaefer forwarded these to Liberty Mutual.

Coverage was denied based on the petitions, the policy, and the conversations with Mash. No additional investigation was done. Ten petitions were ultimately filed. MGM settled these for \$ 100,000 (\$ 10,000 for each plaintiff).

This action was brought seeking a determination that coverage existed and that the insurer's duty to defend had been breached and damages for that breach. The district court held there was coverage under the "advertising injury" provision of the policy and that the insurer breached its duty to defend. Liberty Mutual was ordered to pay: (1) \$ 55,000, which was the amount [**79] paid out in settlement by MGM and Mash; (2) \$ 45,000, which was the balance due on the settlement of the lawsuits; (3) \$ 57,786 for attorney fees; and (4) prejudgment interest and costs. Liberty Mutual appealed therefrom, and MGM and Mash cross-appealed [***7] the district court's refusal to consider certain claimed consequential damages.

We turn now to the issues in the appeal of Liberty Mutual. The district court found there was coverage and a corresponding duty to defend under the "advertising injury" portion of the [*201] policy. The plaintiffs did not claim coverage under such policy provisions. They relied, instead, on personal injury coverage policy provisions. Before us and the Court of Appeals, the plaintiffs do not argue that the district court's reliance on the "advertising

injury" portion was correct.

Instead, they argue the judgment of the district court should be affirmed on the basis that it was correct for the wrong reason -- specifically, that there was coverage and a duty to defend under the personal injury policy provisions. The Court of Appeals opinion herein discusses the "advertising injury" policy provisions and correctly concludes the conduct giving rise to the claims herein is unrelated to advertising activities and such coverage is inapplicable. Little would be gained, under the circumstances herein, from further discussion of the "advertising injury" policy provisions.

We turn then to the question of [***8] whether there was coverage and a duty to defend under personal injury policy provisions. Liberty Mutual contends there was no coverage as: (1) the evidence is uncontroverted that there was no publication or utterance of the intercepted telephone conversations and hence the employees' claims were not included within the policy personal injury definitions; and (2) coverage was specifically excluded as the conduct arose out of a wilful violation of penal statutes (K.S.A. 21-4002 and 18 U.S.C. § 2511 [1988]).

We shall first consider whether there was coverage under the personal injury provisions of the policy. The definitions contained therein provide:

"Personal Injury' means injury arising out of one or more of the following offenses committed during the policy period:

- (1) false arrest, detention, imprisonment, or malicious prosecution;
- (2) wrongful entry or eviction or other invasion of the right of private occupancy;
- (3) a *publication or utterance*

(a) of a libel or slander or other defamatory or disparaging material,
or

(b) *in violation of an individual's right of privacy*;
except publications or utterances in the course of [***9] or related to advertising, broadcasting, publishing or telecasting activities conducted by or on behalf of the **named insured** shall not be deemed **personal injury**." (Emphasis supplied.)

[*202] Liberty Mutual is correct in its statement that the evidence is uncontroverted that Mash never disclosed the content of or discussed the recorded conversations with anyone. Hence, there was no publication or utterance in violation of an individual's right of privacy and no coverage under said policy provisions.

This determination does not, however, resolve the duty to defend question. The petitions filed by the employees and former employees each alleged disclosure of the recorded conversations. In State Farm Fire & Casualty Co. v. Finney, 244 Kan. 545, 553-54, 770 P.2d 460 (1989):

HN1

"The duty to defend arises whenever there is a 'potential of liability' under the policy. Spruill Motors, Inc. v. Universal Underwriters Ins. Co., 212 Kan. 681, 512 P.2d 403 (1973). The insurer determines if there is a potential of liability under the policy by examining the allegations in the complaint and [***10] considering any facts brought to its attention or which it could reasonably discover. Where a petition alleges an act that is clearly not covered, for example, that the defendant acted willfully and intentionally, a declaratory judgment would then be proper to determine the issue of coverage, since there would [be]

no 'potential of liability' under the policy for intentional **[**80]** acts. Where the complaint alleges both a negligent and intentional act, these alleged facts give rise to the potential for liability and the duty to defend arises. 212 Kan. at 686."

In Patrons Mut. Ins. Ass'n v. Harmon, 240 Kan. 707, 710, 732 P.2d 741 (1987), we stated:

"The possibility of coverage may be remote, but if it exists the [insurance] company owes the insured a defense. The possibility of coverage must be determined by a good faith analysis of all information known to the insured or all information reasonably ascertainable by inquiry and investigation."

Here, Liberty Mutual conducted no investigation before denying coverage and defense. If these were the only applicable policy provisions, it could **[***11]** well be concluded that a duty to defend was owed. However, the policy contains the following exclusion:

"(B) This insurance does not apply:

.....

(2) to **personal injury or advertising injury** arising out of the wilful violation of a penal statute or ordinance committed by or with the knowledge or consent of the **insured.**"

The concealed recording devices were intentionally installed by Mash, the conversations intentionally recorded, and the recordings intentionally listened to by Mash. Wilful and intentional **[*203]** are synonymous. See Websters New Collegiate Dictionary 1341 (1977): "2: done deliberately: INTENTIONAL *syn.*" See also ^{HN2} K.S.A. 21-3201(2), which provides:

"(2) Willful conduct is conduct that is purposeful and intentional and not accidental. As used in this code, the terms 'knowing,' 'intentional,' 'purposeful,' and 'on purpose' are included within the term 'willful.'"

^{HN3} K.S.A. 21-4002 provides:

"(1) Breach of privacy is knowingly and without lawful authority:

(a) Intercepting, without the consent of the sender or receiver, a message by telephone, telegraph, letter or other means of private communication."

^{HN4}

18 U.S.C. § 2511 **[***12]** provides:

"(1) Except as otherwise specifically provided in this chapter any person who --

(a) intentionally intercepts, endeavors to intercept, or procures any other person to intercept or endeavor to intercept, any wire, oral, or electronic communication;

.....

shall be punished as provided in subsection (4) or shall be subject to suit as provided in subsection (5)."

Disclosure of information intercepted is not an element of either offense -- the interception itself completes the offense. MGM and Mash argue that there is evidence that of the employees who sued two or three knew of the existence of the recording devices and this is the equivalent of consent. Note, the employees denied such knowledge. No authority is cited

for the proposition that such knowledge of the existence of the recording devices would be a defense to a prosecution under either statute.

We conclude ^{HN5} the wilful violation of a penal statute exclusion is controlling on the duty to defend issue and, if reached on the coverage issue, it would have been applicable therein to deny coverage. Thus, there was no coverage afforded by the policy or duty to defend the lawsuits filed herein by the employees and former *****13** employees, and the district court erred in holding otherwise and awarding damages to the plaintiffs herein. This is the same result reached by the Court of Appeals and, like said court, this determination renders moot the balance of the issues raised in the appeal of Liberty Mutual and the cross-appeal of MGM ***204** and Mash as they all relate to the trial court's computation of damages herein.

The judgment of the Court of Appeals is affirmed. The judgment of the district court is reversed; the cross-appeal is dismissed.

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7

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1998 U.S. Dist. LEXIS 17287, *

Nestle U.S.A. v. Travelers Cas. & Surety Co. et al.

Case No. CV98-5515-HLH (Mcx) (consolidated w/98-5829-HLH (Mcx)

UNITED STATES DISTRICT COURT FOR THE CENTRAL DISTRICT OF CALIFORNIA

1998 U.S. Dist. LEXIS 17287

October 26, 1998, Decided
October 26, 1998, Filed

DISPOSITION: [*1] Motion of Travelers Companies (joined by Northbrook in CV 98-5829) for summary judgment determining that the choice of law rules of Massachusetts are to be applied is denied. Cross motion of Nestle for a determination that the choice of law rules of California apply, and that those rules require the application of California substantive law, granted.

CASE SUMMARY


PROCEDURAL POSTURE: In connection with an underlying action by plaintiff California corporation against defendant insurance company's insured, the insurer moved for summary judgment, alleging that the choice of law rules of Massachusetts should have been applied. The corporation cross-moved for a determination that the choice of law rules of California should be applied, and that those rules required the application of California substantive law.

OVERVIEW: In an underlying action, the California Corporation brought an action against the insurance company's insured. The corporation then brought this action against the insurer for its alleged failure to defend and indemnify. The insurer moved for summary judgment, seeking a determination that the choice of law rules of Massachusetts applied; the corporation cross-moved, seeking a determination that the choice of law rules of California applied. The court first held that, assuming an essential difference between the two states' rules, California choice of law rules applied because the bulk of the sales at issue took place there, most of the damage occurred there, the underlying suit was filed there by the California corporation, and the insurer was a Massachusetts company with a California office. Furthermore, assuming no essential difference between the two states' rules, the forum state of California would still apply. Second, in applying the choice of rule laws, California substantive law applied because there was no conflict in the substantive law of Massachusetts and California, and again, California was the forum state.


OUTCOME: The insurer's motion for summary judgment to determine that the choice of law rules of Massachusetts should have been applied was denied. The cross motion of the California corporation for a determination that the choice of law rules of California should have been applied, and that those rules required the application of California substantive law, was granted.

CORE TERMS: choice of law, insured, substantive law, duty to defend, transferred, indemnify, insurer, governmental interest, consolidated case, preponderate, coverage, formula, owed, summary judgment, consolidated, domestic


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HN1 Federal law is that the federal court applies the choice of law rules of the state in which it sits. [More Like This Headnote](#)


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HN2 If there is no conflict, the law of the forum applies. [More Like This Headnote](#)

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HN3 In a contract dispute, the law of the state with the most significant relationship to the transaction and the parties applies. [More Like This Headnote](#)

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HN4 Cal. Civ. Code § 1646 provides that a contract is to be interpreted according to the law and usage of the place where it is to be performed. [More Like This Headnote](#)

COUNSEL: For CHARTER OAK FIRE INSURANCE CO, TRAVELERS INDEMNITY CO, TRAVELERS CASUALTY & SURETY COMPANY OF AMERICA, TRAVELERS CASUALTY & SURETY COMPANY, plaintiffs (98-CV-5829): George C Rockas, Daniel B Trinkle, Peabody & Arnold, Boston, MA.

For CHARTER OAK FIRE INSURANCE CO, TRAVELERS INDEMNITY CO, TRAVELERS CASUALTY & SURETY COMPANY OF AMERICA, TRAVELERS CASUALTY & SURETY COMPANY, plaintiffs (98-CV-5829): Richard C Weston, Weston & McElvain, Los Angeles, CA.

For NESTLE FOOD COMPANY, defendant (98-CV-5829): Laurence M Berman, Jeffrey N Mausner, Mona D Miller, Berman Blanchard Mausner & Resser, Los Angeles, CA.

For NESTLE FOOD COMPANY, defendant (98-CV-5829): Christopher J Petrini, Stylianus Sinnis, Conn Kavanaugh Rosenthal Peisch & Ford, Boston, MA.

For NESTLE FOOD COMPANY, counter-claimant (98-CV-5829): Laurence M Berman, [***2**] Jeffrey N Mausner, Mona D Miller, Berman Blanchard Mausner & Resser, Los Angeles, CA.

For NESTLE FOOD COMPANY, counter-claimant (98-CV-5829): Christopher J Petrini, Stylianus Sinnis, Conn Kavanaugh Rosenthal Peisch & Ford, Boston, MA.

For CHARTER OAK FIRE INSURANCE CO, TRAVELERS INDEMNITY CO, TRAVELERS CASUALTY & SURETY COMPANY OF AMERICA, TRAVELERS CASUALTY & SURETY COMPANY, counter-defendants (98-CV-5829): George C Rockas, Daniel B Trinkle, Peabody & Arnold, Boston, MA.

For CHARTER OAK FIRE INSURANCE CO, TRAVELERS INDEMNITY CO, TRAVELERS CASUALTY & SURETY COMPANY OF AMERICA, TRAVELERS CASUALTY & SURETY COMPANY, counter-defendants (98-CV-5829): Richard C Weston, Weston & McElvain, Los Angeles, CA.

JUDGES: PRESENT HON. HARRY L. HUPP, JUDGE.

OPINION BY: HARRY L. HUPP

OPINION:

PROCEEDINGS: DEFT TRAVELERS' MOTION FOR SUMMARY JUDGMENT RE CHOICE OF LAW; PLAINTIFF NESTLE'S CROSS MOTION

The motion of Travelers Companies (joined by Northbrook in CV 98-5829) for summary judgment determining that the choice of law rules of Massachusetts are to be applied is denied. The cross motion of Nestle for a determination that the choice of law rules of California apply, and that those rules [*3] require the application of California substantive law, is granted. This minute order is to be filed in both consolidated cases.

The declaratory relief claims regarding duty to defend and indemnify against the prior action in this court between Nestle and Traveler's insured, Stoner, were first asserted by Travelers in Massachusetts federal court and thereafter by Nestle in this court (No. CV 98-5515). The Massachusetts case was transferred here (now No. CV-98-5929) pursuant to 28 U.S.C. § 1404(a) as being for the "convenience of the parties and witnesses in the interest of justice." This court consolidated the two actions (each is the mirror image of the other). ^{HN1} Federal law is that the federal court applies the choice of law rules of the state in which it sits. (Ferens '90 494 U.S. 516, 108 L. Ed. 2d 443, 110 S. Ct. 1274; Van Dusen '64 376 U.S. 612, 11 L. Ed. 2d 945, 84 S. Ct. 805.) Under the above cases, when a case is transferred under § 1404(a), the choice of law rules of the state of original filing apply. Thus, the dilemma is that Massachusetts choice of law concepts apply to the transferred Massachusetts case and California choice of law concepts apply to the Central District case. [*4] The dilemma needs resolving, since only one state's substantive law should be applied. The court is convinced that the 11th Circuit case of Boardman Petroleum 11Cir'98 135 F.3d 750 provides the most logical answer. That case holds that in a consolidated case when there are two states whose choice of law rules would apply under the Van Dusen formula, and those choice of law rules result in two states' substantive laws being applied, then the court determines which state's substantive law applies by balancing the interests of each state in having its law apply. Although Boardman concerns the choice of one state's substantive law rather than choice of law rules, this court will borrow the logic of Boardman to weigh the interests of each state in having its choice of law rules apply in a consolidated case where the two suits are mirror images of each other. This question of the interests of each state is similar to the 1404(a) analysis applied in this case by the Massachusetts federal court in determining to transfer its case to this court. The facts preponderate in favor of applying California choice of law rules. The underlying lawsuit against the insured was filed in [*5] this court by a corporation with its principal place of business in the Central District. It involved a transaction with a Massachusetts company with a California office who negotiated the transaction in this district. The bulk of the sales giving rise to the original action took place in California and most of the damage occurred in this state. The original lawsuit was handled in this court without protest by the insured. If duties of defense and indemnity were owed by Travelers and Northbrook, the performance of those duties were owed in the litigation in this district. As opposed to this, the headquarters of the insured is in Massachusetts and of the carriers was in Connecticut and Illinois. The interest of California clearly preponderates in having its choice of law rules apply.

The above analysis assumes that there is an essential difference between California and Massachusetts choice of law rules. California follows the "governmental interest" approach described in Reich '67 67 Cal. 2d 551, 432 P.2d 727, 63 Cal. Rptr. 31, and Hurtado '74 11 Cal. 3d 574, 522 P.2d 666, 114 Cal. Rptr. 106. These cases are followed in this circuit where California law is involved. (See Arno 9Cir'94 22 F.3d 1464 (weighing each state's interest in having its [*6] law applied after discarding "false conflicts"). ^{HN2} If there is no conflict, the law of the forum applies. Massachusetts applies the Restatement 2d of Conflicts rules. As summarized in A. Johnson & Co. DMA'90 741 F. Supp. 298, applying § 145 of Restatement 2d, Conflicts, the applicable factors are 1. the place where the injury occurred (California in

this case), 2. the place where the conduct causing the injury occurred (alleged failure to defend and indemnify in California), 3. the domicile of the parties (California for plaintiff and Massachusetts with a California office for the insured), and 4. the place where the relationship between the parties was centered (California). Section 188 provides that ^{HN3} in a contract dispute, the law of the state with the most significant relationship to the transaction and the parties applies, and suggests factors to consider. Thus, the alternative holding is that there is no conflict between California and Massachusetts law as to whose choice of law rules are to be applied; California choice of law rules apply. Travelers argues for a rule that the choice of law of the state of first filing should apply. There is something to be said for such a rule [*7] (for which there is no precedent)--certainty. However, the modern tendency is to downgrade such arbitrary rules in favor of a more rational analysis of the interests of the jurisdictions involved. This makes the intellectual challenge greater but leads to more just results. In this case, applying such a rule would make no difference since the result is still to apply California choice of law rules. Travelers also argues that Cal. Civ. Code § 1646 points toward Massachusetts substantive law. ^{HN4} That section merely provides that "...a contract is to be interpreted according to the law and usage of the place where it is to be performed...." However, if anything, that place is California where the alleged duty to indemnify and defend was due. However, it seems clear that the section is to be applied in conformity with the new theories of conflicts adopted in California. (Strassberg 9 Cir. '78 575 F.2d 1262; Stonewall Surplus Lines '93 14 Cal. App. 4th 637, 17 Cal. Rptr. 2d 713 (applying the governmental interest test to liability coverage)).

The next task is to apply California choice of law rules. Under the Reich formula, the first thing to do is to determine if there is a "true conflict" (if not, [*8] the law of the forum applies). Generally, insurers in both Massachusetts and California must defend a suit that potentially seeks damages within the coverage of the policy. Gray v. Zurich, (1966) 65 Cal. 2d 263, 419 P.2d 168, 54 Cal. Rptr. 104, Sterilite Corp. (1983) 17 Mass. App. Ct. 316, 458 N.E.2d 338. More specifically, California courts have held that allegations in a complaint alleging trademark infringement are sufficient to trigger a duty to defend under a policy with the words "misappropriation of advertising ideas or style of doing business." Lebas Fashion '96 50 Cal. App. 4th 548, Dogloo '95 907 F. Supp. 1383. Massachusetts does not have any reported cases addressing this issue, so there is no conflict with California law. Gitano, '94 26 Cal. App. 4th 49 at 57. California, with its relatively generous (to insureds) coverage and defense duty rules, generally attempts to protect the insured (recalling that plaintiff is suing on Stoner's claim where the alleged breach of the duty to defend took place in California). No Massachusetts policy in conflict with this philosophy is cited. In addition, the insurance companies are headquartered in Connecticut and Illinois whose interests Massachusetts would seem to have little incentive in protecting. There [*9] is no conflict and California substantive law applies.

Alternatively, the interest of California in having its domestic rules apply to a conflict between a California company suing a foreign insurer on a claim to defend and indemnify against a California action about a California transaction with most of the damage occurring in California would seem to be very strong indeed. The countervailing consideration is whether Massachusetts law should apply to benefit, if it does, an insurer foreign to Massachusetts where the claim sued on is that of a Massachusetts resident. If there could be said to be a "true conflict", the interests of California are much more impinged by applying foreign law than are the interests of Massachusetts in having California law applied. California domestic law applies. A:985515.026-add

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8

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*2006 U.S. Dist. LEXIS 7246, **

✚ View Available Briefs and Other Documents Related to this Case

NUTMEG INSURANCE COMPANY, Plaintiff, v. EMPLOYERS INSURANCE COMPANY OF WAUSAU,
and VIRGINIA SURETY COMPANY, INC., Defendants.

Civil Action No. 3:04-CV-1762-BF (R)

UNITED STATES DISTRICT COURT FOR THE NORTHERN DISTRICT OF TEXAS, DALLAS
DIVISION

2006 U.S. Dist. LEXIS 7246

February 24, 2006, Decided
February 24, 2006, Filed

CORE TERMS: insured, insurer, coverage, advertising injury, duty to defend, facsimile, advertisement, advertising, unsolicited, fax, summary judgment, privacy, notice, policy period, insurance policy, right to privacy, triggered, offending, right of privacy, duty, seclusion, property damage, pro rata, endorsement, defending, sending, third party, prejudiced, machine, applicable limit

✚ Available Briefs and Other Documents Related to this Case:

- ◆ U.S. District Court Motion(s)
- ◆ U.S. District Court Motion(s)
- ◆ U.S. District Court Pleading(s)
- ◆ U.S. District Court Pleading(s)
- ◆ U.S. District Court Motion(s)

COUNSEL: [*1] For Nutmeg Insurance Company, Plaintiff: Robert D Allen, Christopher T Colby, Baker & McKenzie -- Dallas, Dallas, TX.

For Employers Insurance Company of Wausau, Defendant: Gregory J Phillips, Veronica M Bates, Hermes Sargent Bates, Dallas, TX.

For Virginia Surety Company, Inc, Defendant: Thomas J Stutz, Martin Keener Mason Stutz, Dallas, TX.

For Virginia Surety Company, Inc, Counter Claimant: Thomas J Stutz, Martin Keener Mason Stutz, Dallas, TX.

JUDGES: PAUL D. STICKNEY, UNITED STATES MAGISTRATE JUDGE.

OPINION BY: PAUL D. STICKNEY

OPINION: MEMORANDUM OPINION AND ORDER

The Joint Motion Submission of the Motions for Summary Judgment of Plaintiff Nutmeg Insurance Company ("Nutmeg"), Defendant Employers Insurance Company of Wausau ("Wausau"), and Defendant Virginia Surety Company Inc. ("Virginia Surety"), filed on October 28, 2005, is before the Court for consideration. The Joint Motion Submission includes the parties' responses to the summary judgment motions and the appendices.

Background

This case involves a dispute between three insurance companies concerning coverage and the relative obligations for defense costs under three different policies of insurance issued [*2] to Apartment Investment and Management Company ("AIMCO"). In August 2001, James M. Suggs and Suggs and Associates, P.C., ("Suggs") brought a putative class action against AIMCO and American Blast Fax, Inc. ("ABF") in the 162nd District Court of Dallas County, Texas ("the Suggs action"). The Suggs sought damages under the Telephone Consumer Protection Act ("TCPA") for violations of their right to privacy caused by AIMCO's sending numerous uninvited advertising faxes. Nutmeg, which had issued a Miscellaneous Professional Liability Policy to AIMCO, successfully defended AIMCO in the Suggs action. As a result, AIMCO did not claim any right of indemnity from any of its insurance carriers. Nutmeg is subrogated to any rights AIMCO may have to recover the defense costs in the Suggs action under the policies issued by Wausau and Virginia Surety.

The Contentions of the Parties

Nutmeg seeks summary judgment on the grounds that Wausau and Virginia Surety had a duty to defend AIMCO in the Suggs action. Nutmeg further contends that the coverage provided by the insurance policies issued to AIMCO by Wausau and Virginia Surety provided primary insurance coverage for the Suggs action. Nutmeg [*3] claims that the coverage in the policy that it issued to AIMCO is in excess of the insurance coverage provided by Wausau and Virginia Surety and does not apply until the limits of the Wausau and Virginia Surety policies have been exhausted. Nutmeg asserts that Wausau and Virginia Surety breached their insurance contracts with AIMCO by refusing and failing to defend AIMCO in the Suggs action or to pay the defense costs. Nutmeg seeks to recover from Wausau and Virginia Surety, jointly and severally, the fees and expenses it paid on AIMCO's behalf in the Suggs action, as a result of Wausau and Virginia Surety's alleged breach of contract. Nutmeg also seeks costs, pre-judgment interest, post-judgment interest, and attorney fees.

Wausau and Virginia Surety have each filed counterclaims for declaratory judgment against Nutmeg and cross-claims for declaratory judgment against each other. Wausau contends that: (1) it had no duty to defend AIMCO because its policy does not cover the underlying claims, and (2) it did not breach any contract. Alternatively, Wausau claims the notice provisions and other insurance clauses in the Nutmeg, Virginia Surety, and Wausau policies limit Wausau's obligations [*4] to pay for AIMCO's defense in the Suggs action.

Virginia Surety claims that it had no duty to defend AIMCO in the Suggs action. Alternatively, Virginia Surety contends that AIMCO breached its obligation regarding notice and tender, that Virginia Surety has no liability for fees that AIMCO incurred pre-tender, and that the "first publication exclusion" bars any recovery.

Material Undisputed Facts

In 2001, the Suggs action was filed against AIMCO, alleging that AIMCO engaged in a mass facsimile advertisement campaign through an outside vendor, ABF, in violation of the putative class members' rights of privacy under the TCPA. Specifically, the Suggs action alleges in pertinent part:

15. The defendant or an affiliate (as the contracts are unclear as to the precise juridical entity who is advertising) entered one or more fax advertising contracts which were to advertise its apartment properties. Through these contracts over 100,000 unsolicited, and therefore unlawful fax ads were sent and received on the defendants' behalves. Each of these contracts was entered with American Blast Fax, Inc. ("ABF").

* * *

19. It is unlawful to use any telephone facsimile machine, [*5] computer, or other device to send any unsolicited advertisement to a telephone facsimile machine under 47 U.S.C. § 227(b)(1)(C) commonly known as the Telephone Consumer Protection Act. The sending of unauthorized facsimiles in violation of this statute has violated and violates the Plaintiffs' right to privacy. Moreover, it unilaterally forces them to incur an expense which they did not request, including but not limited to, the loss of business opportunity and the valuable time and productivity that a business or individual loses in receiving, reading, distributing, circulating, calling, faxing, or writing to the sender to get them to stop and usually trashing the junk fax. Next, this illegal activity deprives the Plaintiffs of the full use of their property.

(App., Vol. 2 at 5-7.) The Suggs action also alleges that the putative class plaintiffs are individuals or entities that engage in "commercial, professional, or personal matters in the Dallas/ Fort Worth metropolitan area" and that AIMCO sent unsolicited facsimile advertisements to the Suggs. (*Id.* at 3.) Additionally, the Suggs action alleges that AIMCO entered into contracts to engage in "two [*6] rounds of fax advertising on behalf of itself and its properties." (*Id.*) AIMCO allegedly contracted to send out the first round of mass facsimile advertisements between October 4, 2000, and December 20, 2000. (*Id.* at 4.) Exhibits attached to and referenced in the Suggs action demonstrate that these dates in 2000 were the dates upon which AIMCO's first round of facsimile advertisements were scheduled to begin. (*Id.* at 27-31.) The Suggs allege that they received AIMCO's facsimiles from this first round of advertising. (*Id.* at 3.)

AIMCO allegedly entered into contracts to send out a second round of facsimile advertisements. (*Id.* at 4.) Exhibits attached to and referenced in the Suggs action show that this second round was scheduled to begin sometime between January 2001 and February 2001. (*Id.* at 18-26.) The Suggs allege that they received AIMCO's facsimiles from the second round of advertising. (*Id.* at 3.)

Wausau issued a Commercial General Liability Insurance Policy ("Wausau Policy") to AIMCO, under Policy Number 4720-00-000135-06-001, for the Policy Period of June 1, 1999, through June 1, 2002. (App., Vol. 1 at W00001.) The Wausau Policy proves a general aggregate [*7] limit of two million dollars and a limit of one million dollars for claims arising from "advertising injury." (*Id.*)

Virginia Surety issued a Commercial General Liability Insurance Policy ("Virginia Surety Policy") to AIMCO, under Policy Number IPGA 7000000120002, for the Policy Period of December 31, 2000, through December 31, 2003. (*Id.* at VSC0547.) Both the Wausau Policy and the Virginia Surety Policy contain insuring agreements that set forth certain obligations of Wausau and Virginia Surety to AIMCO under their respective Policies. (*Id.* at W00262, VSC0121.) The Wausau Policy and the Virginia Surety Policy each contain the following endorsement covering an "advertising injury:"

1. Insuring Agreement.

a. We will pay those sums that the insured becomes legally obligated to pay as damages because of "personal injury" or "advertising injury" to which this insurance applies. We will have the right and duty to defend the insured against any "suit" seeking those damages . . .

b. This insurance applies to "personal injury" or "advertising injury" only if:

(1) The "personal injury" or "advertising injury" arises out of an offense committed during the [*8] policy period.

(*Id.*) The definition of "advertising injury" in the Wausau Policy is supplied by an endorsement, which states:

1. "Advertising injury" means injury, other than "bodily injury" or "property damage" or "personal injury," arising out of one or more of the following offenses committed in the course of "your advertising activities:"

a. Oral or written publication of material that slanders or libels a person or organization or disparages a person's or organization's goods, products, or services;

b. Oral or written publication of material that violates a person's right of privacy;

c. Misappropriation of advertising ideas; or

d. Infringement of copyright, title or slogan.

(*Id.* at W00263.) The term "your advertising activities" is further defined by an endorsement to the Wausau Policy to mean "widespread distribution of material promoting your goods, products or services." (*Id.* at W00264.) Both the Wausau Policy and the Virginia Surety Policy apply only to "advertising injury" if such injury arises during the Policy Period and is committed in the "coverage territory," which, in pertinent part, is the United States [*9] of America.

The Wausau Policy also provides that, if other valid insurance exists to cover AIMCO for a loss, the insurance provided by the Wausau Policy is primary, except in the following specifically enumerated instances:

4. Other Insurance.

If other valid and collectible insurance is available to the insured for a loss we cover under Coverages A or B of this Coverage Part, our obligations are limited as follows:

a. Primary Insurance

This insurance is primary except when b. below applies. If this insurance is primary, our obligations are not affected unless any of the other insurance is also primary. Then, we will share with all that other insurance by the method described in c. below.

b. Excess Insurance

This insurance is excess over:

(1) Any of the other insurance, whether primary, excess, contingent or on any other basis:

(a) That is Fire, Extended coverage, Builder's Risk, Installation Risk or similar coverages for "your work";

(b) That is Fire Insurance for premises rented to you or temporarily occupied by you with permission of the owner; or

(c) If the loss arises out of the maintenance or use of aircraft, "autos", [*10] or watercraft to the extent not subject to Exclusion g. of COVERAGE A (SECTION I).

(2) Any other primary insurance available to you covering liability for damages arising out of the premises or operations for which you have been added as an additional insured by attachment of an endorsement.

c. Method of Sharing

If all of the other insurance permits contribution by equal shares, we will follow this method also. Under this approach each insurer contributes equal amounts until it has paid its applicable limit of insurance or none of the loss remains, whichever comes first.

If any of the other insurance does not permit contribution by equal shares, we will contribute by limits. Under this method, each insurer's share is based on the ratio of its applicable limit of insurance to the total applicable limits of insurance of all insurers.

(*Id.* at W00018-19, W00071.)

Under the Virginia Surety Policy, the definition of "advertising injury" is supplied by an endorsement, which states:

1. "Advertising injury" means injury, other than "bodily injury" or "property damage" or "personal injury," arising out of one or more of the following

offenses **[*11]** committed in the course of "your advertising activities:"

- a. Oral or written publication of material that slanders or libels a person or organization or disparages a person's or organization's goods, products, or services;
- b. Oral or written publication of material that violates a person's right of privacy;
- c. Misappropriation of advertising ideas; or
- d. Infringement of copyright, title or slogan.

(*Id.* at VSC0123.) The term "your advertising activities" is further defined by an endorsement to the Virginia Surety Policy to mean "widespread distribution of material promoting your goods, products or services." (*Id.*)

Like the Wausau Policy, the Virginia Surety Policy provides that, if other valid insurance exists to cover AIMCO for a loss, the insurance provided by the Virginia Surety Policy is primary, except in the following specifically enumerated instances:

4. Other Insurance.

If other valid and collectible insurance is available to the insured for a loss we cover under Coverages A or B of this Coverage Part, our obligations are limited as follows:

a. Primary Insurance

This insurance is primary except when b. **[*12]** below applies. If this insurance is primary, our obligations are not affected unless any of the other insurance is also primary. Then, we will share with all that other insurance by the method described in c. below.

b. Excess Insurance

This insurance is excess over any of the other insurance, whether primary, excess, contingent or on any other basis:

- (1) That is Fire, Extended coverage, Builder's Risk, Installation Risk or similar coverages for "your work";
- (2) That is Fire Insurance for premises rented to you or temporarily occupied by you with permission of the owner; or
- (3) If the loss arises out of the maintenance or use of aircraft, "autos," or watercraft to the extent not subject to Exclusion g. of Coverage A (Section I).

When this insurance is excess, we will have no duty under Coverages A or B to defend the insured against any "suit" if any other insurer

has a duty to defend the insured against that "suit." If no other insurer defends, we will undertake to do so, but we will be entitled to the insured's rights against all those other insurers.

c. Method of Sharing

If all of the other insurance permits contribution by equal shares, [*13] we will follow this method also. Under this approach each insurer contributes equal amounts until it has paid its applicable limit of insurance or none of the loss remains, whichever comes first.

If any of the other insurance does not permit contribution by equal shares, we will contribute by limits. Under this method, each insurer's share is based on the ratio of its applicable limit of insurance to the total applicable limits of insurance of all insurers.

(*Id.* at VSC0081.)

Nutmeg issued Policy Number NPG0150962 ("Nutmeg Policy") to AIMCO. (*Id.* at Nutmeg 0181.) The Nutmeg Policy is a Miscellaneous Professional Liability Insurance policy, for the Policy Period of November 20, 2000, to November 20, 2002 (retroactive date to May 31, 1988). (*Id.*) It provides a limit of ten million dollars per claim, which includes Damages and Claims Expenses. (*Id.*) Under its Insuring Agreement, the Nutmeg Policy provides that:

The Company will pay on behalf of the **Insured** all sums in excess of the Deductible amount stated in the Declarations which the **Insured** shall become legally obligated to pay as **Damages and Claim Expenses** resulting from **Claims [*14]** first made against the **Insured** during the **Policy Period or Extended Reporting Period**, if applicable, as a result of a **Wrongful Act** by the **Insured** or any **Entity** for whom the **Insured** is legally liable, provided that such **Wrongful Act** was committed on or after the **Retroactive Date** and before the end of the **Policy Period**.

(*Id.* at Nutmeg 0182, [Emphasis in original].) With respect to other insurance, the Nutmeg Policy provides:

(G) OTHER INSURANCE

If any **Claim or Wrongful Act** noticed to the company under this Policy is insured by another valid policy or policies, then this Policy shall apply only in excess of the amount of any deductibles, retentions and limits of liability under such other policy or policies, whether such other policy or policies are stated to be primary, contributory, excess, contingent or otherwise, unless such other insurance is written specifically excess of this Policy by reference in such other policy to the Policy Number indicated on this Policy's Declarations.

(*Id.* at Nutmeg 0188, [Emphasis in original].)

AIMCO notified Wausau of the Suggs action on October 25, 2001, and [*15] demanded that Wausau defend AIMCO under the Wausau Policy. (App., Vol. 2 at 43-45, 62-65, 72.) Wausau refused to defend AIMCO, claiming, *inter alia*, that the Suggs action did not allege a covered

"advertising injury." (*Id.* at 62-65, 160-63.)

On October 2, 2002, AIMCO notified Virginia Surety of the Suggs action and demanded that it defend AIMCO in the action. (*Id.* at 78-82.) Virginia Surety initially denied that it owed a duty to defend AIMCO in the Suggs action. (*Id.* at 111-114.) Later, it acknowledged its duty to defend AIMCO, stating that "the claims as specifically described and contained in the last amended Plaintiff's Petition invoke the Virginia Surety Policy's obligation to provide a defense to the claims." (*Id.* at 165-55.) However, in the same letter, Virginia Surety speculated that an exclusion might apply and reserved its rights under the policy. (*Id.*) Virginia Surety did not provide a defense or contribute to the defense costs. Virginia Surety did not raise the defense of late or improper notice.

On November 9, 2001, AIMCO notified Nutmeg of the Suggs action and demanded that Nutmeg provide a defense. (*Id.* at 133-38.) Nutmeg agreed to pay for [*16] AIMCO's defense under a full reservation of its rights. (*Id.* at 139-47.) Judgment was rendered in AIMCO's favor on January 21, 2005. (App., Vol. 2 at 183-84.) Nutmeg incurred attorney fees and expenses in the amount of \$ 918,735 in defending the Suggs action. (*Id.* at 131; App., Vol. 3 at 228-30.) The Nutmeg Policy provides as follows with respect to subrogation:

(H) SUBROGATION

In the event of any payment under this Policy, [Nutmeg] shall be subrogated to all of the Insured's rights of recovery against any person or organization, and the Insured shall execute and deliver instruments and papers and do whatever else is necessary to preserve and secure such rights. The Insured shall do nothing to prejudice such rights.

(App., Vol. 1 at Nutmeg 0188.)

Summary Judgment Standard

Pursuant to Federal Rule of Civil Procedure 56(c), summary judgment "shall be rendered forthwith if the pleadings, depositions, answers to interrogatories, and admissions on file, together with the affidavits, if any, show that there is no genuine issue as to any material fact and that the moving party is entitled to judgment [*17] as a matter of law." FED. R. CIV. P. 56(c). A "material fact" is one that "might affect" the outcome of the suit. Anderson v. Liberty Lobby, Inc., 477 U.S. 242, 248, 106 S. Ct. 2505, 91 L. Ed. 2d 202 (1986); Bazan v. Hidalgo County, 246 F.3d 481, 489 (5th Cir. 2001). A "genuine" issue is "real and substantial, as opposed to merely formal, pretended, or a sham." Bazan, 246 F.3d at 489. Accordingly, a genuine issue of material fact is present if the jury could potentially find in the non-moving party's favor. Anderson, 477 U.S. at 248; Harken Exploration Co. v. Sphere Drake Ins. PLC, 261 F.3d 466, 471 (5th Cir. 2001).

Once a party has made a proper motion for summary judgment, the court reviews the record as a whole in the light most favorable to the non-moving party. Matsushita Elec. Indus. Co., Ltd. v. Zenith Radio Corp., 475 U.S. 574, 587, 106 S. Ct. 1348, 89 L. Ed. 2d 538 (1986); Williams v. Time Warner Operation, Inc., 98 F.3d 179, 181 (5th Cir. 1996). The moving party bears the burden of establishing the absence of a genuine issue of material fact. Celotex Corp. v. Catrett, 477 U.S. 317, 323, 106 S. Ct. 2548, 91 L. Ed. 2d 265 (1986); [*18] Martinez v. Schlumberger, Ltd., 338 F.3d 407, 411 (5th Cir. 2003).

General principles of contract interpretation govern the interpretation of an insurance policy, and issues of insurance policy interpretation are questions of law. St. Paul Guardian Ins. Co.

v. Centrum GSI Ltd., 283 F.3d 709, 713 (5th Cir. 2002). A federal court with diversity jurisdiction applies state law when interpreting insurance policies. *Erie R.R. Co. v. Tompkins*, 304 U.S. 64, 78-79, 58 S. Ct. 817, 82 L. Ed. 1188 (1938); *Harken Exploration Co.*, 261 F.3d at 471. The substantive law of Texas applies in this case. See *Sentry Ins. v. R. J. Weber Co., Inc.*, 2 F.3d 554, 556 (5th Cir. 1993). In diversity actions where state law has been announced by the state's highest court, the state law must be followed. *Bailey v. Southern Pac. Transp. Co.*, 613 F.2d 1385, 1388 (5th Cir. 1980) (citing *Commissioner v. Bosch*, 387 U.S. 456, 465, 87 S. Ct. 1776, 18 L. Ed. 2d 886 (1967)). In the absence of a decision from the state's highest court, intermediate state court decisions must also be followed, unless the Court is convinced that the highest court would decide otherwise. [*19] *Id.*

The insured bears the burden of demonstrating that a third-party claim is within the coverage of its insurance policy. *Harken Exploration Co.*, 261 F.3d at 471. The insurer then bears the burden of illustrating that an exclusion contained within the policy applies. *Id.* "If multiple interpretations are reasonable, [the court] must construe the [policy] against the insurer." *St. Paul Fire & Marine Ins. v. Green Tree Fin. Corp.*, 249 F.3d 389, 392 (5th Cir. 2001).

ANALYSIS

The TCPA

In 1992, the TCPA became effective. See 47 U.S.C. § 227, *et seq.* One of the purposes of the TCPA is to protect the privacy rights of individuals who receive certain types of unsolicited advertisements, including advertisements sent by facsimile. *Western Rim Inv. Advisors, Inc. v. Gulf Ins. Co.*, 269 F. Supp. 2d 836, 846-47 (N.D. Tex. 2003), *aff'd* 96 Fed. Appx. 960 (5th Cir. 2004) (applying Texas law); *TIG Ins. Co. v. Dallas Basketball, Ltd.*, 129 S.W.3d 232, 238 (Tex. App.-Dallas Feb 25, 2004) (No. 05-03-00134-CV), rehearing overruled (Apr 05, 2004), review denied (2 [*20] pets.) (Feb 11, 2005), rehearing of petition for review denied (Aug 22, 2005). The TCPA deems all unsolicited advertising to be an offensive intrusion into the recipient's privacy. *Id.* The TCPA is not a penal statute. *Western Rim*, 269 F. Supp. at 849.

Duty to Defend

The first issue before the Court is whether Wausau and Virginia Surety had a duty to defend AIMCO in the Suggs action. Under Texas Law, the duty to defend and the duty to indemnify are distinct and separate duties, creating distinct and separate causes of action. *Trinity Universal Ins. Co. v. Cowan*, 945 S.W.2d 819, 821-22, 40 Tex. Sup. Ct. J. 583 (Tex. 1997). The duty to defend is broader than the duty to indemnify. *Colony Ins. Co. v. H.R.K., Inc.*, 728 S.W.2d 848, 850 (Tex. App. -- Dallas 1987, no writ). The duty to defend is not affected by facts ascertained before suit, by facts developed in the process of the litigation, or by the ultimate outcome of the suit. *Am. Alliance Ins. Co. v. Frito-Lay, Inc.*, 788 S.W.2d 152, 153-54 (Tex. App. -- Dallas 1990, writ *dism'd*).

An insurer's duty to defend "is determined by the allegations of the petition when considered in [*21] light of the policy provisions without reference to the truth or falsity of such allegations." *Argonaut SW Ins. Co. v. Maupin*, 500 S.W.2d 633, 635, 17 Tex. Sup. Ct. J. 40 (Tex. 1973). "The duty arises when a third party sues the insured on allegations that, if taken as true, potentially state a cause of action within the terms of the policy." *Cont'l Sav. Ass'n v. United States Fid. & Guar. Co.*, 762 F.2d 1239, 1243 (5th Cir.) (emphasis in original), *opinion amended on other grounds*, 768 F.2d 89 (5th Cir. 1985). Any doubt as to whether the allegations in the petition state a cause of action that falls within the coverage of the policy and that compels an insurer to defend must be resolved in favor of the insured. *American Nat'l Gen. Ins. Co. v. Ryan*, 274 F.3d 319, 324 (5th Cir. 2001).

Texas follows the "eight corners" rule, which means that when a court examines whether an insurer has a duty to defend, the court only examines the language in the insurance policy

and the claims against the insured in the most recent petition to make its determination. Harken Exploration Co., 261 F.3d at 471. To determine whether the claim [*22] falls within the scope of the insurance policy, the court examines the facts of the claim to determine whether the facts alleged are within the policy's coverage. Nat'l Union Fire Ins. Co. of Pittsburgh v. Merchants Fast Motor Lines, Inc., 939 S.W.2d 139, 141, 40 Tex. Sup. Ct. J. 353 (Tex. 1997); Houston Petroleum Co., 830 S.W.2d at 155. The reviewing court must focus on the "factual allegations that show origin of damages rather than on legal theories alleged." Merchants, 939 S.W.2d at 1341. If the complaint alleges one cause of action potentially within the scope of the policy, it triggers the duty to defend, and the insurer must defend against the entire lawsuit. Lafarge Corp. v. Hartford Cas. Ins. Co., 61 F.3d 389, 393 (5th Cir. 1995) overruled on other grounds by Grapevine Excavation, Inc. v. Maryland Lloyds, 35 S.W.3d 1, 5, 43 Tex. Sup. Ct. J. 1086 (Tex. 2000); Green Tree Corp., 249 F.3d at 391; see generally Hillson Steel Products v. Wirth Ltd., 538 S.W.2d 162, 165-66 (Tex. App. -- Hous. [1 Dist.] 1976, no pet. h.) (holding that where documentary exhibits are attached to and made part of the petition, [*23] the court has to consider them in determining whether the petition alleges a valid cause of action).

The Court must compare the allegations of the latest underlying complaint in the Suggs action with the language of the advertising injury provisions. n1 The Suggs complaint alleges that AIMCO violated the TCPA by sending over 100,000 unsolicited unlawful fax ads to fax machines (including those of the Suggs) without obtaining prior consent. Specifically, the Suggs allege that "[t]he sending of unauthorized facsimiles in violation of this statute has violated and violates the Plaintiffs' right to privacy." Under the Wausau Policy and the Virginia Surety Policy, "personal and advertising injury" includes injury from "[o]ral or written publication of material that violates a person's right of privacy." The Wausau Policy includes an additional definition that states: "'Your advertising activities' means widespread distribution of material promoting your good, products or services."

----- Footnotes -----

n1 Nutmeg did not contend for purposes of summary judgment that the Suggs petition triggered the "property damage" coverage of the Wausau Policy and the Virginia Surety Policy. However, Wausau and Virginia Surety each sought summary judgment on the ground that the "property damage" provisions of their respective policies were not triggered. In its response to the summary judgment motions, Nutmeg states that it does not concede that the "property damage" provisions of the Wausau Policy and the Virginia Surety Policy have not been triggered. The Court finds that in light of its findings with respect to the "advertising injury" provisions of the policies, the Court need not reach the issue of whether the "property damage" provisions are also triggered.

----- End Footnotes----- [*24]

The policies do not define the words "publication" or "privacy." Nevertheless, Wausau and Virginia Surety urge the Court to employ common-law tort definitions of these terms. Specifically, Wausau and Virginia Surety contend that the factual allegations in the Suggs action do not allege an "advertising injury," and therefore, they have no duty to defend.

Advertising Injury

This Court is *Erie-Bound* to apply Texas law. Erie R.R. Co. v. Tompkins, 304 U.S. 64, 78-79, 58 S. Ct. 817, 82 L. Ed. 1188 (1938); Harken Exploration Co., 261 F.3d at 471. As noted previously, when the Texas Supreme Court has not spoken on an issue, the examining court must follow intermediate state court decisions -- unless that court is convinced that the highest court would decide otherwise. Bailey, 613 F.2d at 1388 (citing Bosch, 387 U.S. at

465). In *TIG Ins. Co. v. Dallas Basketball, Ltd.*, a case that is directly on point, the Texas Court of Appeals holds that an action brought against a party for sending unsolicited advertisements by a telephone facsimile machine alleges injuries that fall within the advertising injury coverage of a commercial general [*25] liability policy. *TIG Ins. Co.*, 129 S.W.3d at 238.

This Court is not convinced that the Texas Supreme Court would disagree with the state appellate court in *TIG Insurance Co. n2 Wausau and Virginia Surety* rely upon cases from the United States Courts of Appeals for the Fourth and Seventh Circuits to support their argument that the type of privacy invasions envisioned by the TCPA's unsolicited fax prohibition are not covered by commercial general liability policies like the policies in question here. See *Resource Bankshares Corp. v. St. Paul Mercury Ins. Co.*, 407 F.3d 631, 639-42 (4th Cir. 2005)(applying Virginia law to an underlying petition, which unlike the Suggs petition, did not even mention the word "privacy") and *Am. States Ins. Co. v. Capital Assoc. of Jackson County, Inc.*, 392 F.3d 939, 941-43 (7th Cir. 2004) (construing the "advertising injury" provision of an insurance policy under Illinois law). But see *Valley Forge Ins. Co. v. Swiderski Elecs., Inc.*, 359 Ill. App. 3d 872, 834 N.E.2d 562, 570, 296 Ill. Dec. 5 (Ill. Ct. App. Aug. 17, 2005) (criticizing the "contextual approach" used in *American States* as not being the standard governing [*26] the judicial construction of an insurance policy under Illinois law). Wausau and Virginia Surety claim that the Suggs petition does not allege an "advertising injury" because it does not allege (1) an injury arising from a "publication," or (2) an injury arising from "material that violates a person's right of privacy." However, the Suggs petition alleges that "[t]he sending of unauthorized facsimiles in violation of [the TCPA] has violated and violates the Plaintiffs' right to privacy."

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n2 The Court agrees with the United States District Court for the Northern District of Texas in *Registry Dallas Associates, L.P. v. Wausau Business Insurance Company*, 2004 U.S. Dist. LEXIS 5771, 2004 WL 614836 at *4 (N.D. Tex. 2004) that the state appellate court's analysis in *TIG Ins.* is a well-reasoned application of Texas law.

----- End Footnotes -----

"Publication"

Unlike the federal court decisions relied upon by Wausau and Virginia Surety, the Texas rules of contract construction preclude the Court from limiting the term "publication" in [*27] advertising injury coverage to the publication of material that wrongfully discloses private facts to third parties. *TIG Ins. Co.*, 129 S.W.3d at 238. See *Western Rim*, 269 F. Supp.2d at 846. Rather, under Texas law, the word "publication" must be given its plain, ordinary, and generally accepted meaning. *TIG Ins. Co.*, 129 S.W.3d at 238; see also *Western Rim*, 269 F. Supp. 2d at 846-47 (there is nothing in the policy indicating that the word "publication" necessarily means communicating the offending material to a third party). "Publish" generally means "to disclose, circulate, or prepare and issue printed material for public distribution." See *State v. Doe*, 61 S.W.3d 99, 102 (Tex. App -- Dallas 2001), *aff'd*, 112 S.W.3d 532 (Tex. Crim. App. 2003). Thus, contrary to Wausau and Virginia Surety's assertions, the scope of "publication" is not limited to offending material sent to a third party. See *TIG Ins. Co.*, 129 S.W.3d at 238; *Western Rim*, 269 F. Supp.2d at 847. The fact that the Wausau Policy requires "widespread distribution" of material does not [*28] limit the scope of "publication" to offending material sent to a third party. Rather, giving the term "distribution" its plain meaning, the faxing of the unsolicited advertisements to many parties must be considered widespread distribution of advertising material. The Court finds that the Texas Supreme Court would agree with the state appellate court that the word "publication" would not

convey to the average, ordinary, normal, reasonable person an intention to include only the communication of offending material to a third party.

"Right to Privacy"

The policies in this case state that "advertising injury" includes an injury arising out of oral or written publication of material that violates a person's right of privacy. Like the term "publication," the term "right of privacy" is not defined in the Policies and is open to numerous interpretations. Relying once again on *American States Insurance Co.*, Wausau and Virginia Surety contend that unsolicited faxes involve, at most, the tort of intrusion on "seclusion," while the policy coverage is limited to content-based or "secrecy" interests. After recognizing that the TCPA protects at least a slight interest in seclusion, [*29] the court in *Am. States Ins. Co.* stated that the central question in the case was "whether the policy covers the sort of seclusion interest affected by faxed ads." *Am. States Ins. Co.*, 392 F.3d at 942. Distinguishing secrecy from seclusion, the court concluded that, while the TCPA condemns a particular means of communicating an advertisement rather than the contents of that advertisement, advertising injury coverage deals with informational content. *Am. States Ins. Co.*, 392 F.3d at 943. Thus, the policy issued by *Am. States* did not cover the normal consequences of "junk advertising faxes." *Am. States Ins. Co.*, 392 F.3d at 943.

By contrast, the Texas appellate court did not import Texas tort standards to determine the meaning of privacy in commercial liability policies of the kind involved here. See *TIG Ins. Co.*, 129 S.W.3d at 237. Rather, the state appellate court noted that because the TIG Policy did not define "privacy," the court was required to give "privacy" its plain, ordinary, and popular meaning. *Id.* It noted that if the language used in the policy is susceptible to more than one reasonable interpretation, [*30] the court must resolve the uncertainty by adopting the construction that most favors the insured. *Id.* According to the state appellate court, the average person would reasonably understand that he or she would be covered under the advertising injury provision of the policy because the transmission of an unwanted facsimile constitutes an intrusion on seclusion, and hence violates one's right of privacy. *Id.* Taking into consideration an insurer's broad duty to defend in Texas and the fact that the insurers who drafted the contracts neither defined privacy nor differentiated between secrecy and seclusion privacy, this Court finds that the Texas Supreme Court would agree with the state appellate court in *TIG Ins. Co.* and find in favor of coverage. n3

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n3 Texas law providing that claims alleging violations of the TCPA by transmission of unsolicited facsimiles trigger insurance coverage or other relief that is available for invasions of the right to privacy is consistent with the holdings of federal courts that have decided this issue based upon the laws of the forum states. See generally, *Park Univ. Enters. v. Am. Cas. Co. of Reading*, 314 F. Supp. 2d 1094, 1110 (D. Kan. 2004) (finding a duty to defend under Kansas law based upon the "advertising injury" provisions of a commercial liability policy where the plaintiffs received unsolicited facsimiles in violation of the TCPA and their right to privacy); *Universal Underwriters Ins. Co. v. Lou Fusz Auto. Network, Inc.*, 300 F. Supp. 2d 888, 895 (E.D. Mo. 2004) (applying Missouri law and finding that insurance coverage is implicated by unsolicited facsimile advertising based upon the invasion of privacy, private nuisance, and interference with possession of personal property provisions of the policies); *Hooters of Augusta, Inc. v. Am. Global Ins. Co.*, 272 F. Supp. 2d 1365, 1373 (S.D. Ga. 2003) (relying on Georgia law and finding that a TCPA violation may constitute an invasion of privacy within the meaning of the "advertising injury" provisions of a commercial liability policy); *Prime TV, LLC v. Travelers Ins. Co.*, 223 F. Supp. 2d 744, 752-53 (M.D. N.C. 2002) (relying on North Carolina law and providing that the "act of faxing DirecTV advertisements to the recipients constitutes advertising injury" as defined by the Travelers policies").

----- End Footnotes----- **[*31]**

Accordingly, the state appellate opinion in *TIG Ins. Co.* governs here because the Texas Supreme Court is unlikely to disturb the well-reasoned holdings of the intermediate state court. According to the Suggs petition, AIMCO sent hundreds of thousands of unsolicited facsimile advertisements in the Dallas and Fort Worth metroplex, and those advertisements violated the TCPA and the class plaintiffs' right to privacy. The Suggs action alleges that an "advertising injury" occurred in the "coverage territory" during the Policy Periods of the Wausau Policy and the Virginia Surety Policy. The term "widespread distribution," given its plain meaning, includes distribution of advertising material by facsimile machine. At least one of several claims in the Suggs complaint potentially falls within the scope of coverage. The Court finds as a matter of law that Wausau has a duty to defend AIMCO under the Wausau Policy. Likewise, Virginia Surety has a duty to defend AIMCO under the Virginia Surety Policy, unless the "first publication" exclusion bars coverage.

Virginia Surety's Claimed Exclusion

Virginia Surety argues that any advertising injury coverage is barred by the "first publication" **[*32]** exclusion in the Virginia Surety Policy because the allegations in the Suggs action show that the first publication of AIMCO's offending facsimile advertisements in violation of the TCPA occurred prior to the Virginia Surety Policy Period which began December 31, 2000. Virginia Surety also claims that ABF, as AIMCO's alleged agent, was on notice of TCPA violations before December 2000 because it had received a citation from the Federal Communications Commission ("FCC") in August 2000.

A court must construe a policy provision that purports to exclude or limit coverage "more stringently" than other parts of the insurance policy or the factual allegations in the petition or complaint. *Harken*, 261 F.3d at 475 (citing *Barnett v. Aetna Life Ins. Co.*, 723 S.W.2d 663, 666, 30 Tex. Sup. Ct. J. 191 (Tex. 1987)). "In an insurance coverage dispute analyzed under the eight corners rule, [t]he insured bears the initial burden of showing that there is coverage, while the insurer bears the burden of proving the applicability of any exclusions in the policy. Once the insurer has proven that an exclusion applies, the burden shifts back to the insured to show that the claim falls within **[*33]** an exception to the exclusion." *Primrose Operating Co. v. Nat'l Am. Ins. Co.*, 382 F.3d 546, 552-553 (5th Cir. 2004) (quoting *Guar. Nat'l Ins. Co. v. Vic Mfg. Co.*, 143 F.3d 192, 193 (5th Cir. 1998)).

The Virginia Surety Policy provides:

This Insurance does not apply to:

"[an] advertising injury"

- (2) Arising out of the oral or written publication of material whose first publication took place before the beginning of the policy period.

(App. 1, Tab.2, VSC 0122.) Virginia Surety claims that the purpose of the exclusion is to prevent an insured from obtaining coverage for risks already taken and which are known to have been taken. *Matagorda Ventures, Inc. v. Travelers Lloyds Ins. Co.*, 203 F. Supp. 2d 704, 716, 208 F. Supp. 2d 687 (S.D. Tex. 2001). However, if some of the advertisements

have been published after the beginning of the insured's policy period, then the "first publication" exclusion does not apply. See, e.g., Everett Assocs. Inc. v. Transcontinental Ins. Co., 56 F. Supp. 2d 874, 885 (N.D. Cal. 1999) (concluding that the "first publication" exclusion did not prevent coverage where each advertisement was [*34] considered separately and some of the advertisements were published after the commencement of the policy period).

The allegations in the Suggs action do not provide a date when the offending faxes in this case were received. Rather, they assert that they received AIMCO's facsimiles sent from rounds of advertising between: (1) October 4, 2000 and December 20, 2000 and (2) January 2001 and February 2001. (App., Vol. 2 at 3.) The record does not show that the Suggs placed AIMCO, or even ABF, on notice that they had received the offending facsimile in violation of the TCPA. before December 31, 2000. The Suggs allegations support a claim that at least part of the alleged "advertising injury" occurred on or after December 31, 2000. Additionally, the Suggs action allegations support an interpretation that each written publication of material should be treated as a separate and distinct act of violating the Suggs' right to privacy. The Court concludes that Virginia Surety did not meet its burden to show that the "first publication" exclusion applies. Therefore, Virginia Surety has a duty under the Virginia Surety Policy to defend AIMCO in the Suggs action.

The Relative Obligations of [*35] the Three Insurers

Nutmeg contends that the Wausau Policy and the Virginia Surety Policy provide primary coverage for the duty to defend AIMCO in the Suggs action and that since other insurance covers the claims against AIMCO, the other insurance clause in the Nutmeg Policy renders Nutmeg's coverage excess. (Nutmeg Br. at 29-33.) Wausau contends that the costs incurred in defending AIMCO in the underlying Suggs action should be shared on a pro-rata basis between Nutmeg, Virginia Surety, and Wausau because a conflict exists in the "other insurance" clauses. (Wausau Br. at 28.) Virginia Surety contends that the Nutmeg Policy is not excess because the Wausau Policy and the Virginia Surety Policy do not cover the same kind of claims as the Nutmeg Policy, -rendering them something other than "valid claims" under Nutmeg's excess insurance clause. (Virginia Surety Resp. at 25.) It contends alternatively that each carrier should share pro rata the post-tender defense costs. (*Id.*)

To determine the relative obligations of the three insurers concerning the defense of the Suggs action, the Court must consider the meaning and applicability of the "other insurance" clauses with respect [*36] to claims made in the Suggs action. "Other insurance" clauses only apply when the coverages at issue are "concurrent." See St. Paul Mercury Ins. Co. v. Lexington Ins. Co., 78 F.3d 202, 206 (5th Cir.1996); CNA Lloyds of Tex. v. St. Paul Ins. Co., 902 S.W.2d 657, 659-60 (Tex.App.-Austin 1995, writ dismissed by agr.). Two or more policies must "generally cover the same property and interest therein against the same risk in favor of the same party" for the policies to be concurrent. State Farm Fire & Cas. v. Griffin, 888 S.W.2d 150, 155 (Tex. App.-Hous. [1 Dist.] 1994).

Although the three policies do not provide identical coverage on all potential claims because the Nutmeg Policy is a Professional Liability Policy and the Wausau Policy and the Virginia Surety Policy are General Commercial Insurance Policies, their coverage need not be completely coextensive for them to be considered "other insurance" as to each other. Am. Cent. Ins. Co. v. Harrison, 205 S.W.2d 417, 420 (Tex.Civ.App. -- Eastland 1947, writ refused n.r.e.). The three policies provide coverage to AIMCO for the "advertising injury" alleged in the Suggs action. [*37] Hence, they are "other insurance" with respect to each other, at least for the Suggs action claims, regardless of any additional or different coverages that the policies may provide.

If the "other insurance clauses" conflict, Texas law follows the rule of "dominant consideration" of the rights of the insured. Hardware Dealers Mut. Fire Ins. Co. v. Farmers

Ins. Exch., 444 S.W.2d 583, 590, 12 Tex. Sup. Ct. J. 570 (Tex. 1969). Under the "dominant consideration" rule, if a conflict would cause a gap in the coverage for the insured, the policies must be prorated. *Id.*; St. Paul Mercury, 78 F.3d at 210. However, if the terms of an insurance policy are clear and unambiguous, a court may not vary the policy's terms. Canutillo Indep. Sch. Dist. v. National Union Fire Ins. Co., 99 F.3d 696, 700 (5th Cir. 1996). In this case, *Hardware Dealers* is not applicable because the other insurance clauses do not conflict and are not mutually exclusive. Application of the other insurance clauses in the three policies does not provide a gap in insurance for AIMCO.

Wausau and Virginia Surety contend they are not primary because their policies provide that they are excess over: **[*38]**

(1) Any of the other insurance, whether primary, excess, contingent or on any other basis:

(a) That is Fire, Extended Coverage, Builder's Risk, Installation Risk or similar coverages for "your work."

(App., Vol. 1 at W00071; VSC 0081.) "Your work" is defined by the Wausau and Virginia Surety Policies as: (a) "Work or operations performed by you on your behalf;" and (b) "Materials, parts or equipment furnished in connection with such work or operations." (App., Vol. 1 at W0024, VSC 0085.) The Policies also state that "your work" includes: (a) "Warranties or representations made at any time with respect to fitness, quality, durability, performance or use of your work" and (b) "The providing of or failure to provide warnings or instructions." (*Id.* at W00025, VSC0085.) The Court finds that the Nutmeg Policy is not a policy covering "your work" within the meaning of the Wausau and Virginia Surety Policies, and therefore, they are not excess over the Nutmeg Policy. In fact, none of the exceptions listed in the policies are present to make the Wausau and Virginia Surety coverage "excess" under the terms of Wausau Policy and the Virginia Surety Policy.

Texas **[*39]** courts follow the majority rule that when a dispute exists between the liability of an insurer with a policy that contains a "pro rata" other insurance clause and the liability of an insurer with a policy that contains an "excess clause," the "excess clause" is given full effect, making the policy with the "pro rata" clause liable to its limits. n4 See Snyder v. Allstate Ins. Co., 485 S.W.2d 769, 770, 15 Tex. Sup. Ct. J. 390 (Tex. 1972); Allstate Ins. Co. v. Universal Underwriters Ins. Co., 439 S.W.2d 385, 387 (Tex. Civ. App. -- Houston [14th Dist.] 1969, no writ); Canal Ins. Co. v. Gensco, Inc., 404 S.W.2d 908, 910 (Tex. Civ. App. -- San Antonio 1966, no writ). In this case, the Wausau and Virginia Surety Policies are primary with "equal shares" and "pro rata" "other insurance clauses." The "other insurance" clause of the Nutmeg Policy provides that if any claim or wrongful act noticed to Nutmeg under its policy is insured by another valid policy or policies, then the Nutmeg Policy shall apply only in excess of the amount of any deductibles, retentions and limits of liability under such other policy or policies, whether the other policies are stated to **[*40]** be primary, contributory, excess, contingent or otherwise, unless they are written specifically excess of the Nutmeg Policy by reference to the Nutmeg Policy by policy number. Applying Texas law, Wausau and Virginia Surety owe AIMCO a duty to defend it in the Suggs action as its primary insurers, and Nutmeg's duty to defend is excess.

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n4 The Nutmeg Policy is not a "true excess policy" that results from an insured's purchasing one policy specifically as primary coverage and another specifically as excess coverage. See,

e.g. Utica Nat'l Ins. Co. v. Tex. Prop. & Cas. Ins. Guar. Ass'n, 110 S.W.3d 450, 459-61 (Tex. App. -- Austin, 2001) (rev'd in part on other grounds). Nevertheless, as previously stated, under the circumstances of this case Texas law provides that "excess clauses" are enforceable.

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An excess carrier is only responsible for defense and settlement costs when the limits of the primary coverages are exhausted. See Tex. Employers Ins. Ass'n v. Underwriting Members of Lloyds, 836 F. Supp. 398, 407 (S.D. Tex. 1993) [*41] ("excess or umbrella carriers are responsible for defense costs only after exhaustion of the primary policy limits"); Carrabba v. Employers Cas. Co., 742 S.W.2d 709, 715 (Tex. App. -- Hous. [14th Dist.] 1987, no writ). Therefore, Nutmeg is not bound to pay any defense costs until the coverages under the Wausau Policy and the Virginia Surety Policy are exhausted.

Each of several insurers on concurrently triggered policies has a legal obligation to provide a full defense to the insured. Tex. Prop. & Cas. Ins. Guar. Ass'n v. SW. Aggregates, Inc. 982 S.W.2d 600, 605 (Tex. App. -- Austin 1998, no pet.); see also Keene Corp. v. INA, 215 U.S. App. D.C. 156, 667 F.2d 1034, 1047-48 (D.C. Cir. 1981). When multiple policies apply to a loss, the "other insurance" provisions in insurance contracts determine how liability is to be apportioned between insurers, but this provision does not affect the relationship between the insurer and the insured. Tex. Prop. & Cas., 982 S.W.2d at 606. The insurer has a duty to defend its insured, not a duty to provide a pro rata defense. *Id.* See Utica, 110 S.W.3d at 457. When a claim falls partially [*42] within and partially outside of a coverage period, the liability insurer's duty is to provide its insured with a complete defense; the contract obligates the insurer to defend its insured. Tex. Prop. & Cas., 982 S.W.2d at 606. Wausau contends the defense costs should be shared on a prorated basis, either according to policy limits or based upon the number of faxes sent during the policy periods. The policy limits under the Wausau Policy and the Virginia Surety Policy do not decrease with the payment of defense costs. (App. at VSCoo78 and W-00014.) Wausau and Virginia Surety each owe Nutmeg, as the subrogee of AIMCO, a complete defense. Therefore, Wausau and Virginia Surety are each liable to Nutmeg for the actual defense costs.

Breach of Contract

A valid contract exists between AIMCO and Wausau and between AIMCO and Virginia Surety, giving them the duty to defend AIMCO in the Suggs action. AIMCO tendered performance under the policies and Wausau and Virginia Surety breached their obligations under the contracts by failing and refusing to defend AIMCO in the Suggs action. Wausau and Virginia Surety's duties to defend AIMCO arose before Nutmeg's obligation [*43] to pay defense costs was triggered. AIMCO suffered damages, namely the defense costs in the Suggs action. Nutmeg is subrogated to AIMCO's interests and is entitled to summary judgment against Wausau and Virginia Surety on its claim for breach of contract.

DAMAGES

Pre-tender Defense Costs

An insurer's duty to defend an insured is only triggered by the actual service of process upon its insured and its relay to the insurer. Travelers Indem. Co. v. Citgo Petroleum Corp., 166 F.3d 761, 768 (5th Cir. 1999) (citing Members Ins. Co. v. Branscum, 803 S.W.2d 462, 466-67 (Tex. App. -- Dallas 1991, no writ.)). A notice of suit provision notifies the insurer that the insured has been served with process and that the insurer is expected to defend. Harwell v. State Farm Mut. Auto. Ins. Co., 896 S.W.2d 170, 173, 38 Tex. Sup. Ct. J. 458 (Tex. 1995). "Compliance with the notice of suit provision is a condition precedent' to the insurer's liability

on the policy." *Harwell*, 896 S.W.2d at 173-174. Nevertheless, if notice was not given according to the policy, the insurer does not escape liability, unless it was prejudiced because of the [*44] lack of notice. *Harwell*, 896 S.W.2d at 173-74; *Liberty Mut. Ins. Co. v. Cruz*, 883 S.W.2d 164, 165-66, 37 Tex. Sup. Ct. J. 276 (1993).

Virginia Surety claims AIMCO did not notify it of its claim arising out of the Suggs action until October 2002, approximately fourteen months after the litigation commenced. n5 Nutmeg claims the date of tender is unknown, but concedes the tender was no earlier than October 8, 2002. (App., Vol. 2, Nutmeg at 78-82.) Virginia Surety contends it is not liable for the pre-tender fees and costs incurred in defending the Suggs action. The limitation on the duty to defend is based in part on the voluntary payment provisions contained in insurance contracts. The Virginia Surety Policy provides:

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n5 Virginia Surety also contends that AIMCO served it with the Third Amended Petition in the Suggs action although the Suggs had filed a Fourth Amended Petition. Virginia Surety complains that it was never served with a "live petition." The Court finds that the service of the Third Amended Petition was sufficient to put Virginia Surety on notice of the claim and permit it to investigate its duty to defend. Its refusal to defend waived any right to notice of subsequent developments in the case. Moreover, it has not shown that it was prejudiced by AIMCO's failure to serve it with the latest amended petition.

----- End Footnotes -----

[*45]

No insured will, except at that insured's own cost, voluntarily make a payment, assume any obligation, or incur any expense other than for first aid, without our consent.

(App., Vol. 1 at VSC 0081, P IV(2)(d).) Nutmeg and Wausau argue that Virginia Surety has not shown that it was prejudiced by the late tender, and therefore, Virginia Surety is liable for the pre-tender costs of defense.

Texas courts have found that an insurer was prejudiced from lack of notice by its insured when (1) the insurer, without notice or actual knowledge of the suit, received notice after the entry of a default judgment against the insured; (2) the insurer received notice of the suit, but the trial date was fast approaching, thereby depriving it of an opportunity to investigate the claims or mount an adequate defense; (3) the insurer received notice of a lawsuit after the case had proceeded to trial and judgment has been entered against the insured; and (4) the insurer received notice of a default judgment against its insured after the judgment had become final and could not be appealed. See *Harwell*, 896 S.W.2d at 175; *Cruz*, 883 S.W.2d at 166 n 4 (citing examples [*46] of the required prejudice).

Moreover, an insurer that breaches its duty to defend cannot enforce against the insured any conditions precedent in the policy; the insured is no longer constrained by "no action" or "no voluntary assumption of liability" clauses. *Enserch Corp. v. Shand Morcham & Co., Inc.*, 952 F.2d 1485, 1496 n. 17; *Gulf Ins. Co. v. Parker Prods., Inc.*, 498 S.W.2d 676, 679, 16 Tex.

Sup. Ct. J. 433 (Tex. 1973); St. Paul Ins. Co. v. Rahn, 641 S.W.2d 276, 278 (Tex. App. -- Corpus Christi 1982, no writ); First Nat'l Indem. Co. v. Mercado, 511 S.W.2d 354, 357-58 (Tex. App. -- Austin 1974, no writ).

Virginia Surety has not proven that it was prejudiced by the late notice of AIMCO's failure to serve it with the latest petition. When it did receive notice, it did not defend, contribute to the defense costs, or participate in any decisions regarding the defense. Moreover, its failure to defend is a material breach of the policy which bars it from enforcing the notice and voluntary payments provision. Additionally, the Court finds that Wausau was notified within a reasonable time of the commencement of the Suggs action and that any delay [*47] was *de minimis*. Accordingly, both Virginia Surety and Wausau owed AIMCO a full defense.

Amount of Damages

Both Wausau and Virginia Surety object to the Court's determining the defense costs for the Suggs action based entirely on the affidavit of an insurance adjuster who cannot testify to what reasonable attorney fees would be in Texas for defending such an action. The amount of reasonable attorneys fees in Texas for defending the Suggs action is not the proper measure of damages. Nutmeg's damages are the actual defense costs in the underlying lawsuit. See Md. Ins. Co. v. Head Indus. Coatings and Servs., Inc., 938 S.W.2d 27, 29, 40 Tex. Sup. Ct. J. 49 (Tex. 1996). The parties do not dispute that \$ 918,735 is the actual amount that was paid to defend the Suggs action. An insurer loses its right to control an insured's defense by initially breaching the duty to defend. See Witt v. Universal Auto. Ins. Co., 116 S.W.2d 1094, 1098 (Tex. App.-Waco 1938, writ disp'd.). The Court finds that by not participating in the defense, Wausau and Virginia Surety gave up the right to control the defense costs. Accordingly, Wausau and Virginia Surety are each liable to Nutmeg [*48] for the \$ 918,735 that Nutmeg, as AIMCO's subrogee, paid to defend the Suggs action.

The Cross-Claims of Wausau and Virginia Surety

Nutmeg is not required to contribute to the defense costs. Therefore, the Court will look to the Other Insurance Clauses of Wausau and Virginia Surety to determine their obligations to each other. Both of the policies provide as follows with respect to the Method of Sharing:

If all of the other insurance permits contribution by equal shares, we will follow this method also. Under this approach each insurer contributes equal amounts until it has paid its applicable limit of insurance or none of the loss remains, whichever comes first.

(App., Vol. 1 at W00018-19, VSC0081.) The wording is broad enough to include defense costs. Therefore, the Court finds that the equal share provision is applicable to the defense costs because both the Wausau and Virginia Surety Policies permit contribution by equal shares. In light of this clause, the pro rata clause is inapplicable. There is no legal basis for prorating the defense costs based upon the limits of liability or upon the number of faxes sent by AIMCO. Therefore, Wausau and Virginia [*49] are each entitled to contribution from each other for one-half of the defense costs in accordance with the equal share provisions of their policies.

Conclusion

Wausau and Virginia Surety have a primary duty to defend AIMCO under the "advertising injury" provisions of the Wausau and the Virginia Surety Policies. Nutmeg's duty to defend is triggered only after the limits of those two policies have been exhausted. The policies will not

be exhausted because the policy limits in the Wausau and Virginia Surety Policies do not decrease with the payment of defense costs. Accordingly, Wausau and Virginia Surety have an obligation to defend and thus to pay all of the actual defense costs for Suggs action. Wausau and Virginia Surety wrongfully have failed to provide a defense or pay AIMCO's defense costs incurred in the Suggs action. As a result of Wausau and Virginia Surety's breach of the insurance contract, Nutmeg had to defend AIMCO in the Suggs action and paid a debt of AIMCO for which Wausau and Virginia Surety are primarily liable. Nutmeg is equitably subrogated to AIMCO's rights under the Wausau Policy and the Virginia Surety Policy. Wausau and Virginia Surety are jointly [*50] and severally liable to Nutmeg for defense costs for defending the Suggs action in the amount of \$ 918,735. As between Wausau and Virginia Surety, each is entitled to contribution from the other for one-half of the defense costs.

Nutmeg contends that it is entitled to its reasonable and necessary attorney fees in this action. Additionally, Nutmeg has requested pre-judgment interest in an amount to be determined and post-judgment interest at the legal rate.

Nutmeg shall file, within thirty days of the date of the order, a motion which includes (1) the amount of prejudgment interest it is claiming, and (3) its motion for attorney fees, including, *inter alia*, the legal authority for its claim to attorney fees and a properly supported submission of its attorney fees. Any objections shall be filed within twenty days of Nutmeg's motion.

For the forgoing reasons, Nutmeg's Motion for Summary Judgment against Wausau and Virginia Surety is GRANTED. Wausau's Motion for Summary Judgment against Nutmeg is DENIED. Virginia Surety's Motion for Summary Judgment against Nutmeg is DENIED. Wausau and Virginia Surety's motions for judgment against each other are granted in part and denied in part [*51] to the extent that each is liable to the other for one-half of the defense costs.

SIGNED February 24, 2006.

PAUL D. STICKNEY

UNITED STATES MAGISTRATE JUDGE

JUDGMENT

This case came on for consideration on the cross motions for summary judgment of the parties. The Court hereby grants judgment in favor of Plaintiff Nutmeg Insurance Company against Defendants Employers Insurance Company of Wausau and Virginia Surety Company, Inc., jointly and severally, in the amount of \$ 918,735, together with pre-judgment interest in an amount to be determined and post-judgment interest as allowed by law.

The Court hereby declares that Employers Insurance Company of Wausau and Virginia Surety Company, Inc. are each entitled to contribution from the other for one-half of the amounts they pay in satisfaction of the judgment.

Signed February 24, 2006.

PAUL D. STICKNEY

UNITED STATES MAGISTRATE JUDGE







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